INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D69/03

Penalty tax – incorrect returns – re-opening an issue – whether assessment excessive – whether unco-operative attitude – section 70 of the Inland Revenue Ordinance (' IRO').

Panel: Ronny Wong Fook Hum SC (chairman), William Cheng Chuk Man and Lily Yew.

Date of hearing: 28 July 2003.
Date of decision: 23 October 2003.

Mr A and the appellant were husband and wife but they divorced in 2000.

During their marriage, Mr A was running a business and the appellant appeared to be working for him.

In early 1996, the Revenue commenced investigation into the affairs of them. The Revenue sent to Mr A an assets betterment statement on 22 July 1998.

By notice of additional assessment dated 20 August 1998, the Revenue sought to make additional assessment against the appellant. The assessment was later confirmed by a determination ('the Determination').

The appellant appealed against the Determination but she withdrew the appeal at the hearing in September 2002.

By notices dated 11 April 2003, the Commissioner imposed additional tax in the average of 118% of the tax undercharged.

The appellant sought to appeal against the additional tax imposed on the grounds that:

(a) she did not make any incorrect tax returns;

(b) the assessments were excessive.

Held:

1. The Board held that the appellant was not entitled to re-open the issue that she did not make any incorrect tax returns as she voluntarily abandoned the appeal against the Determination which decided the same issue (D40/88 followed).

2. Having reviewed the relevant cases, the Board was of the view that the starting point for additional tax cases involving incorrect tax return should be 100% of the tax undercharged (D118/02 and D34/88 considered).

3. No doubt that this case involves compilation of an assets betterment statement. The Board found that the appellant was not unco-operative in the course of investigation. The assets betterment statement was first compiled on the information furnished by Mr A and the appellant played no part in it.

4. The appellant eventually bowed to the assessments on the revised statement. She also made genuine efforts to discharge the disputed assessments.

5. The Board was of the view that 75% of the amount of the tax undercharged would be the appropriate penalty.

Appeal allowed in part.

Cases referred to:

D40/88, IRBRD, vol 3, 377
D118/02, IRBRD, vol 18, 90
D53/88, IRBRD, vol 4, 10
D34/88, IRBRD, vol 3, 336
D62/90, IRBRD, vol 5, 451
D52/93, IRBRD, vol 8, 372
D22/90, IRBRD, vol 5, 167
D53/92, IRBRD, vol 7, 446

D43/01, IRBRD, vol 16, 391

Mei Yin for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. Mr A and the Appellant were husband and wife. Their marriage was dissolved on 2 May 2000. Mr A was adjudicated bankrupt on 4 April 2002.

2. On 31 December 1985, a flat (' Property 1') was purchased in the name of the Appellant.

3. On 1 April 1986, Mr A started a sole proprietorship business in the name of Company B. On 20 February 1989, Company B opened an account with Bank C. That account could only be operated by the joint signatures of Mr A and the Appellant. In a letter dated 31 October 1988 from Mr A to the Revenue, the Revenue was informed that the Appellant had been working in Company B since its commencement of business.

4. On 27 December 1989, another flat (' Property 2') was acquired in the name of the Appellant.

5. On 27 July 1992, the Appellant acquired a third piece of property at Address D (' Property 3').

6. Between 12 March 1993 and 30 July 1993, Mr A and the Appellant drew cheques on the Bank C account of Company B in favour of the Appellant. Some of those cheques were deposited into an account with Bank E in the name of the Appellant.

7. Company F is a company incorporated in Hong Kong on 23 June 1993. Mr A, the Appellant and the Appellant' s father were its first directors. Each of them held 3,333 shares in that company. The Appellant was further appointed secretary of Company F. The Appellant' s father resigned his directorship on 7 August 1996. Two named persons were appointed additional directors that day. The two named persons subsequently resigned in June and August 1999.

8. Company F took over the business of Company B. The operations of Company B ceased on 31 July 1993.

9. On 3 November 1993, Company F opened an account with Bank C. Just like the account of Company B this account could only be operated upon the joint signatories of the Appellant and Mr A.

