

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D68/95

Penalty tax – incorrect profits tax and salaries tax returns – amount of penalties – mitigating factors.

Panel: William Turnbull (chairman), Albert Ho Chun Yan and Charles Hui Chun Ping.

Date of hearing: 11 May 1995.

Date of decision: 6 October 1995.

The taxpayer was the sole proprietor of a property agency business. The taxpayer was also a shareholder or director of more than 20 corporations. The profits tax and salaries tax returns filed were incorrect. The amount of tax involved and the percentage of the under declaration were substantial. The penalties were of the amount equal to 131% of the tax involved. The taxpayer argued that normally penalty of only 100% would be imposed.

Held:

The failure to keep proper accounts and records and having no intention to evade tax were not mitigating factors but their presence would be an aggravating factor. The penalties imposed are excessive. All of the facts are to be considered in the light of the obligations imposed upon the taxpayer by the Inland Revenue Ordinance. The penalty tax assessments imposed was reduced.

Appeal partly allowed.

Case referred to:

D52/93, IRBRD, vol 8, 372

Chan Wan Chun for the Commissioner of Inland Revenue.
Robert Chiu of Messrs Robert Chiu & Co for the taxpayer.

Decision:

This is an appeal by a taxpayer against penalty tax assessments raised upon him in respect of his filing incorrect profits tax returns and salaries tax returns. The facts are as follows:

INLAND REVENUE BOARD OF REVIEW DECISIONS

1. The Taxpayer was the sole proprietor of a property agency business which commenced operation in 1979. The Taxpayer submitted profits tax returns in respect of the business for the years of assessment 1983/84 to 1986/87 inclusive showing the following profits.

Year of Assessment	Basic Period	Date of Filing Return	Returned Profits (loss) per return \$	Profits originally assessed \$
1983/84	year ended 31 March 1984	12-7-1984	(99,806)	110,289
1984/85	year ended 31 March 1985	25-9-1985	17,706	10,683
1985/86	period ended 31 December 1985 (reported dated of cessation)	undated (received on 24-4-1986)	57,657	54,771
1986/87	year ended 31 March 1987	undated (received on 30-3-1988)	nil (no trading)	120,000

For the year of assessment 1983/84 the loss of \$99,806 reported was computed as follows:

Net profit for the year	\$85,206
Loss for the previous year brought forward	(\$185,012)
Loss	(\$99,806)

Except for the year of assessment 1986/87 the profits tax returns submitted were accepted by the assessor with some minor technical adjustments and assessments were raised accordingly. For the year of assessment 1986/87 an estimated assessment under section 59(3) of the Inland Revenue Ordinance (the IRO) was raised on 7 January 1988 in the absence of a return and the estimated assessable profit was \$120,000. No objection was filed by the Taxpayer and the assessment had therefore become final and conclusive under section 70 of the IRO. The profits tax return was only filed two months after the issue of the estimated assessment.

2. In 1989 the investigation unit of the Inland Revenue Department commenced an investigation into the tax affairs of the Taxpayer. On 2 June 1989 the Taxpayer accompanied by his wife and his tax representative was interviewed by two officers of the Department. In the interview the Taxpayer handed to the officers lists of unincorporated and incorporated businesses and landed properties in which the Taxpayer and/or his wife had interests and a list of bank accounts held by the Taxpayer and/or his wife. It was found that the Taxpayer was a shareholder or director of more than 20 corporations. The Taxpayer also confirmed that the profits tax returns previously submitted by his businesses were correct.

