

Case No. D66/05

Penalty tax – quantum – whether excessive – assessment increased by the Board for being manifestly inadequate.

Panel: Kenneth Kwok Hing Wai SC (chairman), Paul Chan Mo Po and William Tsui Hing Chuen.

Date of hearing: 6 October 2005.

Date of decision: 29 December 2005.

The appellant is a son and the personal representative of the estate of his father who passed away in May 1998 (the deceased). The deceased reported no or low salary income in his tax returns for the years of assessment 1993/94 – 1996/97.

In January 1999, there was an investigation commenced by the assessor into the tax affairs of the deceased.

In October 2004, the appellant met the assessor and reached an agreement with the assessor on the amounts of income understated by the deceased, i.e. \$5,730,000 and thus being 95.26% of his income.

As a result, additional tax was assessed at \$231,000 i.e. 24.4% of the tax undercharged.

In March 2005, the appellant disputed the assessment by even threatening to make complaints against the Revenue to the mass media.

Held:

1. The deceased submitted incorrect returns for four years. He omitted or understated his income by 95.26%. The Revenue had to resort to investigation and it took 5 years 9 months. It is a case where a 100% starting point would have been appropriate. (D118/02 applied)
2. Up to and including the stage of compromise, the appellant was co-operative. After that date, the appellant tried to re-open the compromise by threatening the Revenue with groundless complaints to the mass media.

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3. The Board is of the view that the additional tax which was imposed at 24.4% of the tax undercharged is manifestly inadequate. The Board increases the additional tax to \$473,500 i.e. about 50% of the amount of the tax undercharged.

Appeal dismissed.

Cases referred to:

D118/02, IRBRD, vol 18, 90
D3/02, IRBRD, vol 17, 396
D65/02, IRBRD, vol 15, 610

Taxpayer in person.

Wong Wing Yu and Poon Wai Yiu for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the following assessments ('the Assessments') all dated 15 April 2005 by the Deputy Commissioner of Inland Revenue, assessing the appellant to additional tax under section 82A of the Inland Revenue Ordinance, Chapter 112 ('the Ordinance'), in the following sums:

Year of assessment	Additional tax	Charge no
1993/94	\$88,400	9-9452701-94-7
1994/95	\$68,400	9-9452644-95-1
1995/96	\$47,100	9-4222349-96-1
1996/97	<u>\$27,100</u>	9-2629538-97-8
Total	<u>\$231,000</u>	

2. The relevant provision is section 82A(1)(a) of the Ordinance for making an incorrect return by omitting or understating income.

The salient facts

3. The parties agreed the facts in the statement of facts and we find them as facts.
4. The salient facts are as follows.

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5. The appellant is a son and the personal representative of the estate of his father who passed away on 15 May 1998.
6. The deceased reported no or low salary income in his tax returns for individuals for the years of assessment 1993/94 – 1996/97.
7. In January 1999, the appellant was informed by the assessor of an investigation commenced by the assessor into the tax affairs of the deceased.
8. By April 1999, the appellant had appointed an accounting firm to be his tax representative.
9. By letter dated 10 August 1999, the appellant informed the assessor that the deceased had omitted to report income of \$1,009,101 for the year of assessment 1993/94.
10. In February 2002, the assessor informed the appellant that the assessor would use an assets betterment statement to assess the income understated by the deceased.
11. On 14 October 2004, the appellant, accompanied by his brother and his tax representative, met the assessor.
12. The assessor informed the appellant that:
 - (a) once a settlement was reached on the amounts of income understated, the compromise would become final and conclusive under section 70 of the Ordinance, and
 - (b) the matter would be submitted to the Commissioner or the Deputy Commissioner for consideration of penal actions under Part XIV of the Ordinance.
13. The appellant reached an agreement with the assessor on the amounts of income understated by the deceased:

Year of assessment	Income before investigation	Income after investigation	Income understated	Tax undercharged
	\$	\$	\$	\$
1993/94	0	1,432,500	1,432,500	234,535
1994/95	57,000	1,489,500	1,432,500	240,835
1995/96	158,000	1,590,500	1,432,500	238,575
1996/97	<u>70,000</u>	<u>1,502,500</u>	<u>1,432,500</u>	<u>232,755</u>
Total:	<u>285,000</u>	<u>6,015,000</u>	<u>5,730,000</u>	<u>946,700</u>

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14. In these four years of assessment, the deceased understated his income by 95.26%.

15. By the Assessments, the Deputy Commissioner assessed the appellant to additional tax at 24.40% of the tax undercharged.