10. Between 20 August 1994 and 26 September 1995, cheques were drawn on Company F's account with Bank C in favour of the Appellant. Some of these cheques were deposited into an account with Bank G in the joint names of the Appellant and Mr A whilst others were deposited into the Appellant's personal account with Bank E.

11. On 16 June 1995, the Appellant acquired a fourth piece of property ('Property 4').

12. On 6 November 1995, Bank G advised the Appellant and Mr A that a sum of C$235,000 was remitted to their account at Bank E of Canada Port Coquitlam Branch. On 6 March 1996, a sum of US$130,000 was transferred by Bank G to an investment account maintained by the Appellant and Mr A with Bank G for the purchase of bonds and equity funds.

13. The Appellant submitted the following returns in respect of her income for the years of assessment 1993/94 to 1995/96:

Year of assessment	**Date when return submitted**	**Income**		**Rental income**	
		Source	**Amount**	**Property**	**Amount**
			$		$
1993/94	17-6-1994			Property 1	101,000
1994/95	6-6-1995	As clerk of Company F	52,000	Ditto	114,000
1995/96	27-6-1996	Ditto	70,000	Ditto	76,000

14. Mr A submitted the following returns in respect of his income for those years of assessment:

Year of assessment	**Income**		**Profits**	
	Source	**Amount**	**Source**	**Amount**
		$		$
1993/94	Company F	135,000	Company B	9,224
1994/95	Ditto	221,000		
1995/96	Ditto	260,000		

15. In early 1996, the Revenue commenced investigation into the affairs of the Appellant and Mr A. They had an interview with Mr A on 29 March 1993. By letter dated 11 April 1996, the Revenue asked Mr A to provide various heads of information in relation to Mr A and the Appellant. An accountants' firm ('the Tax Representative') replied on behalf of Mr A on 25 March

1997. The Tax Representative informed the Revenue the circumstances surrounding the acquisition by the Appellant of Properties 3 and 4. In response to the Revenue's inquiries on 'Loans to/from others' and on 'Remittance received', the Tax Representative indicated that there were 'No loans to/from other after April 1, 1990' and there was no remittance received.

16. Mr A was further interviewed by the Revenue on 19 March 1998. By letter dated 20 May 1998, the Tax Representative furnished to the Revenue information requested by the Revenue at the 19 March 1998 interview.

17. By letter dated 22 July 1998, the Revenue sent to Mr A an assets betterment statement for the period between 1 April 1990 and 31 March 1996. The Tax Representative commented on this assets betterment statement on behalf of Mr A by their letter dated 5 August 1998. Further exchanges ensued between the Revenue and the Tax Representative on behalf of Mr A on 27 August 1998 and 25 September 1998.

18. By notices of additional assessment for the years of assessment 1992/93 and 1993/94 dated 20 August 1998, the Revenue sought to make additional assessment against the Appellant for the year of assessment 1992/93. By letter dated 4 September 1998, the Tax Representative objected on behalf of the Appellant against such assessment.

19. No further correspondence passed between the parties until 5 November 1999. By three notices of assessment bearing that date ('the 5 November 1999 Assessments'), the Appellant was assessed as follows:

Charge number	**Year of assessment**	**Income**	**Tax payable**
		$	$
9-2896132-94-9	1993/94	1,200,000	180,000
9-2832081-95-2	1994/95	2,252,000	337,800
9-4032823-96-4	1995/96	2,270,000	340,500
			858,300

20. By letters dated 9 November 1999, the Tax Representative objected on behalf of the Appellant the assessments summarised in paragraph 19 above on the ground that 'the assessment is excessive'. Without prejudice to such objections, the Tax Representative applied to the Revenue by letter dated 17 December 1999 for payment of those assessments by instalments.

21. The Appellant attended her first interview with the Revenue on 28 December 1999. She was not accompanied by the Tax Representative for this interview. She informed the Revenue that she had just returned from Canada. She had separated from Mr A and did not know his whereabouts. The Revenue explained to her that the assessments for the years of assessment 1993/94 to 1995/96 were raised by virtue of discrepancies found in the assets betterment statements. She was invited to arrange for a further interview with Mr A the following week.

