

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D69/00**

**Penalty tax** – starting point – extenuating factors – Inland Revenue Ordinance (‘IRO’) section 82A.

Panel: Anna Chow Suk Han (chairman), Vernon F Moore and Tse Tak Yin.

Date of hearing: 19 July 2000.

Date of decision: 17 October 2000.

The taxpayer was a partnership business. The taxpayer was demanded for additional tax for failing to submit tax returns for the years of assessment 1987/88, 1988/89 and 1990/91 within the time prescribed in the notices under section 51(1) of the IRO.

The taxpayer appealed against the assessments on the following grounds:

- (a) the final agreed assessable profits were arbitrary and were accepted for the sake of settling the investigation;
- (b) Mr B ceased to be a partner of the business in 1989 and thus he was not liable to the liabilities of the taxpayer; and
- (c) the penalties were excessive under the circumstances and, in particular, the one for the year of assessment 1987/88.

**Held:**

1. As the taxpayer failed to submit the profits tax returns within the stipulated time, the estimated assessments raised on the taxpayer by the assessor, in the absence of taxpayer’s objection, became final and conclusive.
2. Mr B failed to substantiate his contention that he sold his share of the taxpayer’s business and was not liable to the tax assessments.
3. The starting point for assessing an appropriate penalty for cases where there are no submission of profits tax returns within time, is approximately 100% of the tax

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undercharged. The question then to decide is whether there are any extenuating circumstances which merit a decrease in the amount of the penalties.

4. The Board did not find the taxpayer's pleas of ignorance of its tax obligations, heavy work schedule, delegation of accounting task to employee, lack of intention to avoid tax liabilities and financial hardship justify departure from the starting point. The assessments are not excessive in the circumstances.

### **Appeal dismissed.**

Cases referred to:

D29/88, IRBRD, vol 3, 319  
D34/88, IRBRD, vol 3, 336  
D36/88, IRBRD, vol 3, 354  
D42/88, IRBRD, vol 3, 395  
D54/88, IRBRD, vol 4, 15

Kwok Yin Ping for the Commissioner of Inland Revenue.  
Taxpayer represented by one of the partners.

### **Decision:**

#### **The appeal**

1. This is an appeal by Company A ('the Taxpayer') against the additional tax assessments raised on it under section 82A of the IRO. The assessments under appeal are penalty assessments for failing to submit tax returns for the years of assessment 1987/88, 1988/89 and 1990/91 within the time prescribed in the notices given under section 51(1) of the IRO.
2. At all material times, the Taxpayer was a partnership business comprising three partners, Mr B, Mr C and Mr D. The partnership business of a tutorial centre commenced on 21 April 1987 and ceased on 30 April 1990.
3. On divers dates, profits tax returns for the years of assessment 1987/88 to 1990/91, were issued to the Taxpayer.
4. For the years of assessment 1987/88, 1988/89 and 1990/91, the Taxpayer did not submit the profits tax returns within the stipulated time. In the absence of the completed tax returns,

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the assessor raised on the Taxpayer estimated profits tax assessments of \$50,000, \$100,000 and \$40,780 respectively for those years of assessment and an additional profits tax assessment of \$150,000 for the year of assessment 1988/89.

5. The Taxpayer did not lodge objection to those estimated assessments which had become final and conclusive in terms of section 70 of the IRO.

6. On diver dates, the Inland Revenue Department ( ' the Department ' ) received the profits tax returns from the Taxpayer for the years of assessment 1989/90 and 1990/91. An assessment based on the Taxpayer' s return was raised for the year of assessment 1989/90.

7. In February 1994, the assessor commenced an investigation into the tax affairs of Mr B, the Taxpayer and two companies of which Mr B was one of the shareholders and directors.

8. On 28 February 1994, the assessor raised on the Taxpayer an estimated additional profits tax assessment of \$500,000 for the year of assessment 1987/88, to which the Taxpayer filed an objection. The Taxpayer then filed the profits tax return for that year of assessment showing the returned profits of \$221,674.

9. By a notice of 15 April 1994, part of the tax in dispute for the year of assessment 1987/88 was held over and the Taxpayer was required to pay \$40,000 pending settlement of the objection.