Year of assessment	Tax undercharged	Additional tax	Additional tax/tax undercharged
	\$	\$	%
1993/94	234,535	88,400	37.69
1994/95	240,835	68,400	28.40
1995/96	238,575	47,100	19.74
1996/97	<u>232,755</u>	<u>27,100</u>	<u>11.64</u>
	<u>946,700</u>	<u>231,000</u>	<u>24.40</u>

The appellant's conduct after the compromise on 14 October 2004

16. In his letter dated 17 March 2005 making representations under section 82A(4)(b) of the Ordinance, the appellant:

- (a) argued that the salary tax assessments were exaggerated and estimated;
- (b) requested the Department to review and carefully analyse the whole case;
- (c) stated that if the Department should require the payment of any additional tax, they would write to the Commissioner for a thorough investigation of this case; and
- (d) stated that if the Department should require the payment of any additional tax, they would complain to the mass media about maladministration.

17. In his notice of appeal dated 13 May 2005, the appellant made various allegations and assertions, including:

- (a) an assertion that it was impossible, unreasonable and unfair to request them to explain the deceased's increase in assets as shown in the assets betterment statement;
- (b) an assertion that they were angry and discontented; and
- (c) a request that he be exempted from additional tax.

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18. At the hearing of the appeal, the appellant contended that as the investigation was conducted after the death of the deceased, he had no materials for objecting and that he had incurred lawyers' and accountants' fees.

19. The appellant did not give evidence on oath and did not call any witness.

The Board's decision

The relevant statutory provisions

20. Section 68(4) of the Ordinance provides that the onus of proving that the assessment appealed against is excessive or incorrect shall lie on the appellant.

21. Section 70 provides that:

'Where no valid objection or appeal has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable income or profits or net assessable value assessed thereby, or where an appeal against an assessment has been withdrawn under section 68(1A)(a) or dismissed under subsection (2B) of that section, or where the amount of the assessable income or profits or net assessable value has been agreed to under section 64(3), or where the amount of such assessable income or profits or net assessable value has been determined on objection or appeal, the assessment as made or agreed to or determined on objection or appeal, as the case may be, shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income or profits or net assessable value:

Provided that nothing in this Part shall prevent an assessor from making an assessment or additional assessment for any year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for the year.'

22. Section 82A(1) provides that:

'(1) Any person who without reasonable excuse-

(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person or a partnership;
or

(b) ...

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shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which-

- (i) has been undercharged in consequence of such incorrect return, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct ...'*

23. Section 82A(6) provides that:

'(6) Where a person who is liable to be assessed to additional tax has died, an assessment to additional tax may be made on his executor, and the additional tax shall be recovered as a debt due from and payable out of the deceased person's estate.'

24. Section 82B(2) provides that:

'(2) On an appeal against assessment to additional tax, it shall be open to the appellant to argue that-

- (a) he is not liable to additional tax;*
- (b) the amount of additional tax assessed on him exceeds the amount for which he is liable under section 82A;*
- (c) the amount of additional tax, although not in excess of that for which he is liable under section 82A, is excessive having regard to the circumstances.'*

25. Section 82B(3) provides that section 68 shall, so far as applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax. The Board's power under section 68(8)(a) includes the power to **increase** the assessment appealed against.

Incorrect returns

26. There was no objection to any of the assessments issued pursuant to the compromise reached on 14 October 2004. These assessments have become final and conclusive under section

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70. The appellant had clearly been told that by the assessor before the compromise that the matter could not be re-opened afterwards.

27. The deceased submitted incorrect returns in all four years of assessment. He omitted or understated his income by 95.26%. In dollar terms, he omitted or understated his income by \$5,730,000. The amount of tax undercharged, or would have been so undercharged if his returns had been accepted as correct, was \$946,700. The tax undercharged is 3.32 times his total reported income of \$285,000.

Whether liable for additional tax

28. Section 82A(6) makes it clear that a person's liability for additional tax does not end with his death. The beneficiaries of a deceased's estate are not allowed to benefit at the expense of the Revenue, the Government and the public from the deceased's omission or understatement of income and from the deceased's death.

29. We do not accept that the appellant has any insurmountable difficulty in dealing with the deceased's tax matters. There is no evidence in support of the bare assertion. Moreover, the appellant was able to inform the assessor by letter dated 10 August 1999 that the deceased had omitted to report income of \$1,009,101 for the year of assessment 1993/94. The appellant was also able to present materials to the assessor which resulted in the reduction of the amount of discrepancy by more than \$2,300,000.

30. If the appellant had any real difficulty, he should blame the deceased for not reporting the correct amounts of income and not keeping proper records of his income.