22. The Appellant attended a further interview with the Revenue on 4 January 2000. She was accompanied by the Tax Representative but not Mr A at this interview. The Revenue referred to the assets betterment statement and observed that most of the assets were held in the name of the Appellant. The Revenue told her that it was for those reasons that the 5 November 1999 Assessments were issued against her.

23. The Tax Representative continued to pursue the Appellant's application for payment by instalments in the months of January and February 2000. In their letter dated 1 February 2000, the Tax Representative informed the Revenue that the Appellant 'cannot provide cashflow forecasts for the coming 12 months since the business prospect is uncertain and the company business condition is bad'. By further letter dated 14 February 2000, the Tax Representative offered to charge the properties in the name of the Appellant as security for her tax liabilities. This offer was not immediately taken up by the Revenue as the parties differed on the value to be attached to the properties.

24. By letter dated 7 March 2000, the Revenue informed the Appellant that her 9 November 1999 objections through the Tax Representative 'cannot be settled at present because the review of your tax affairs is still in progress' and that the Revenue shall be preparing a statement of facts for her comment in the near future.

25. No statement of facts was prepared by the Revenue in the year 2000. By letter dated 15 June 2000, the Appellant was invited to attend a further interview with the Revenue in relation to her application for instalment payment. The Appellant made no response to that letter. She simply made monthly payments of $5,000 to reduce the amounts due under the 5 November 1999 Assessments.

26. The Appellant complained to the Ombudsman that she had been improperly assessed of the profits made by Mr A in the operation of his business. The materials before us disclose two conflicting dates for lodgment of this complaint. According to the Revenue's letter dated 4 June 2001, the complaint was laid by the Appellant's letter dated 12 April 2000. According to the Appellant, the complaint was laid in April 2001. We are of the view that the reference in the Revenue's 4 June 2001 letter is an error. This is supported by the fact that the Appellant's solicitors adverted to the absence of the statement of facts in their letter to the Revenue dated 17 April 2001 and the Revenue's response to the complaint to the Ombudsman was dated 4 June 2001.

27. By letter dated 4 June 2001, the Revenue explained to the Appellant their basis of assessment. They referred to the Appellant's status and interests in Company F; her role as authorised signatory to Company F's account and her holding of the principal assets. They relied on their previous assets betterment statement and pointed out that their revised computations revealed discrepancies as follows:

Year of assessment	Original discrepancies	Revised discrepancies
	$	$
1993/94	1,682,399	2,101,140
1994/95	2,155,632	2,229,992
1995/96	2,195,712	3,204,444

28. The revised discrepancies were provisionally apportioned by the Revenue between the Appellant and Mr A on a 50:50 basis as follows:

(A) Year of assessment	(B) Revised discrepancies	(C) Assessable income/Additional assessable income	(D) Reasons for the figures in column (C)
	$	$	
1993/94	2,101,140	700,000	Half of the discrepancy for the year ended 31 March 1994 as per the revised assets betterment statement × 8/12 (rounded down to nearest thousand)
1994/95	2,229,992	1,115,000	Half of the discrepancy for the relevant year as per the revised assets betterment statement (rounded down to the nearest thousand)
1995/96	3,204,444	1,602,000	Half of the discrepancy for the relevant year as per the revised assets betterment statement (rounded down to the nearest thousand)

The Revenue explained that such apportionment was made as a matter of fairness and in the light of the divorce between the Appellant and Mr A in May 2000. A revised assets betterment statement was sent to the Appellant on the same day.

29. According to an undated letter received by the Revenue on 28 June 2001, the Appellant explained as follows:

(a) She did not exercise any control over the affairs of Company B or Company F. She only performed occasional clerical works.

(b) Her name was used for the purchase of trucks and trailers. This was a risk reduction exercise at the request of the finance compan(ies).

(c) Her status as an authorised signatory to the various bank accounts was no more than a ploy to delay payments to creditors of those entitles. Mr A had complete control over the operation of those accounts as she provided him with cheques which she signed in blank.

(d) Mr A handled all withdrawals and deposits. The receipts were held by Mr A on behalf of others. Those receipts were not receipts of the company and could not be treated as part of her income.