10. On 16 August 1994, Mr B had an interview with two investigation officers of the Department. The note of the interview was sent to Mr B for confirmation but no response was received by the Department from Mr B.

11. By a letter dated 17 February 1995, Mr B objected to the Department' s recovery of tax for the year of assessment 1987/88 from the Taxpayer. The assessor wrote and explained that the tax was based on the Taxpayer' s returned profits for that year of assessment.

12. On divers dates, additional profits tax assessments of \$500,000 each for the years of assessment 1989/90 and 1990/91 were raised on the Taxpayer basing on the bank statements obtained by the assessor from the Taxpayer' s bankers.

13. Meanwhile the assessor made extensive enquiries with the Taxpayer' s bankers and obtained from them volumes of bank statements. The assessor asked Mr B to explain the discrepancies found in the bank deposits but Mr B failed to give any explanation on them.

14. On 7 July 1999, Mr B' s tax representatives had a meeting with two investigation officers of the Department, when they were informed that the profits tax returns for the years of

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assessment 1987/88 and 1990/91 were submitted out of time and the return for the year of assessment 1988/89 was still outstanding.

15. By letters dated 24 August 1989 and 25 August 1999, the Taxpayer, Mr B and Mr B's companies submitted proposals for settlement of their cases.

16. On 30 August 1999, the Taxpayer submitted to the Department via facsimile profits tax return for the year of assessment 1988/89 and the original on 1 September 1999. The assessable profits declared was \$250,000.

17. On 31 August 1999, revised assessments for the relevant years of assessment were issued to the Taxpayer.

18. The following is a comparative table of the assessable profits before and after investigation in respect of the Taxpayer and the amount of the tax undercharged in consequence of the late filing of the profits tax returns for the years of assessment 1987/88, 1988/89 and 1990/91:

<b>Year of assessment t</b>	<b>Profits before investigation</b>	<b>Profits after investigation</b>	<b>Profits understated</b>	<b>Tax undercharged</b>
	\$	\$	\$	\$
1987/88	0	300,000	300,000	49,500
1988/89	0	250,000	250,000	38,750
1990/91	0	40,780	40,780	<u>6,117</u>
				<u><u>94,367</u></u>

The percentage of total understatement to total profits after investigation is 100%.

19. By a notice under section 82A(4) of the IRO dated 17 September 1999, the Commissioner informed the Taxpayer of her intention to assess additional tax in respect of the failure to comply with the requirements under section 51(1) of the IRO.

20. Having considered and taken into account the representations made on behalf of the Taxpayer by its tax representatives, the Commissioner issued, on 28 February 2000, the following notices of assessment and demand for additional tax under section 82A of the IRO.

<b>Year of assessment</b>	<b>Tax undercharged</b>	<b>Section 82A additional tax</b>	<b>Additional tax as percentage of tax undercharged</b>
	\$	\$	
1987/88	49,500	64,000	129%
1988/89	38,750	39,000	101%

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1990/91	<u>6,117</u>	<u>6,000</u>	<u>98%</u>
	<u>94,367</u>	<u>109,000</u>	<u>116%</u> (average)

21. On 24 March 2000, the Taxpayer gave notice of appeal to the Board of Review.
22. Mr B appeared on behalf of the Taxpayer and chose to address this Board but not to give evidence under oath due to the long lapse of time since the tax assessments arose. From the grounds of appeal and Mr B' s submission at the hearing, we sum up the contentions under this appeal as follows:
- (a) the final agreed assessable profits were arbitrary and were accepted for the sake of settling the investigation;
  - (b) Mr B ceased to be a partner of the business in 1989 and thus he was not liable to the liabilities of the Taxpayer; and
  - (c) the penalties were excessive under the circumstances and, in particular, the one for the year of assessment 1987/88.
23. On the first contention, we hold that by section 70 of the IRO the assessments were final and conclusive. The Taxpayer failed to submit the profits tax returns within the stipulated time and the assessor raised on the Taxpayer estimated assessments which, in the absence of the Taxpayer' s objection, became final and conclusive. Hence, it is not open to the Taxpayer to dispute the agreed assessments before us.
24. On the second contention, Mr B claimed that he sold his share of the Taxpayer' s business in summer 1989 and was therefore not liable to the tax assessments. The onus is on Mr B to substantiate the sale of his share of the business. Despite the Revenue' s repeated request for proof during the course of the investigation, Mr B had failed to supply any. On the evidence, Mr B was a partner of the Taxpayer at all the material times. Thus, Mr B is jointly and severally liable to the tax liabilities of the partnership. Even if Mr B were to prove the sale of his share in the business, such proof would only release Mr B from the tax liabilities but not the Taxpayer.
25. We now turn to consider the third contention, whether the penalties levied against the Taxpayer were excessive under the circumstances.
26. The Respondent referred us to several Board of Review decisions, namely D29/88, D34/88, D36/88, D42/88 and D54/88.
27. Under section 82A of the IRO, the maximum amount of penalty which can be imposed in any case is three times the amount of tax underpaid. It is well recognized that the starting point for assessing an appropriate penalty for cases where there are no submission of profits tax returns

