INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D69/94

Penalty tax – sole proprietor of business – incorrect tax return – substantial understatement of profits – quantum of penalties – section 82A of the Inland Revenue Ordinance.

Panel: Robert Wei Wen Nam QC (chairman), Christopher Chan Cheuk and Raphael Chan Cheuk Yuen.

Date of hearing: 21 November 1994.
Date of decision: 26 January 1995.

The taxpayer was the sole proprietor of a business. He filed six tax returns in each of which he substantially understated his taxable income. Following an investigation it was found that the taxpayer had substantially understated his taxable income. Consequent and subsequent thereto penalties were imposed upon the taxpayer which were in total 102% of the tax undercharged. The taxpayer appealed to the Board of Review on the ground that the quantum of the understated profits had been overstated and made other allegations.

Held:

The tax assessment on which the penalties were made had become final and conclusive so that the taxpayer could not challenge the same. A penalty of approximately 100% of the tax undercharged was not excessive in cases of this nature. The other allegations made were not the concern of the Board.

Appeal dismissed.

Cases referred to:

D93/89, IRBRD, vol 6, 342
D55/88, IRBRD, vol 4, 20
Aspin v Estill [1987] STC 723 CA
D12/93, IRBRD, vol 8, 147
D54/94, IRBRD, vol 9

Tang Ngan Ling for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

INLAND REVENUE BOARD OF REVIEW DECISIONS

1. This is an appeal by an individual (the Taxpayer) against the additional tax assessments (penalty assessments) raised on him for the years of assessment 1986/87 to 1991/92 on the ground that the agreed amount of understated profits for those years were overstated.

2. Documents were submitted by both sides to the Board for the purposes of this appeal:

(a) Statement of facts with appendices prepared by the Revenue:

(b) Written representations by the Taxpayer under section 82A(4) of the Inland Revenue Ordinance (the IRO);

(c) Notice and grounds of appeal;

(d) Taxpayer's amendments to the statement of facts prepared by the Revenue;

(e) Taxpayer's own statement of facts with vouchers and documents attached;

(f) Calculations of interest prepared by the Revenue;

(g) Notices of assessment for profits tax referred to in paragraph 3.7 below.

3.1 The Taxpayer appeared in person. Having heard him and Miss Tang the representative for the Commissioner of Inland Revenue, and having perused the documents, the Board found the following facts.

3.2 The Taxpayer was the sole proprietor of a firm which commenced business in April 1984. The business was that of a garment manufacturer until early 1991, when it changed to retail of fashionable clothes. In 1984 the Taxpayer was a subcontractor of garments receiving orders from his former employer. Subsequently he started to engage in the design and production of ladies' fashionable clothes. Orders were received prior to production. In order to meet the market demand, the business changed its production to jeans wear in 1988. Four to five workers were employed. Work was also subcontracted to two outside workers.

3.3 Profits tax returns were submitted by the Taxpayer in respect of his business for the 6 years in question, each ended 31 March. Based on the returns and with technical adjustments where required, profits tax assessments were raised on the Taxpayer as follows:

Year of Assessment	**Date of Filing Return**	**Profits Returned ($)**	**Profits Assessed ($)**
1986/87	19-10-1987	44,238	36,732
1987/88	17-6-1988	71,278	63,280

1988/89	9-5-1989	65,803	68,727
1989/90	26-9-1990	78,348	78,348
1990/91	31-10-1991	53,611	129,204
1991/92	31-12-1992	65,335	-

The Taxpayer elected for personal assessment in respect of each of those years.

3.4 In May 1992 the Revenue commenced an investigation into the tax affairs of the Taxpayer.

3.5 On 15 February 1993, the assessor raised on the Taxpayer an additional profits tax assessment for the year of assessment 1986/87 with additional profits assessed in the sum of $400,000. The Taxpayer lodged an objection against the assessment on the ground that it was excessive.

