Case No. D62/90

Penalty tax – understatement of profits – norm of 100% of tax undercharged applied in case with no exceptional features – section 82A of the Inland Revenue Ordinance.

Panel: Robert Wei (chairman), Hwang King Hung and William Chan Wai Leung.

Date of hearing: 18 December 1990.
Date of decision: 28 January 1991.

The taxpayer was the sole proprietor of a company which carried on business in Hong Kong. He failed to keep proper accounts and his tax affairs were investigated by the Inland Revenue Department. The taxpayer challenged a proposed assets betterment statement and the matter was referred to the Board of Review which supported the taxpayer in part but held that he had understated the taxable profits by almost 90%. Subsequently the Commissioner imposed penalties upon the taxpayer which amounted to approximately 150% of the amount of tax undercharged. The taxpayer appealed to the Board of Review on the ground that the quantum of the penalties was excessive.

Held:

The penalties were excessive and should be reduced to an amount equal to the tax undercharged. The cause of the problem in this case was that the taxpayer had failed to keep proper accounts and there was no suggestion that he had tried to evade tax. Accordingly the norm should be applied which is a penalty of an amount equal to the tax undercharged.

Appeal allowed in part.

Case referred to:

D97/89 (unreported)

Yeung Kwai Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Taxpayer, trading as X Limited ('X Ltd'), against additional tax assessments raised on him under section 82A of the Inland Revenue Ordinance for the years of assessment 1979/80 to 1984/85 totalling $436,000 or 149.93% of the total amount of profits tax undercharged for those years.

2. The Taxpayer was the sole proprietor of X Ltd which commenced business in June 1965 rendering machine repair services. An investigation into his tax affairs commenced in about 1985 and the Taxpayer has since fought every step of the way. He objected to the profits tax assessments raised on him for 1979/80 and 1980/81, the additional profits tax assessments for 1981/82 to 1983/84 and the profits tax assessment for 1984/85. His tax representative repeatedly addressed representations to the Inland Revenue Department regarding various items in the assets betterment statement compiled by the assessor for the years of assessment 1979/80 to 1984/85 and objected to the revised betterment profits proposed by the assessor. The Taxpayer then appealed to a previous Board in D97/89 against the determination of the Commissioner of Inland Revenue revising the assessments under objection. The appeal was allowed in part, resulting in a reduction of the assessments. He is now appealing to us against the additional tax assessments made by the Commissioner of Inland Revenue under section 82A which made on the ground that he has without reasonable excuse made incorrect returns by understating almost 90% of the true profits.

3. Mr Yeung, the Commissioner's representative, submitted that there was no reasonable excuse for making the incorrect returns. That we accept, but we think that the Taxpayer's case is not that he is not liable to additional tax at all, but that the additional tax imposed on him is excessive having regard to the circumstances.

4. The Taxpayer conducted his own appeal. He did not give evidence; instead he handed up a signed statement which says in part that he is illiterate; that the cause for his misfortune was that for many years he kept no records of receipts and payments; but that he did not mean to evade tax.

4.1 On 1 November 1985 during an initial interview with the assessor, he stated that he had kept no complete record of debtors or creditors, the figures in the balance sheets being dependent on his memory as well as on work contracts with his customers. In about December 1985 he engaged a certified accountant as his tax representative who entered into correspondence with the assessor, supplying on 5 February 1986 some documents including a proposed assets betterment statement and a bundle of invoices. In response to the assessor's request for information and evidence regarding some 114 bank withdrawals, the tax representative by letter dated 21 April 1987 supplied relevant information enclosing some copy cheques. As a result the number of unidentified withdrawals was reduced to about 56 totalling some $1,297,000.