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within time, be approximately 100% of the tax undercharged. It was said in D34/88 that if that is taken as the starting point for cases of the type, the question then to be decided is whether on the particular facts of that case there are any extenuating circumstances which would merit a decrease in the amount of the penalties. It was also said in D42/88, that in assessing penalties, relevant factors to be taken into consideration, include the gravity of the case, the loss suffered by the Revenue, the co-operation given by the taxpayer, the sophistication of the taxpayer, the sophistication of the taxpayer's business and the absence of evidence that the taxpayer deliberately concealed his tax liability.

28. In its written representations to the Commissioner, the Taxpayer's tax representatives submitted that Mr B was a university graduate. He returned to Hong Kong from overseas in the mid-1980s and started the Taxpayer's business of a tutorial centre with two other partners in 1987. All the partners had been required to devote their full time and efforts to teaching as well as managing the business. As the business was small, they could only engage a part-time accountant to whom they delegated the task of maintaining the accounts and filing tax returns. Because of the partners' lack of accounting knowledge, the tax returns were filed out of time. It was also submitted that the delay was neither deliberate nor intentional. The progress of the investigation was impeded by certain misunderstanding of the Taxpayer's former tax representatives and the late responses from the banks. Further, Mr B and his business had been badly hit by the Asian economic crisis and Mr B was experiencing grave financial difficulties.

29. At the hearing, Mr B made the following submissions. He had no intention to avoid his tax obligations. He had mistaken that the estimated assessments were final and conclusive and needed no follow-ups. He had not been unco-operative during the investigation. He had engaged three firms of tax representatives to assist him in the investigation. As the investigation commenced in 1994, by then it was difficult for him to locate the files and records of the business. Delays were due to the banks' slow responses and refusals to supply bank statements without the other partners' authorization. The assessable profits agreed by him were higher than those in the tax returns. He had personally settled all the outstanding taxes. He submitted that the penalties were excessive in the circumstances.

30. The Revenue submitted that there were no mitigating factors in this case which warranted a reduction. The Taxpayer did not file the tax returns for the years of assessment 1987/88, 1988/89 and 1990/91 within time. The investigation commenced in 1994 and it only ended in 1999. Mr B had been busy and the Respondent had difficulties in reaching him. They resorted to the banks for the Taxpayer's bank statements and carried out the investigation on that basis. The investigation took five years and the documents on the matters were voluminous. Had the Revenue not investigated into the Taxpayer's affairs, the tax recovered would be substantially less. The Respondent did not agree that the agreed assessments were higher than those in the tax returns. The higher figures were the results of the Taxpayer's own mistake and certain technical adjustments. They submitted that the penalties were reasonable in the circumstances.

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31. We have carefully considered the Board of Review decisions cited, the documents and submissions before us. We do not consider the Taxpayer's pleas of ignorance of its tax obligations, heavy work schedule, delegation of accounting task to an employee, lack of intention to avoid tax liabilities and financial hardship, are mitigating factors which justify a departure from the general principle of charging approximately 100% of the tax undercharged in cases where taxpayers failed to submit profits tax returns within time. On the other hand, we find that there are aggravating factors such as, the long duration of the investigation and a lack of full co-operation from the Taxpayer, which qualify an adjustment above the 'norm'. Consequently, we come to the conclusion that the penalty assessments under this appeal are by no means excessive in the circumstances.

32. For these reasons, we dismiss the appeal and confirm the additional tax assessments raised on the Taxpayer.