3.6 Following a series of interviews, extensive enquiries and negotiations on an assets betterment statement prepared by the Revenue, the investigation was completed on 7 March 1994 when the Taxpayer, after obtaining counselling from his tax representative who was present, agreed that the total amount of understated profits for the 6 years should be quantified at $1,000,000 to be allocated as additional profits for the 6 years as follows:

Year of Assessment	**Additional Profits ($)**
1986/87	170,000
1987/88	170,000
1988/89	170,000
1989/90	170,000
1990/91	160,000
1991/92	160,000
	1,000,000

On the same occasion, the Taxpayer signed a settlement agreement in the Chinese language (in the presence of his tax representative who signed as a witness) which was translated in the following terms:

'I … hereby agree that the assessable profits of … be computed as:

Year of	**Assessable**	**Profits Already**	**Additional**

Assessment	Profits	Reported/Assessed ($)	Assessable Profits ($)
1987/88	233,280	63,280	170,000
1988/89	238,727	68,727	170,000
1989/90	248,348	78,348	170,000
1990/91	289,204	129,204	160,000
1991/92	225,335	65,335	160,000

2. I also agree to accept the following revised additional assessable profits in settlement of my previous objections to the original/additional profits tax assessments:

Year of Assessment	Original/Additional Assessable Profits under Objection ($)	Revised Additional Assessable Profits ($)
1986/87	400,000	170,000

3. I also understand that the acceptance of the above-mentioned profits for the years of assessment 1987/88 to 1991/92 inclusive does not conclude the whole matter and the case will have to be put up to the Commissioner or his deputy for consideration of penal actions including prosecution, compound penalty and Additional Tax under Part XIV of the Inland Revenue Ordinance. If penal action by way of Additional Tax is imposed the maximum amount could be treble the amount of tax undercharged.'

3.7 In implementation of the settlement agreement, the assessor on 25 March 1994 raised the following profits tax/additional profits tax assessments on the Taxpayer:

Year of Assessment	Additional Assessable Profits ($)	Total Assessable Profits ($)
1986/87	-	206,732
1987/88	170,000	-
1988/89	170,000	-
1989/90	170,000	-
1990/91	160,000	-

1991/92	-	225,335

The 6 assessments were notified to the Taxpayer on 25 March 1994 by notices of assessment of that date, and were not objected to by the Taxpayer.

3.8 Tax which was undercharged or would have been undercharged in consequence of the understated profits was as follows:

Year of Assessment	**Additional Assessable Profits ($)**	**Total Assessable Profits ($)**
1986/87	170,000	35,144
1987/88	170,000	36,960
1988/89	170,000	35,833
1989/90	170,000	35,517
1990/91	160,000	33,229
1991/92	160,000	27,735
	1,000,000	204,418

The Taxpayer has arranged to pay the tax undercharged b 12 monthly instalments and has up to the date of the hearing paid 7 instalments.

3.9 On 6 May 1994, the Commissioner of Inland Revenue gave notice under section 82A(4) of the IRO to the Taxpayer of his intention to assess the Taxpayer to additional tax by way of penalty in respect of the years of assessment 1986/87 to 1991/92 inclusive. Having considered and taken into account the Taxpayer's written representations, the Commissioner of Inland Revenue issued on 23 June 1994 notices of assessment and demand for additional tax under section 82A for the 6 years in the following amounts:

Year of Assessment	**Tax Undercharged ($)**	**Additional Tax (Penalty) ($)**	**Additional Tax as Percentage of Tax undercharged**
1986/87	35,144	37,000	105%
1987/88	36,960	41,000	111%
1988/89	35,833	38,000	106%

1989/90	35,517	36,000	101%
1990/91	33,229	32,000	96%
1991/92	27,735	25,000	90%
	204,418	209,000	102%

3.10 By a letter dated 20 July 1994 the Taxpayer gave notice of appeal under section 82B to the Board against the additional tax assessments (penalty assessments) on the ground that the understated profits of $1,000,000 were overstated.

4.1 The object of the investigation of the Taxpayer's tax affairs was to see whether he had omitted any profits from his profits tax returns, and, if so, how much, and to tax him on the omitted profits. They have been referred to as the understated profits, the additional profits, or more formally, the additional assessable profits. The amount of these profits for each of the 6 years in question and the total amount were agreed between the Taxpayer and the Revenue (see paragraph 3.6 above). They were the subject of the 6 assessments made on 25 March 1994 (see paragraph 3.7 above). By reason of section 70 of the IRO, these assessments are final and conclusive as regards the respective amounts of the additional assessable profits:

(a) The year of assessment 1986/87 was in the sum of $206,732, comprising the sum of $36,732 being the profits already assessed (see paragraph 3.3 above) and the sum of $170,000 being the amount of the additional assessable profits (see paragraph 3.6 above). The last-mentioned sum was agreed between the Taxpayer and the Revenue when the additional profits tax assessment for the year of assessment 1986/87 was under objection (see paragraph 3.5 above). The year of assessment 1986/87 made on 25 March 1994 was therefore an 'assessment agreed to' within the meaning of section 70 and was final and conclusive as soon as it was made, with the consequence that the amount of the additional assessable profits, assessed at $170,000, cannot be re-opened.

