Case No. D6/03

Penalty tax – reasonable excuses for understating one's income – whether additional tax representing 14.46% of the amount of tax undercharged excessive – section 82A of the Inland Revenue Ordinance ('IRO').

Panel: Anthony Ho Yiu Wah (chairman), Ng Ching Wo and Duffy Wong Chun Nam.

Date of hearing: 24 January 2003.
Date of decision: 29 April 2003.

The appellant appealed against the imposition and the quantum of additional tax by way of penalty for making incorrect return by understating her income in her tax return - individuals for the year of assessment 2000/01.

In her tax return - individuals for the year of assessment 1996/97, the appellant had understated her income and when assessed with the correct assessable income the appellant did not raise any objection. In May 1998, a warning letter was issued to the appellant reminding her to ensure in future that her tax returns were correctly completed. In her sworn testimony given at the present hearing, the appellant denied having received the said warning letter.

A tax return - individuals for the year of assessment 2000/01 ('the 2000/01 return') was submitted by the appellant in which the appellant declared her incomes. Examination of the employer's returns by the assessor revealed that the appellant's income from Organization B was in fact $545,420 instead of $423,420 as reported in the 2000/01 return. Additional salaries tax assessment was therefore raised on the appellant and the appellant did not raise any objection against the assessment.

On 14 August 2002, the Commissioner gave notice to the appellant under the terms of section 82A(4) that he proposed to assess the appellant to additional tax in respect of the year of assessment 2000/01. The appellant submitted her representations to the Inland Revenue Department ('IRD') in which she admitted that the understated amount of income was her lecturing fee from Organization B which she had forgotten to report because of absent-mindedness. On 10 October 2002, the Commissioner issued notice of assessment for additional tax under section 82A of the IRO for the year of assessment 2000/01 in the sum of $3,000, representing 14.46% of the amount of tax which have been so undercharged.

The appellant gave notice of appeal on the grounds, inter alia, that the lecture fee paid by Organization B to her was a subcontractor fee and that she heard that the remuneration paid to subcontractors might not need to be reported to the IRD.

Held:

1. The issue before the Board is not whether the appellant had understated her income but whether or not she had reasonable excuse for such default. As to the argument that the understatement of income by the appellant might have been caused by wordings used in her agreements with Organization B which labelled the relationship as a subcontracting relationship instead of an employment relationship, the Board does not agree that this would have constituted a reasonable excuse for the appellant's default because from the total sum of $545,420 received from Organization B, the appellant had simply made a deduction of $122,000 and reported a salary income of $423,420 in the 2000/01 return.

2. As to the appellant's allegation that she had heard from someone that remuneration paid to subcontractors might not need to be reported to the IRD, the appellant did not disclose the identity of the person uttering such an opinion. Even accepting that someone did express to the appellant such a misguided opinion, the Board is of the view this would not constitute a reasonable excuse. In D179/98, it was held that '*a casual canvassing of opinion on her tax liability without any steps being taken to verify that opinion cannot constitute a reasonable excuse*'.

3. As to the other grounds put forward by the appellant including her financial difficulty and her prompt payment of tax, these are not reasonable excuses for the appellant's default.

4. As to the quantum of the additional tax by way of penalty assessed upon the appellant, the Board is of the view that it is irrelevant whether or not the appellant did receive the warning letter. The fact remained that this was the second time the appellant submitted an incorrect return and the Board does not agree that the penalty rate of 14.46% charged on the appellant in this case was excessive.

Appeal dismissed.

Case referred to:

D179/98, IRBRD, vol 14, 78

Francis Tse Kin Chuen for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. This is an appeal by the Appellant against the imposition and the quantum of additional tax by way of penalty assessed upon her under section 82A of the IRO for making incorrect return by understating her income in the tax return - individuals for the year of assessment 2000/01.

The facts

2. The following facts are not in dispute and we find them proved.

3. On 1 June 1997, the Appellant submitted a tax return - individuals for the year of assessment 1996/97 ('the 1996/97 Return'). The Appellant stated in the 1996/97 Return that she had received a total income of $291,995 from Company A during the period 1 April 1996 to 31 March 1997. By examination of the employer's return, the assessor found that the Appellant had understated her income by $57,363 and her income received from Company A should be $349,358. Salaries tax assessment with assessable income of $349,358 was raised on 4 September 1997 and the Appellant did not raise any objection against the assessment.

4. A warning letter was issued to the Appellant on 8 May 1998 ('the 1998 Warning Letter') informing her that she had understated her income in the 1996/97 Return but the IRD did not intend to impose any penalty on this particular occasion. The Appellant was reminded to ensure in future that her tax returns were correctly completed. In her sworn testimony given at the hearing, the Appellant denied having received the 1998 Warning Letter (see paragraph 13(c) and (d) below).

5. A tax return - individuals for the year of assessment 2000/01 ('the 2000/01 Return') was submitted by the Appellant in which the Appellant declared, among other things, the following income in part 4 – salaries tax:

Employer	**Capacity employed**	**Period**	**Amount** $
Organization B	---	1-4-2000 to 1-3-2001	423,420
University C	---	1-4-2000 to 31-3-2001	59,600
University D	---	5-2-2001 to 31-3-2001	2,362

6. Examination of the employer's returns by the assessor revealed that the Appellant's income from Organization B was in fact $545,420 instead of $423,420 as reported in the 2000/01 Return.