INLAND REVENUE BOARD OF REVIEW DECISIONS

3. On 12 June 1989 the senior assessor issued a letter to the Taxpayer asking for further information. The Taxpayer provided certain additional information on 25 September 1989 and further additional information on 26 July 1990.
4. On 28 March 1990 the assessor raised two estimated assessments on the Taxpayer for the years of assessment 1983/84 in respect of estimated income assessable to salaries tax of \$450,000 and estimated additional assessable profits for the business also of \$450,000.
5. Salaries tax returns for the years of assessment 1983/84 to 1988/89 inclusive were issued with the 1983/84 estimated salaries tax assessment. The returns and the assessments were redirected on 11 April 1990 due to a change of the Taxpayer's address not known to the assessor at the time when the returns and assessments were issued.
6. By notices dated 10 May 1990 the Taxpayer objected against the two estimated assessments. Salaries tax returns were also filed by the Taxpayer on 12 May 1990 and the following income was declared:

Year of Assessment	Taxpayer's Income per return \$	Wife's income per return \$	Quarters provided by employer
1983/84	Nil	Nil	Nil
1984/85	50,400	Nil	Nil
1985/86	60,000	Nil	Nil
1986/87	Nil	Nil	Nil
1987/88	Nil	Nil	Nil
1988/89	420,000	78,000	Yes (1-10-1988 To 31-3-1989)

7. As the Taxpayer had not provided all of the information requested by the senior assessor in his letter of 12 June 1989 the assessor again wrote on 1 February 1991 setting out the information still outstanding and asking for some additional information. The Taxpayer provided some additional information on 22 November 1991 and on 1 June 1992 but did not provide all of the information requested by the assessor.

INLAND REVENUE BOARD OF REVIEW DECISIONS

8. While enquiries were being carried on two additional estimated assessments for the year of assessment 1984/85 were raised on 21 February 1991 one in respect of salaries tax and one in respect of profits tax both in the sum of \$450,000. The Taxpayer objected to both of these estimated assessments.
9. On 25 March 1992 the assessor raised two further estimated assessments for the year of assessment 1985/86 again both in the sum of \$450,000 and in respect of salaries tax and profits tax respectively. Again the Taxpayer objected to both assessments.
10. On 20 May 1992 the assessor issued further letters to the Taxpayer and his wife respectively requesting additional information but no replies were received.
11. After extensive enquiries and analysis the assessor compiled an assets betterment statement for the Taxpayer showing a total discrepancy of \$13,964,189 for the period 1 April 1983 to 31 March 1989. The statement was issued to the Taxpayer on 4 August 1992. The Taxpayer asked for extension of time to 15 September 1992 for the submission of representations. The request was rejected by the Department and on 4 September 1992 the assessor raised the following additional assessments on the Taxpayer:

	Year of Assessment	Estimated Income \$
Salaries Tax	1986/87	2,300,000 =====
	1987/88	2,300,000 =====
	1988/89	2,840,000 =====
	Year of Assessment	Estimated Additional Assessable Profits \$
The Business	1986/87	2,300,000 =====

The Taxpayer duly objected to these assessments.

INLAND REVENUE BOARD OF REVIEW DECISIONS

12. On 19 January 1993 the Taxpayer attended an interview at the Inland Revenue Department and made representations with regard to the assets betterment statement. He said that full representations would be ready by the end of February 1993.
13. The Taxpayer failed to make further representations by the end of February 1993 and a holding over of tax in respect of the Taxpayer's salaries tax assessments for the years of assessment 1983/84 to 1986/87 was cancelled.
14. Further representations were made by the Taxpayer on 17 May 1993. On 30 June 1993 the assessor issued a letter to the Taxpayer requesting further information to support claims which the Taxpayer had made in the representations.
15. On 5 July 1993 the Taxpayer notified the Inland Revenue Department that he had changed his tax representative.
16. The new tax representative submitted further information to support the claims made on 19 August 1993, 27 August 1993, 3 September 1993 and 19 October 1993 respectively.
17. Based on the information supplied by the Taxpayer and after some discussions with the tax representative a revised assets betterment statement covering the period from 1 April 1983 to 31 March 1989 with a total discrepancy increased to \$14,993,918 was issued to the Taxpayer on 6 January 1994.
18. Negotiations with the Taxpayer continued and further information was filed by the Taxpayer on 4 January 1994, 17 January 1994, 12 July 1994 and 23 August 1994.
19. On 28 February 1994 an estimated additional assessment for the year of assessment 1987/88 with assessable profits of \$2,500,000 was issued in respect of the business. The Taxpayer duly objected to the assessment.
20. On 14 September 1994 an interview with the Taxpayer and his new tax representative was held. During the interview the Taxpayer was shown a revised computation with revised total discrepancy for the period from 1 April 1983 to 31 March 1989 reduced from \$14,993,918 to \$11,949,894. The discrepancy was apportioned evenly throughout the period and was allocated to the business for the years of assessment 1983/84 to 1986/87 and to the Taxpayer's salaries tax for the years of assessment 1987/88 and 1988/89. In the interview the Taxpayer also confirmed that all the tax returns for the years of assessment 1989/90 and onwards were correct. On 11 October 1994 the Taxpayer disclosed that quarters provided by the employer had been omitted for the year of assessment 1991/92 and 92/93. On 7 December 1994 the Taxpayer further disclosed that the income (before quarters value) for the year

