

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D63/87

Penalty assessment – whether penalties excessive – grounds for reduction – s 82A of the Inland Revenue Ordinance.

Panel: Andrew Li QC (chairman), Edmond Lau and David Wu.

Date of hearing: 17 December 1987.

Date of decision: 25 February 1988.

The taxpayer was a businessman who understated his income over four years. After an investigation, he was further assessed on the basis of an assets betterment statement. In addition, the Commissioner imposed penalties equal to 47.4%, 47.5%, 47.6% and 45.5% of the maxima permitted. This included an interest element.

The taxpayer had undertaken private transactions outside Hong Kong, the earnings of which had been included in the assets betterment statement. He had accepted the statement and had not appealed against the further assessments because he was unable to distinguish his personal and business affairs due to insufficient accounting staff, administrative inefficiency and lack of adequate records.

The taxpayer claimed that he had a reasonable excuse for filing incorrect returns. Alternatively, he claimed that the penalties were excessive.

Held:

- (a) It was not open to the taxpayer to dispute the further assessments.
- (b) The taxpayer did not have a reasonable excuse for making incorrect returns.
- (c) The penalties were excessive in view of the taxpayer's lack of wilfulness and his full cooperation with the Revenue's investigation, and should be reduced to 33.33% of the maxima permitted.

Appeal allowed in part.

Chan Yuen Jor for the Commissioner of Inland Revenue.

The taxpayer in person.

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Decision:

This is an appeal by the Taxpayer against the assessment of additional tax under section 82A of the Ordinance for the years of assessment 1977/78 to 1980/81 inclusive.

The Taxpayer carried on the business of 'interior design and window display'. He submitted profits tax returns for the years of assessment 1977/78 to 1980/81 inclusive.

From about February 1983, the Revenue conducted an investigation into his tax affairs. During this investigation he was represented by a firm of certified public accountants and submitted various representations. On about 20 March 1986, the Taxpayer and the Revenue agreed an assets betterment statement which expressly stated that the Taxpayer understood that penal action on incorrect returns submitted will be separately considered by the Commissioner. Based on this agreed assets betterment statement, revised assessments for 1977/78 to 1980/81 were accordingly issued. The following is a comparative table of the assessable profits before and after investigation and the computation of the tax undercharged.

<u>Year of Assessment</u>	Profits (Loss) assessed per Returns <u>filed</u> (A)	Profit assessed after investi- <u>gation</u> (B)	Profit under- <u>stated</u> (C)=(B)-(A)	Tax charged per Returns <u>filed</u> (D)	Tax charged after investi- <u>gation</u> (E)	Tax under- <u>charged</u> (F)=(E)-(D)
1977/78	\$162,809	\$303,454	\$140,645	\$24,421	\$45,517	\$21,096
1978/79	(17,274)	383,098	383,098	NIL	57,464	57,464
1979/80	54,210	326,428	272,218	5,540	48,963	43,423
1980/81	<u>32,330</u>	<u>767,872</u>	<u>735,542</u>	<u>4,849</u>	<u>115,180</u>	<u>110,331</u>
Total	<u>249,349</u>	<u>1,780,852</u>	<u>1,531,503</u>	<u>34,810</u>	<u>267,124</u>	<u>232,314</u>

On 28 April 1986 the Commissioner gave notice to the Taxpayer pursuant to section 82A(4) that he proposed to assess the Taxpayer to additional tax.

By letters dated 13 May 1986 from his tax representatives, the Taxpayer made the following representations.

'Our client has various business undertakings both in Hong Kong and overseas and such funds from these businesses would normally mingle up with one another owing to insufficient accounting staff and identification of the assets

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acquired from profits derived from these businesses would be extremely difficult if proper accounting records were not maintained.

In order to avoid a protracted investigation of the case, our client had generously withdrawn a claim of \$667,619.26 being an off-shore income generated from work done in the Philippine Islands thereby bringing an early settlement of the case within a very short period of three months since we took over the case from our client's former tax representatives.

We trust the foregoing representations have brought out fully the circumstances that gave rise to the discrepancies for the various Years of Assessment under investigation and our client will be most grateful if credits can be given to our client for his complete co-operation and the rapidness in reaching final conclusion of the case when additional tax is imposed on our client under section 82A of the Inland Revenue Ordinance.'

