INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D69/89

Penalty tax – reasonable excuse – quantum of penalty – section 82A of the Inland Revenue Ordinance.

Panel: Della P H Chan (chairman), Cheung Wing In and Tse Tak Yin.

Date of hearing: 21 September 1989.
Date of decision: 3 November 1989.

The taxpayer carried on business and was assessed to tax following the assets betterment statement procedure. After his tax affairs had been finalised, a number of penalty tax assessments were made against him in respect of a total of four years amounting to approximately 83% of the tax undercharged. The taxpayer argued that he had a reasonable excuse because of his lack of accounting knowledge, loss of records, and inability to produce evidence of losses, all of which had contributed to his being unable to successfully challenge the assets betterment statement. With regard to the quantum of the penalties, the taxpayer submitted that he had no intention to evade tax.

Held:

The excuses put forward by the taxpayer did not amount to a reasonable excuse. Likewise the quantum of the penalties were not excessive.

Appeal dismissed.

Cases referred to:

D28/88, IRBRD, vol 3, 312
D58/87, IRBRD, vol 3, 11
D42/88, IRBRD, vol 3, 395
D56/88, IRBRD, vol 4, 25

Tse Hon Kin for the Commissioner of Inland Revenue.
Christopher Yip of C & D Management Services for the taxpayer.

Decision:

This is an appeal against additional tax assessments imposed by the Commissioner pursuant to section 82A of the Inland Revenue Ordinance on the Taxpayer for making incorrect profits tax returns for the years of assessment 1980/81 to 1983/84.

The facts which are not in dispute are as follows:

1. The Taxpayer is the precedent partner of an advertising agency ('the agency') which commenced business in August 1979 and whose business is that of an advertising agency placing advertisements in newspapers, magazines and periodicals, mainly for record companies.

2. In 1982, the Inland Revenue Department carried out an investigation into the Taxpayer's financial affairs and requested him to attend an interview by letter. The Taxpayer neither responded to the letter nor attended any interview. Profits tax returns for 1980/81 and 1981/82 under section 51(1) were issued to the Taxpayer in July 1982. The returns were not filed within the time stipulated.

3. The assessor issued estimated assessments on 17 March 1983 under section 59(3) of the Ordinance to the agency in respect of the years of assessment 1980/81 and 1981/82. Notices of objection to these estimated assessments together with profits tax returns for these two years were filed by the agency in April 1983. The ground of objection was that the profits assessed were over-estimated.

4. On 4 May 1983, the assessor interviewed the Taxpayer and a note of interview was sent to the Taxpayer on 9 May 1983 for his comments and confirmation. The Taxpayer did not give any reply.

5. Particulars of the profits tax returns of the agency as submitted by the Taxpayer are as follows:

Year of Assessment	Date of Issue	Date of Filing	Profit/(Loss) Per Return $	Signatory
1980/81	16-7-82	18-4-83	(13,455)	Taxpayer
1981/82	16-7-82	18-4-83	(16,539)	Taxpayer
1982/83	6-4-83	25-10-83	(8,496)	Taxpayer
1983/84	2-4-84	2-5-84	27,108	Taxpayer

6. An assets betterment statement was prepared by the assessor and issued to the Taxpayer on 11 February 1987 and after considering the representations made by the Taxpayer, a revised assets betterment statement was issued on 15 May 1987. On 18 May

1987 the assessor made profits tax assessments for the years 1982/83 and 1983/84 based on the revised assets betterment statement. Objections to these assessments were made by the Taxpayer's tax representative on the ground that the assessments were over-estimated.

7. The assessor subsequently allowed three of the loans claimed by the Taxpayer and rejected the other alleged loans for lack of evidence. On 7 August 1987 the assessor issued a letter proposing to reduce the revised betterment profit. The Taxpayer did not signify his acceptance or disagreement to the revised assessable profits proposed in the assessor's letter.