INLAND REVENUE BOARD OF REVIEW DECISIONS

of assessment 1992/93 should be \$720,000 instead of \$33,500 as declared previously in the salaries tax return.

21. Revised salaries tax assessments and profits tax assessments were issued to the Taxpayer on 20 October 1994. The following is a comparative table of the assessable income/profit before and after the investigation and the amount of tax undercharged.

The Business

Year of Assessment	Profits/Income returned/assessed before investigation \$	Profits/Income assessed after investigation \$	Understatement \$	Tax Undercharged \$
1983/84	110,289	2,101,938	1,991,649	310,672
1984/85	10,683	2,002,332	1,991,649	345,048
1985/86	54,771	2,046,420	1,991,649	338,581
1986/87	<u>Nil</u>	<u>2,111,649</u>	<u>2,111,649</u>	<u>358,980</u>
	<u>175,743</u>	<u>8,262,339</u>	<u>8,086,596</u>	<u>1,353,281</u>

Salaries Tax

Year of Assessment	Profits/Income returned/assessed before investigation \$	Profits/Income assessed after investigation \$	Understatement \$	Tax Undercharged \$
1987/88	Nil	1,991,649	1,991,649	328,622
1988/89	<u>540,000</u>	<u>2,631,231</u>	<u>2,091,231</u>	<u>324,140</u>
	<u>540,000</u>	<u>4,622,880</u>	<u>4,082,880</u>	<u>652,762</u>

The understatement amounted to 94% of the total profits/income assessed after investigation.

22. On 21 November 1994 the Commissioner gave notice under section 82A of the IRO to the Taxpayer informing him of his intention to assess additional tax by way of penalty in respect of the making of incorrect profits tax returns in respect of the business for the years of assessment 1983/84 to 1986/87 inclusive and incorrect salaries tax return for the years of assessment 1987/88 and 1988/89.
23. By letter dated 19 December 1994 the Taxpayer made representations to the Commissioner. After taking into account the representations made by the

INLAND REVENUE BOARD OF REVIEW DECISIONS

Taxpayer the Commissioner on 18 January 1995 issued assessments to additional tax by way of penalty under section 82A of the IRO as follows:

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Percentage of Tax Undercharged
1983/84	310,672	419,000	135%
1984/85	345,048	466,000	135%
1985/86	338,581	457,000	135%
1986/87	358,980	482,000	134%
1987/88	328,622	414,000	126%
1988/89	<u>324,140</u>	<u>383,000</u>	118%
	2,006,043 =====	2,621,000 =====	131%

24. By letter dated 6 February 1995 the Taxpayer gave notice of appeal to the Board of Review against the quanta of the above assessments to additional tax under section 82A.