(b) As for the other 5 assessments for the years of assessment 1987/88 to 1991/92 inclusive, they have become final and conclusive by reason of section 70 because they were not objected to within the time limited (see section 64).

The notice of assessment for each of the 5 years contained the following paragraph:

'If you object to this assessment you must give the Commissioner notice in writing WITHIN ONE MONTH of the date hereof stating precisely the grounds of objection.'

The Taxpayer lodged no objection against any of the 5 assessments. The amounts of the additional assessable profits in question cannot be re-opened.

4.2 The additional assessable profits and the understated profits are one and the same. The Taxpayer cannot dispute the amount of the understated profits. The ground of appeal that the understated profits of $1,000,000 were overstated therefore fails.

5. Section 70A of the IRO provides the only route to the re-opening of an otherwise final and conclusive assessment. Where there is some error or omission in any 'return or statement submitted in respect thereof' (it has been held that the quoted words refer only to a return or statement submitted by the taxpayer: D93/89, IRBRD, vol 6, 342) or some 'arithmetical error or omission' (it may be that the quoted words do not extend to a difference of opinion) in the calculation of the assessable amount or in the amount of the tax charged, the taxpayer may make an application to the assessor to correct the assessment. The Taxpayer in the present case alleged that the Revenue made some mistakes in the calculations. It has been held that section 70A cannot apply where the assessment complained about was issued as a result of an agreement or compromise by the taxpayer (D55/88, IRBRD, vol 4, 20). Further, even assuming that the Taxpayer has a remedy under section 70A (about which he is well advised to seek professional advice), he has come to the wrong place for the correction; a section 70A application must be made to the assessor. Still further, such an application must be made within 6 years after the end of a year of assessment or within 6 months after the date on which the relative notice of assessment was served, whichever is the later; the Taxpayer may wish to seek advice on the question of time-bar at least so far as the earlier part of the 6-year period is concerned.

6. Allegations were made by the Taxpayer against Revenue officers concerning their conduct in connection with the making of the assessments referred to in paragraph 3.7 above. It was alleged that in the course of the investigation it was hinted to him that whether or not he had made any profit, a penalty had to be imposed to cover the overheads of the Revenue and to satisfy the superiors. It was further alleged that he was told that the Revenue officers had ways of 'making people pay' and that, unless he signed the agreement (see paragraph 3.6 above), the Revenue officers would make a 'bigger' assessment for one of the years in question. However, allegations of this nature are not for the Board to investigate; the remedy, if any, lies in the route of judicial review proceedings in the High Court. The function of the Board is to decide the question of whether the subject assessment is correct in terms of the IRO; it does not deal with allegations relating to the conduct of Revenue officers in making assessments (Aspin v Estill [1987] STC 723 CA; D12/93, IRBRD, vol 8, 147; D54/94, IRBRD, vol 9)

7. The Taxpayer stated that he had a cash problem. It was pointed out to him that that was not a ground for reducing the amount of the penalty, but that he could seek better payment terms from the Revenue, although no promises could be made. He also stated that he had been co-operative during the investigation, but Miss Tang, the representative for the Commissioner of Inland Revenue, denied that, stating that the Taxpayer would only give information 'bit by bit'. In a case of understated profits, a penalty equivalent to 100% of the tax undercharged (or which would have been undercharged if the return had been accepted as correct) is generally accepted by these Boards as being the norm, provided there are neither aggravating nor mitigating factors. In the present case, the penalty is $209,000 or 102% of the tax undercharged; in other words, it was quantified on the basis that there were neither aggravating nor mitigating factors, which is in the Board's view the correct basis. The penalty assessments are not excessive.

8. This appeal is dismissed and the penalty assessments for the years 1986/87 to 1991/92 inclusive are hereby confirmed.