31. The deceased had no excuse for understating his income.

Maximum amount of additional tax

32. The maximum amount is treble the amount of tax undercharged or which would have been undercharged had the deceased's returns been accepted as correct. The amount undercharged or which would have been undercharged was \$946,700 and treble that is \$2,840,100.

33. The maximum amount of additional tax is large for the simple reason that the tax undercharged by reason of the omission or understatement of income was large.

Whether excessive having regard to the circumstances

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34. In paragraphs 48 and 50 in D118/02, IRBRD, vol 18, 90, a decision of a panel chaired by Mr Ronny Wong Fook-hum, SC, sitting with Professor Andrew J Halkyard and Mr Kenneth Kwok Hing-wai, SC, the Board said:

‘ 48. One of the earliest statement in relation to assessment at 100% of the tax involved is to be found in D53/88, IRBRD, vol 4, 10. The Board there pointed out that penalty at 100% of the amount of tax undercharged is appropriate to those cases:

- (a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or*
- (b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or*
- (c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.*

49. ...

50. The circumstances of each particular case must be examined bearing in mind that the maximum penalty is 300%. Depending on the circumstances of each individual case, the Board has approved additional tax at 200% of the tax involved in D22/90, IRBRD, vol 5, 167 and in D53/92, IRBRD, vol 7, 446 and at 210% of the tax involved plus 7% compound interest per annum in D43/01, IRBRD, vol 16, 391.’

35. The deceased had totally failed in his obligations under the Ordinance and such failure persisted over a period of four years. The Revenue had to resort to investigations and the preparation of assets betterment statements to assess the tax. The investigation took 5 years 9 months (from January 1999 to October 2004).

36. Applying D118/02, but substituting ‘and’ for ‘or’ in paragraph 48(a) and (b), this is a case where a 100% starting point would have been appropriate.

37. We accept that up to and including the stage of the compromise, the appellant was co-operative.

38. After that date, the appellant tried his very best to destroy mitigating factors and create aggravating factors.

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39. He tried to re-open the compromise. That is a sheer waste of the Revenue and the Board's time and resources.

40. In response to the invitation to make representations under section 82A(4), he threatened the Revenue with groundless complaints to the mass media. Such a threat to a public officer in the proper discharge of his statutory functions is a matter which the Board disapproves in the strongest terms.

41. With the appellant's co-operation, the investigation into the deceased's tax affairs took 5 years 9 months. If the appellant had incurred legal and accounting fees, that was a price which the estate had to pay for the deceased's gross omission or understatement of his income. Public resources and funds were used to investigate the deceased's incorrect tax returns and this is clearly an aggravating, not mitigating, factor.

42. There was actual loss to the Revenue. The average prime rate over the relevant period was more than 7% per annum. The Assessments represented no more than interest on the lost revenue at 7% per annum.

43. In our decision, not only is the additional tax imposed at 24.40% of the amount of the tax involved not excessive, it is manifestly inadequate in all the circumstances of this case.

44. For reasons set out in paragraphs 34 - 42 above, a majority of two of us would not have been inclined to intervene if the Deputy Commissioner had imposed additional tax between 75% and 100%.

45. A minority of one feels uncomfortable about the inclusion of this sentence on the ground that benefit of doubt should be given in this case in considering the appropriate level of penalty. By reason of his death, the deceased was unable to be present to personally explain his financial and taxation affairs to the Revenue. Also, the personal representative of his estate had not taken part in his business activities and did not appear to be a financially literate person.

Increasing the Assessments under sections 68(8)(a) and 82B(3)

46. **Pursuant to sections 68(8)(a) and 82B(3) of the Ordinance, we increase the Assessments as follows:**

Year of assessment	The Assessments	Additional tax increased by us to	Tax undercharged
	\$	\$	\$
1993/94	88,400	117,300	234,535
1994/95	68,400	120,500	240,835
1995/96	47,100	119,300	238,575

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1996/97	<u>27,100</u>	<u>116,400</u>	<u>232,755</u>
Total:	<u>231,000</u>	<u>473,500</u>	<u>946,700</u>

47. The additional tax is increased by us to about 50% of the amount of tax undercharged.

48. As the Board said in D3/02, IRBRD, vol 17, 396, at paragraph 17, instead of considering himself fortunate to have been treated leniently by the Deputy Commissioner, the appellant chose to waste the time and resources of the Board of Review by pursuing this thoroughly unmeritorious appeal. As the Board said in D65/00, IRBRD, vol 15, 610, at paragraph 59, but for the fact that this appeal has served the useful purpose of increasing the manifestly inadequate penalty, we would have made an order for costs under section 68(9).