These withdrawals were included as unidentified withdrawals in the assets betterment statement compiled by the assessor showing a total discrepancy of $2,302,828. The tax representative countered by proposing to revise the assets betterment statement by, inter alia, treating the withdrawals as being for business purposes. The revised total discrepancy of only $40,048 was achieved principally by this treatment. The Commissioner confirmed the assessor's disallowance of the withdrawals on the ground that there was no evidence to identify the receipts and payments. Before the previous Board, the Taxpayer, represented by counsel, gave evidence in respect of only four of the withdrawals, and so did his tax representative. The evidence was not accepted, again because the Taxpayer was unable to identify the relevant receipts and payments. The previous Board had this to say on the subject:

> '3.6.4 In his closing submissions Counsel for the Taxpayer pointed out that only "four or five … have been the subject of cross-examination". The Commissioner's representative remarked that "the Taxpayer was not examined by Counsel in respect to the individual unidentified withdrawals … The Taxpayer and the tax representative gave evidence in respect to four specific unidentified withdrawals". In other words, the Commissioner's representative left it open to us to conclude that even if the burden of proof were discharged for those four items it had not been discharged for the remaining 54 items …
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> 3.6.6 … Having regard to the above can we truly say that we are satisfied with the Taxpayer's explanations? Whilst we might be tempted to excuse the Taxpayer's inability to fix these transactions ten years afterwards with any accuracy, that does not of itself entitle us to say that we are satisfied with the explanations given. We sympathize with the Taxpayer in his state of illiteracy (which we accept to be a fact) but judged by the number of banking transactions recorded and the willingness of the banks to extend not inconsiderable credit it seems to us that he could at the relevant time have afforded to engage a satisfactory accountant to record his affairs and identify those receipt and payments which were for his business. Since he chose not to do so he will have to bear the consequences …
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> 3.6.7 The next question is whether we should adopt the approach urged by the Taxpayer's Counsel at the beginning of paragraph 3.6.4 above. Bearing in mind the time taken at the hearing to deal with the four items at paragraph 3.6.6 above and that the burden of proof is upon the Taxpayer, not the Revenue, it is

> quite understandable that the Commissioner's representative did not attempt to deal with the remaining unidentified withdrawals. Granted the Taxpayer's Counsel might also have been mindful of the time it would take to deal with every item, the decision to limit the evidence and in effect rely on the result for its impact on the other withdrawals was his, difficult though it must have been. On the basis of the above analysis, we are, therefore, bound to say that the Taxpayer has not discharged the onus of proof as regards the remaining 54 items. In reaching that decision we have been mindful of the large number of bearer/cash cheques involved.'

4.2 Before the previous Board, the Taxpayer also gave evidence in respect of a loan of $220,000 from a friend, an advance of $20,000 from his daughter and an advance of $30,000 from his son-in-law. The friend, the daughter and the son-in-law all gave evidence in support. These claims had been rejected by the assessor and the Commissioner but were upheld by the previous Board on the oral evidence, a discrepancy regarding the $220,000 loan being put down to faulty memory on the part of either the Taxpayer or his friend.

5. As to the quantum of an additional tax assessment, it has been the view of these Boards that 100% of the tax undercharged should be taken as the norm, that is, the measure for a case where there are neither aggravating nor mitigating circumstances; we see no reason to depart from that view. An assessment of over 100% needs to be supported by the existence of aggravating circumstances. Are there such circumstances in this case? We would say no. We do not think, nor did the previous Board find, that the failure 'to engage a satisfactory accountant to record his affairs and identify those receipts and payments which were for his business' was due to any deliberate omission to facilitate an attempt to evade tax. It seems to us that this is just a case of an illiterate man accustomed to rely on his memory in going about his business. On the other hand, we find no mitigating circumstances either. Having considered the Taxpayer's representations regarding his illiteracy and inability to pay, we take the view that they are not grounds for reducing the quantum below the 100% mark. If he is financially embarrassed, he could start negotiations with the Inland Revenue Department regarding manner of payment, but that is a matter over which we have no jurisdiction.

6. Our decision is therefore that the additional tax payable in respect of each of the years of assessment in question should be of the same amount as the tax undercharged for that year and that the additional tax assessments under appeal should be varied accordingly.