On 30 May 1986 the Commissioner, having considered the representations, issued notices of assessment to additional tax under section 82A for the years of assessment 1977/78 to 1980/81 in respect of the incorrect tax returns. The amounts of additional tax were as follows:

<u>Year of Assessment</u>	<u>Tax Undercharged</u>	<u>Section 82A Additional Tax</u>
1977/78	\$ 21,096	\$ 30,000
1978/79	57,464	82,000
1979/80	43,423	62,000
1980/81	<u>110,331</u>	<u>151,000</u>
	<u>\$232,314</u>	<u>\$325,000</u>

On 29 May 1986 the Taxpayer submitted further written representations. In these representations, he stated as follows: The incorrect returns were not due to wilfulness on his part. The whole business evolved around business transactions during the years in question with his clients and their friends Mr and Mrs R who were acting on behalf of a hotel in Manila as well as themselves. He signed the assets betterment statement to put an end to the rather lengthy investigation. 'There is far too much money credited to my account as profit but, as unfortunately I cannot prove otherwise, I'll have to accept that. Whatever legitimate profit there was made from these transactions, that is, fees or commissions, was overseas earnings and as such, I was led to believe, should not be liable for Hong Kong profit tax. Therefore as far as I am concerned the whole amount, as computed by your department, is profits tax I am being asked to pay for profits that I never really earned.' Further he is not a rich man.

Upon receiving these further representations, an officer of the Revenue telephoned and informed the Taxpayer that, although they were received after the notices of

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assessment to additional tax were issued, the points made had already been taken into consideration.

On 27 June 1986 the Taxpayer gave notice of appeal to this Board.

At the hearing before us Mr Chan Yuen Jor, senior assessor, appeared for the Revenue. The Taxpayer appeared in person and handed us a typewritten note of his submissions. Three points were made. First, he was highly co-operative during the investigation. Secondly, professional accountants prepared his tax returns and they led him to believe that the transactions in relation to his projects in the Philippines were ex-Hong Kong and non-taxable and he was not obliged to disclose them. Thirdly, a major portion of the 'discrepancy' was attributable to transactions with parties in the Philippines. Most of them were personal and private in nature (such as purchase of jewellery and clothing for Mr and Mrs R). Due to the inadequacy of supporting documentary evidence and to reach an early settlement with the Revenue, he agreed to accept the 'discrepancy'.

The Taxpayer gave evidence before us. He accepted that his personal and business affairs were mingled up and that this was due to insufficient accounting staff and administrative inefficiency. When asked by the Revenue why his business transactions for his Philippines projects cannot be distinguished from his personal dealings, he said that there were some records for his personal dealings but he accepted that, in response to the Revenue's inquires during the investigation, he could produce only very few records.

We have considered the representations the Taxpayer made to the Commissioner as well as his evidence and submissions to us.

The Taxpayer agreed the assets betterment statement on the basis of which the revised assessments for 1977/78 to 1980/81 were issued. They show that the amount of tax undercharged was \$232,314. It is not open to the Taxpayer to dispute such assessments before us.

The first question is whether the Taxpayer had a reasonable excuse for making the incorrect returns. We are satisfied on the materials before us that he did not. The root of the problem was the mingling up of his personal and business dealings due to insufficient accounting staff and administrative inefficiency and the lack of adequate records. As a result one cannot distinguish the personal dealings from the business dealings (some of which may have arisen or may have been derived outside Hong Kong and consequently may not be taxable).

The point that he relied on professional advice to the effect that the transactions in relation to his projects in the Philippines were ex-Hong Kong and non-taxable and he was not obliged to disclose them is of no assistance to the Taxpayer. Such advice was in effect that profits arising in or derived from outside Hong Kong are not subject to profits tax. But it was because of the matters referred to in the preceding paragraph that what may have been such profits could not be identified. This was the Taxpayer's own fault.

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We turn to the separate question of the quantum of additional tax. The maximum amount is \$696,942 (3 x \$232,314). The amount of \$325,000 imposed by the Commissioner represents 46.6% of that maximum. Mr Chan Yuen Jor for the Revenue very fairly accepted that the incorrect returns were not due to wilfulness on the part of the Taxpayer and that he co-operated fully with the Revenue during the investigation. Mr Chan also informed us that the Commissioner attributed about \$90,000 for interest in arriving at his figure. We are of the view that the amount imposed is excessive having regard to the circumstances. Our conclusion is that the amount of additional tax for each of the years of assessment in question should be one third of the maximum, that is, equivalent to the amount of the tax undercharged. The total amount of additional tax should be \$232,314.

Accordingly, we allow the appeal and reduce the amount of additional tax for each year of assessment to the following:

<u>Year of Assessment</u>	<u>Tax Undercharged</u>	<u>Section 82A Additional Tax</u>
1977/78	\$ 21,096	\$ 21,096
1978/79	57,464	57,464
1979/80	43,423	43,423
1980/81	<u>110,331</u>	<u>110,331</u>
	<u>\$232,314</u>	<u>\$232,314</u>