At the time and date fixed for the hearing of the appeal the Taxpayer was represented by his tax representative. He submitted that the amount of the penalty tax was excessive. He pointed out that the amount of the penalties was equal to 131% of the tax involved. He pointed out that normally where a taxpayer under reported his income a penalty of only 100% would be imposed. He submitted that the Taxpayer had fully cooperated with the Inland Revenue Department since the investigation began in 1989 and have not attempted to cover up anything. He said that it was acknowledged that there was some delay by a previous tax representative but since his firm had taken over representation of the Taxpayer's affairs the matter had been speedily resolved. He asked the Board to reduce the amount of the penalty to 100% of the tax involved.

The representative for the Commissioner drew the attention of the Board to Board of Review Case No D52/93, IRBRD, vol 8, 372 and said that failure to keep proper accounts and records and having no intention to evade tax were not mitigating factors but on the other hand the presence of such matters would be an aggravating factor. He said that the negligence of the Taxpayer in keeping proper accounting records had made the investigation work of the Inland Revenue Department more difficult.

INLAND REVENUE BOARD OF REVIEW DECISIONS

The representative for the Commissioner said that the Taxpayer had not given full cooperation to have the matter finalised quickly. He said that even during the course of the investigation the Taxpayer continued to file incorrect salaries tax returns but then pointed out that subsequent tax returns had not been taken into account by the Commissioner when assessing penalties because the tax affairs of the Taxpayer in subsequent years were still under review.

The representative for the Commissioner said that this was a serious case because the understatement was of a substantial amount and also represented 94% of the total amount ascertained after investigation. He said that the Taxpayer was sophisticated and was able to run many businesses. He pointed out that the object of the penalty was to have a deterrent effect. He also drew attention to the loss of interest suffered by the public revenue.

We have given careful consideration to the submissions made by the representative for the Commissioner but in our opinion the penalties imposed are excessive. Board of Review decision D52/93 must be read in the context of its facts and certain words used by the Board in that case cannot be taken out of context. What we must do in this case as was done by the Board in D52/93 is to consider all of the facts in the light of the obligations imposed upon the Taxpayer by the IRO. It is no excuse to say that proper accounts were not kept. Likewise it is no excuse to say that the Taxpayer did not intend to evade tax. If the Taxpayer had kept proper accounts and did not intend to evade tax then correct returns would have been filed and that would have been an end of the matter. If on the other hand correct accounts had been maintained and the Taxpayer had notwithstanding filed incorrect returns there would be an intention to evade and the matter would no doubt be referred to a court having criminal jurisdiction to adjudicate such matters. What we have here is a Taxpayer who appears to have had a very complex state of affairs involving complex businesses and apparently employment. The Commissioner does not allege and there is no suggestion that the Taxpayer deliberately tried to evade tax.

When the Inland Revenue Department began its investigations the Taxpayer did not sit back and ignore what was being done but employed a tax representative to assist him in sorting out his tax affairs. It is unfortunate that apparently the first tax representative was not able to speedily answer the questions asked by the Inland Revenue Department and bring the matter to a rapid conclusion. The Taxpayer showed his good faith by changing his tax representative and following this change the new tax representative was able with comparative speed and efficiency to have the tax affairs of the Taxpayer finalised. It is true that the amount of tax involved and the percentage of the under declaration were substantial. However we remind ourselves that there is no allegation of deliberate evasion.

Having heard the respective parties we feel that this case is no better and no worse than many others where the norm of 100% of the tax involved has been used for assessing penalties. Accordingly we direct that the penalty tax assessments imposed upon the Taxpayer should be reduced to a total of \$2,006,043 made up as follows:

Section 82A

INLAND REVENUE BOARD OF REVIEW DECISIONS

Year of Assessment	Original Assessment \$	Reduced Section 82A Additional Tax \$
1983/84	419,000	310,672
1984/85	466,000	345,048
1985/86	457,000	338,581
1986/87	482,000	358,980
1987/88	414,000	328,622
1988/89	<u>383,000</u>	<u>324,140</u>
	2,621,000 =====	2,006,043 =====