8. On 14 January 1988 the Deputy Commissioner of Inland Revenue issued his determination to the Taxpayer in accordance with section 64(4) of the Ordinance and on 8 February 1988 the Taxpayer, through his tax representative, lodged an appeal to the Board of Review in accordance with section 66 of the Ordinance.

9. The Taxpayer's appeal was heard and dismissed by the Board of Review on 21 June 1988 (D28/88, IRBRD, vol 3, 312) when the assessments made by the Commissioner of Inland Revenue were confirmed.

10. The Commissioner gave notice to the Taxpayer on 1 November 1988 of his intention to assess additional tax under section 82A and the Taxpayer submitted representations through his tax representative on 10 November 1988.

11. On 7 December 1988 the Deputy Commissioner issued notices of assessment and demands for additional tax as follows:

Year of Assessment	Tax Undercharged $	Section 82A Additional Tax $
1980/81	37,500	30,000
1981/82	36,768	30,000
1982/83	30,063	25,000
1983/84	34,120	30,000
	138,451	115,000

12. The Taxpayer through his tax representative gave notice of appeal to the Board of Review on 15 December 1988.

At the hearing, the Taxpayer was represented by Mr Christopher Yip of C & D Management Services. Mr Yip submitted that the Taxpayer did not in fact make any profit but unfortunately he was not able to produce any evidence to support his claim. The reasons he gave for the incorrect returns were the Taxpayer's ignorance of law, his lack of

accounting knowledge, his inability to pay for professional accountants and his failure to keep proper records. He further submitted that it was not the intention of the Taxpayer to object to the decision made by the Board of Review at the hearing on 21 June 1988 but only to show that the Taxpayer did not have any intention of covering up his profits. Mr Yip requested the Board to reduce or waive the additional tax imposed by the Commissioner. The Board pointed out that the absence of intention to evade tax is not sufficient ground to waive or reduce the penalty imposed since were there evidence of intention to evade tax, the case would have been a much more serious one. A brief adjournment was granted to enable Mr Yip to take instructions from the Taxpayer on whether there are any grounds for appeal against the Commissioner's assessments.

After the adjournment, the Taxpayer gave an unsworn statement. He said that apart from the first year of the business when he made a small profit, the business was carried at a loss in the other years of assessment. He considered the payment of tax assessed by the Commissioner and confirmed by the Board of Review was in itself a penalty and he therefore totally objected to the additional assessment by way of penalty. In addition, he said that if he had to pay the additional tax now being appealed against, it would increase his financial burden. He hoped that there could be some negotiations on the amount of penalty now being assessed. He concluded by saying that he did not know about penalty being payable and that it was therefore unfair to impose a penalty on him.

The representative for the Commissioner made his submission in writing. He submitted that the Taxpayer had failed to provide any reasonable excuse for the incorrect returns and did not give any valid ground for saying that the penalty being assessed is excessive. He pointed out that the penalty levied by the Commissioner equals to 83.1% of the tax undercharged or 27.7% of the maximum permitted. The representative went on to ask the Board to exercise its power under section 68(8)(a) of the Inland Revenue Ordinance to increase the assessments appealed against. He submitted that the yardstick or starting point in imposing penalty has been established by different Boards of Review as an amount equal to the tax undercharged. He referred to Board of Review case D58/87, IRBRD, vol 3, 11. The representative for the Commissioner submitted that even after the Taxpayer knew that his tax affairs were being investigated, he only reported 5.8% of the total profits and the understated profits which equal to 94.2% of the total profits were subsequently uncovered by the Revenue. He submitted that the filing of incorrect returns after commencement of investigation and the proportion of the profits understated justify a higher penalty.

The representative for the Commissioner further submitted that had the Revenue not carried out an investigation, the Taxpayer would be charged tax of $13,622 instead of $152,073 and he pointed out that the tax for the year 1980/81 normally payable in 1982 was only paid by the Taxpayer in 1988. He also referred the Board to Board of Review cases D42/88 and D56/88.