30. By letter dated 5 October 2001, the Revenue pointed out that as no agreement could be reached between the parties, her objections would be referred to the Commissioner for her determination.

31. By a determination dated 9 May 2002 ('the Determination'), the Commissioner confirmed the following assessments:

Year of assessment	**As per the 5 November 1999 Assessments**		**As per the Determination**	
	Assessable income	**Tax thereon**	**Revised assessable income**	**Tax thereon**
	$	$	$	$
1993/94	1,200,000	180,000	700,000	114,602
1994/95	2,252,000	337,800	1,167,000	175,050
1995/96	2,270,000	340,500	1,672,000	250,800
		858,300		540,452

32. The Appellant appealed against the Determination. According to her notice dated 7 June 2002, she contended that:

(a) 'The assessments are excessive' and

(b) ' I should not be assessed on the above assessments which should be assessed on my former-husband ...' .

33. The appeal came before a differently constituted Board. After hearing the explanation given by that Board as to her onus of proof, the Appellant informed this Board by letter dated 19 September 2002 that she decided to withdraw her appeal. This Board accordingly dismissed her appeal by letter dated 26 September 2002.

34. By notice dated 23 January 2003, the Commissioner informed the Appellant of her intention to impose additional tax under section 82A(4) of the IRO. By letter dated 12 February 2003, the Appellant reiterated in substance the contentions that she outlined in her letter summarised in paragraph 29 above.

35. By notices dated 11 April 2003, the Commissioner imposed additional tax as follows:

Year of assessment	**Revised assessable income**	**Tax undercharged**	**Additional tax imposed**	**Relationship between additional tax imposed and tax undercharged**
	$	$	$	%
1993/94	700,000	114,602	146,000	127.39
1994/95	1,167,000	175,050	210,000	119.96
1995/96	1,672,000	250,800	282,000	112.44
	3,539,000	540,452	638,000	118.04

36. This is the Appellant' s appeal against the additional tax so imposed. She relies on two grounds in her notice of appeal dated 6 May 2003:

(a) She has not made any incorrect tax returns. She should not be required to make any return on the basis of Mr A' s income.

(b) The assessments are excessive.

Are the returns incorrect or not?

37. Section 70 of the IRO provides that:

' Where ... an appeal against an assessment has been withdrawn under section 68(2A) or dismissed under subsection (2B) of that section ... the assessment as made ... shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income or profits ...' .

38. In D40/88, IRBRD, vol 3, 377, this Board explained that:

> *'In our view, "all purposes of the Ordinance" includes determining the issue as to whether the relevant returns were or were not "incorrect" within the meaning of section 82A thereof.*
>
> *The consequence is that the assessable profits for the relevant periods are conclusively deemed to be the amounts assessed. The relevant returns made by Mr A and Mrs A are therefore for present purposes conclusively presumed to be incorrect in that the amounts of assessable profits returned were far below the amounts thus assessed. ...'*

39. We are of the view that the Appellant is not entitled to re-open an issue which was before this Board in September 2002 and which she voluntarily abandoned to pursue. At all material times, she had the benefit of or access to professional advice. A solicitors' firm acted for her in April 2001. The Tax Representative acted for her in negotiating for instalment payments with the Revenue after she lodged her appeal on 7 June 2002. The Tax Representative continued to act for her for such purpose after she withdrew her appeal on 19 September 2002. The assessment is final and conclusive for all purposes and we are not at liberty to re-open the same.

Are the assessments excessive?

40. The assessments of additional tax ranged between 112.4% and 127.3% with an average of 118% of the tax undercharged.

41. In D118/02, IRBRD, vol 18, 90, this Board reviewed the so-called 100% 'starting point' for additional tax in the context of late submission cases. The Board observed in that case that:

> *'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.

Similar sentiments were expressed by this Board in D34/88, IRBRD, vol 3, 336:

"As previous Board have stated in cases of this nature, the starting point for assessing an appropriate penalty would appear to be approximately 100% of the tax underpaid. In effect, this means that, for completely ignoring one's tax obligations, one can assume that one is likely to have to pay about double the tax which other citizens who handle their tax affairs properly are required to pay." (emphasis added)

These statements are at variance with the position adopted by the Board in D62/90, IRBRD, vol 5, 451 and D52/93, IRBRD, vol 8, 372 where the Board stated 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".