7. Additional salaries tax assessment was therefore raised on the Appellant and the Appellant did not raise any objection against the assessment.

8. On 14 August 2002, the Commissioner of Inland Revenue gave notice to the Appellant under the terms of section 82A(4) of the IRO that he proposed to assess the Appellant to additional tax in respect of the year of assessment 2000/01.

9. By a letter dated 10 September 2002, the Appellant submitted her representations to the IRD in which the Appellant admitted that the understated amount of income was her lecturing fee from Organization B which she had forgotten to report because of absent-mindedness.

10. On 10 October 2002, having considered and taking into account the representations made by the Appellant and the facts recited in paragraphs 3 and 4 above, the Commissioner of Inland Revenue issued notice of assessment for additional tax under section 82A of the IRO for the year of assessment 2000/01 in the sum of $3,000 representing 14.46% of the amount of tax which have been so undercharged if the Appellant's 2000/01 Return had been accepted as correct.

11. By a letter dated 29 October 2002, the Appellant gave notice of appeal to the Board against the said assessment of additional tax on the grounds summarized below:

(a) The lecture fee of $122,000 paid by Organization B to the Appellant was a subcontractor fee under a subcontractor co-operation arrangement and 'the co-operation is not an employment relation from time to time'.

(b) The Appellant heard that the remuneration paid to subcontractors might not need to be reported to the IRD.

(c) The Appellant did not wilfully understate the income, it was only a casual understatement and the reason was that from reading her agreements with Organization B, she noted that her relationship with Organization B was a 'subcontractor' rather than an employment relationship.

(d) The Appellant took a serious, responsive, proactive and co-operative approach and fully disclosed the understated income in her letter dated 10 September 2000 faxed to the IRD.

(e) The Appellant is a good citizen, obeyed the law and paid the tax promptly after clarification with the IRD.

(f) The economic condition was difficult and the additional tax caused financial difficulties to the Appellant.

Sworn testimony of the Appellant

12. At the hearing before the Board, the Appellant gave sworn testimony and was cross-examined by the Commissioner's representative.

13. The Appellant's evidence may be summarized as follows:

(a) The Appellant repeatedly emphasized that her agreements with Organization B clearly stated that she was engaged as an independent contractor to provide services to Organization B and the agreement was not an employment contract.

(b) The Appellant had heard that remuneration paid to subcontractors might not need to be reported to the IRD. Under cross-examination by the Commissioner's representative and in response to questions from the Board, the Appellant admitted that the source of such information was not from Organization B. It was just hearsay informal 'advice' from her friends and the Appellant did not verify the same with a lawyer or accountant.

(c) Regarding the tax for the year of assessment 1996/97, the Appellant explained that she simply paid the tax assessed by the IRD for the year of assessment 1996/97 because she had faith that the IRD was correct. She did not apply her mind to the fact that the tax assessed by the IRD was based on a higher income from that reported by her which meant that she had understated her income in her return.

(d) The Appellant alleged that she had not received the 1998 Warning Letter from the IRD.

(e) The Appellant had settled the additional salaries tax assessed promptly and had no intention to conceal income.

Analysis of the case

14. This is an appeal against a penalty assessment imposed by the Commissioner upon the Appellant under section 82A of the IRO for making incorrect return by understating the income in the 2000/01 Return. The issue before us is not whether the Appellant had understated her income but whether or not she had reasonable excuse for such default.

15. From the notice of appeal and submissions made by the Appellant at the hearing, it was evident that the Appellant no longer relied on the excuse that she had forgotten to report the lecture fee from Organization B because of absent-mindedness. In any event, this line of argument would contradict with the main ground of appeal advanced by the Appellant that the lecture fee was a subcontractor fee and the Appellant had heard (and had genuinely believed) that remuneration paid to subcontractors might not need to be reported to the IRD.

16. As to the argument that the understatement of income by the Appellant might have been caused by wordings used in her agreements with Organization B which labelled the relationship as a subcontracting relationship instead of an employment relationship, we do not agree that this would have constituted a reasonable excuse for the Appellant's default because from the total sum of $545,420 received from Organization B, the Appellant had simply made a deduction of $122,000 and reported a salary income of $423,420 in the 2000/01 Return. The Appellant did not make disclosure of this 'subcontractor income' of $122,000 in other parts of the 2000/01 Return or by way of supplemental information furnished to the IRD.

17. As to the Appellant's allegation that she had heard from someone that remuneration paid to subcontractors might not need to be reported to the IRD, the Appellant did not disclose the identity of the person uttering such an opinion. She did admit at the hearing before us that that person was not a lawyer or an accountant. Even accepting that someone did express to the Appellant such a misguided opinion, we are of the view this would not constitute a reasonable excuse. In D179/98, IRBRD, vol 14, 78 (at page 82) it was held that '*a casual canvassing of opinion on her tax liability without any steps being taken to verify that opinion cannot constitute a reasonable excuse*'.

18. As to the other grounds put forward by the Appellant including her financial difficulty and her prompt payment of tax, these are not reasonable excuses for the Appellant's default.

19. As to the quantum of the additional tax by way of penalty assessed upon the Appellant, we are of the view that it is irrelevant whether or not the Appellant did receive the 1998 Warning Letter. The fact remained that this was the second time the Appellant submitted an incorrect return and we do not agree that the penalty rate of 14.46% charged on the Appellant in this case was excessive.

Decision

20. We therefore dismiss this appeal and confirm the additional tax assessed.