Lastly, the Commissioner's representative in his written submission alleged that the Taxpayer has increased his business investments and should the Taxpayer be in a tight financial position, it is a result of his employment of funds for expansion of his

business interests. The representative referred to a number of the Taxpayer's business interests acquired since 1985. However, as the Commissioner's representative did not call any evidence in support of such allegations, the Board did not make any finding on them and did not take into account this aspect of the submission in reaching its decision on this appeal.

In reply to the Commissioner's representative's submission, the Taxpayer's tax representative said that the Taxpayer provided information to the best of his knowledge to the Revenue, that because the Taxpayer is sophisticated in marketing and in advertising business does not mean he is also good in accounting; that the Taxpayer did attend a number of interviews requested by the Revenue; that he had not been asked to provide information relating to his subsequent investments which were started after 1985.

The first issue to be decided by the Board is whether the Taxpayer had any reasonable excuse in making the incorrect returns. On the evidence before us, the Taxpayer had failed to provide any reasonable excuse for filing the incorrect returns. Lack of accounting knowledge, loss of records, inability to produce evidence of losses claimed are not reasonable excuses.

As for quantum of penalty, the Taxpayer's ground that there was no intention to evade tax is not a valid ground that the penalty assessed is excessive since were there evidence of any intention to evade tax, the case would have been a criminal one and not just a section 82A case.

The general principle established by previous Boards in cases involving section 82A appeals is that the starting point for assessing an appropriate penalty would be 100% of the tax underpaid or undercharged. In cases where there are aggravating circumstances, the penalty would be more than 100% of the tax undercharged with a maximum of three times the tax undercharged and in cases with extenuating circumstances, the amount of the penalty would be reduced.

The Taxpayer impressed us as a sophisticated person who knew what he was doing and we consider the business of an advertising agency as sophisticated by its very nature. Although the amount of tax involved is not phenomenal, nevertheless the amount of tax which would be payable on the profits as reported by the Taxpayer ($13,622) is substantially less than the tax payable after investigations carried out by the Revenue ($152,073). On the facts of this case, we find little co-operation, if any, given by the Taxpayer to the Inland Revenue. The Taxpayer appeared to completely ignore his tax obligations even after he was aware that investigations were being carried out into his financial affairs. The profits tax returns for three years out of the four in question were filed months out of time and only after estimated assessments were made by the Revenue and the Taxpayer considered the profits assessed to be over-estimated. Any subsequent assistance given by the Taxpayer to the Commissioner of Inland Revenue was with a view to reduce the betterment profits assessed based on the assets betterment statement.

We find no merit in the Taxpayer's submission that he did not know that penalty was payable on incorrect returns. In any event, warning of heavy penalties for making an incorrect return was quite clearly printed both in English and Chinese under the signature of the Taxpayer in the profits tax returns made by him.

The Taxpayer also asked for reduction of the penalty imposed because of his financial hardship. No evidence of financial hardship was adduced by the Taxpayer but even had evidence been adduced, we do not consider the present financial position of the Taxpayer to be relevant to the issue. However, the Commissioner has apparently taken that into consideration by agreeing to the additional tax being paid by instalments.

For the reasons given above, we dismiss this appeal.

We now turn to the submission made by the Commissioner's representative urging the Board to exercise its power under section 68(8)(a) of the Inland Revenue Ordinance to increase the penalty imposed. Having carefully considered the facts of this appeal, the evidence given by the Taxpayer, the criteria to be applied in section 82A cases, we find that there are no mitigating or extenuating circumstances in this case which justify a penalty of less than the starting point of 100% of the tax undercharged and we consider that the appropriate quantum of penalty is $138,451 being 100% of the tax undercharged. In exercise of our power under section 68(8)(a), we hereby increase the additional tax from $115,000 to $138,451, apportioned as follows:

Year of Assessment	Tax Undercharged $	Revised Additional Tax $
1980/81	37,500	37,500
1981/82	36,768	36,768
1982/83	30,063	30,063
1983/84	34,120	34,120
	138,451	138,451

Accordingly, we refer the assessment back to the Commissioner for revision in accordance with this decision.