This statement seems to indicate that 100% of the tax undercharged is intended to apply to the run of the mill type of cases. It is inconsistent with the broad categories outlined in D53/88 and D34/88. We prefer the statements in D53/88 and D34/88. Given the fact that 97.5% represents the level of additional fine imposed by the Court for more serious cases, it would be wrong for the Board to adopt 100% as the starting point for a case with no aggravating or mitigating circumstances. 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'.

42. We are of the view that the observations outlined in paragraph 41 above are applicable to cases involving incorrect returns.

43. In this case the assessments are well above the 100% mark said to be applicable to cases involving complete disregard of one's tax obligations. According to the Revenue, the principal justification for this approach is that the Appellant could not be regarded as co-operative in the course of investigation. The Revenue places particular reliance on the Appellant's failure to substantiate her allegation that Mr A held funds on trust for other persons and the fact that the Revenue incurred substantial resources in the compilation of the assets betterment statement.

44. At the hearing before us on 28 July 2003, the Appellant protested strongly against the allegation that she had been unco-operative. We called for a fuller compilation from the Revenue of the correspondence passing between the parties. An additional bundle was placed before us on 4 August 2003. The Appellant made further submissions in the light of that bundle on 18 August 2003. As a result of that bundle, we have a better understanding of the history of the disputes.

45. There is little doubt that this case involves compilation of an assets betterment statement. That statement was first compiled on the basis of information furnished by Mr A. The Revenue did not know the state of the marital relationship between the Appellant and Mr A. We are however satisfied that the 5 November 1999 Assessments were issued on the basis of investigations which the Appellant played no part. Her first substantial involvement came with her objections on 9 November 1999. She attended her first interview on 28 December 1999. She made known to the Revenue that she did not know the whereabouts of Mr A. She attended a further interview on 4 January 2000. The Revenue indicated on 7 March 2000 that a statement of facts would be settled in view of the lack of compromise. The Appellant did not receive this statement. She made a complaint to the Ombudsman in April 2001. This prompted the revised assets betterment statement of 4 June 2001. That revised assets betterment statement must be understood in the context of the objections which the Appellant had in place as long ago as 9 November 1999. Between 9 November 1999 and 4 June 2001, the Revenue did seek information from the Appellant in relation to her financial position. Such information was sought in the context of the Appellant's application for payment by instalment. The Revenue did not press her for materials in the context of their general investigation. For these reasons we are unable to share the Revenue's view that the Appellant had been unco-operative. The delay was on the part of the Revenue. They made no progress in resolving the objection between 7 March 2000 and 4 June 2001.

46. Throughout this period of inactivity by the Revenue, the Appellant was making genuine efforts to discharge the disputed assessments. She made payments at the rate of $5,000 per month. She offered to charge Properties 1, 2, 3 and 4 to secure her liabilities. Three of these properties were acquired well before the tax years in question. According to the Tax Representative's letter dated 18 December 2001, these premises were more than sufficient to cover the amount of tax assessed.

47. In these circumstances, we see no justification whatsoever in assessing the Appellant beyond the 100% mark. We are of the further view that there are good grounds for scaling down from that mark. There is no doubt that this case involves compilation of an assets betterment statement and the Appellant eventually bowed to assessments on the basis of the revised statement. The reality is that the Appellant played no part in the initial compilation. She protested throughout and abandoned her appeal given the futility in seeking help from Mr A. During the pendency of her appeals, she made genuine efforts to secure her liabilities. Having regard to the tax undercharged

and the overall circumstances, we are of the view that 75% of the amount of tax undercharged would be the appropriate penalty.

48. For these reasons, we allow the appeal in part. We set aside the assessments dated 11 April 2003 and order that the Appellant be assessed additional tax as follows:

Year of assessment	**Tax undercharged**	**Assessments ordered by this Board**
	$	$
1993/94	114,602	85,951
1994/95	175,050	131,287
1995/96	250,800	188,100