

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D71/91

Penalty tax – failure to keep proper records and file correct tax returns – onus of proof – section 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Nigel A Rigg and Gillian M G Stirling.

Date of hearing: 5 December 1991.

Date of decision: 6 March 1992.

The taxpayer was a private individual who had been carrying on business as a sole proprietor and/or in partnership with others. He failed to keep proper accounting records and failed to file correct profits tax returns. Following an investigation an assets betterment statement was prepared and agreed. Subsequently penalties were imposed upon the taxpayer under section 82A of the Inland Revenue Ordinance. The taxpayer argued that he was ignorant of the law, had completed his tax returns from memory and had no intention to evade tax. He also said that he had financial difficulties in paying penalties.

Held:

The taxpayer had no reasonable excuse for filing an incorrect return, had acted recklessly and it was irrelevant that the taxpayer had financial difficulties.

Appeal dismissed.

Case referred to:

D4/89, IRBRD, vol 4, 172

Yeung Kwai-cheong for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

#### 1. Subject matter of the Appeal

The Taxpayer appealed against the assessments to additional tax raised on him under section 82A of the Ordinance for the years of assessment 1984/85 to 1988/89, both inclusive ('the relevant years').

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### 2. The Facts

The facts, which were not in dispute, were:

2.1 Until early 1984, when his services were dispensed with, the Taxpayer had been employed as a salesman.

2.2 Shortly thereafter he started his business ('the sole proprietorship'). His business was the casting of gold ornaments. A particular customer supplied him with gold and he returned the completed ornaments, his remuneration being the gold dust resulting from filing the castings smooth and the subsequent polishing. He neither extracted a Business Registration Certificate for this business nor did he inform the Commissioner that he was operating a business with taxable profits.

2.3 In early 1988 he, together with three others, established a partnership ('the partnership') to manufacture jewelry for which a Business Registration Certificate was extracted. Although there was a disagreement between the Revenue and the Taxpayer as to whether the Taxpayer closed the sole proprietorship at the time the partnership was established, the agreement reached between the Taxpayer and the Revenue on 15 May 1991, refer sub-paragraph 2.11 below, makes this disagreement irrelevant to the determination of this appeal, and refer also sub-paragraph 3.3.3 below.

2.4 The partnership did not flourish and in 1989 he established a second sole proprietorship, for which he extracted a Business Registration Certificate, and which continues active.

2.5 An investigation of the Taxpayer and the profits of the sole proprietorship commenced at a date unknown to the Board but on 24 January 1990, he attended an interview with two investigation officers. A record of this interview was kept and sent to the Taxpayer for confirmation and/or comment.

2.6 On 9 February 1990 profits tax returns for the sole proprietorship for each of the relevant years were sent to the Taxpayer. These were returned completed and signed by the Taxpayer with the date of signature being completed as 30 March 1990. The profits returned were:

Year	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
\$	20,000	45,000	65,000	150,000	Nil

2.7 The Taxpayer submitted a letter dated 30 March 1990 to the Commissioner in which he:

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 2.7.1 Returned the record of interview referred to in sub-paragraph 2.5 above signed but requesting the insertion of a paragraph as to his betting and two dividends of \$160,000 and \$100,000 which were said to have been won in November 1988 and October 1989 respectively; and
- 2.7.2 Stated that he had not kept any proper records with respect to the sole proprietorship and set out the basis on which the profits in each of the returns, refer sub-paragraph 2.6 above, had been calculated.
- 2.8 On 3 April 1990 the assessor submitted a letter to the Taxpayer seeking further information from him. The information requested covered the relevant years and contained sixteen sub-paragraphs detailing the information required.
- 2.9 On 13 March 1991 the assessor issued a profits tax assessment for the year of assessment 1984/85 in the sum of \$17,000 based on estimated profits of \$100,000. The Taxpayer lodged a valid objection against this estimated assessment.
- 2.10 Because of the Taxpayer's lack of records, the assessor considered that the only method of ascertaining the true profits of the sole proprietorship was by the preparation of an assets betterment statement. At a meeting on 18 April 1991 the assessor advised the Taxpayer that his betterment profits for the relevant years were estimated as \$1,170,000. After several subsequent telephone conversations, the assessor tentatively agreed to reduce the betterment profits to \$870,000 to take into account a loan which the Taxpayer claimed to have had received from a close friend who had migrated to Canada but in respect of which there was no documentary proof.
- 2.11 At a meeting on 15 May 1991 the Taxpayer agreed to a betterment profit of \$870,000 and signed an agreement, which was dated that day, under which the betterment profits were agreed to be computed as follows:

Year	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
\$	90,000	90,000	170,000	260,000	260,000

As part of this agreement the Taxpayer accepted that his objection to the assessment based on estimated profits for the year of assessment 1984/85, refer sub-paragraph 2.9 above, was settled.

- 2.12 This agreement of 15 May 1991 also contained an acknowledgment by the Taxpayer that the matter would still be referred to the Commissioner for 'consideration of penalty action according to part XIV of the ... Ordinance' and that the maximum 'amount of penalty or additional tax will be treble the amount of tax undercharged'.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

2.13 On 25 June 1991 the assessor issued a revised profits tax assessment, for the year of assessment 1984/85, profits tax assessments for the years of assessment 1985/86 to 1987/88, both inclusive, and a personal assessment for the year of assessment 1988/89. These assessments were based on the betterment profits computed as set out in the agreement of 15 May 1991, refer sub-paragraph 2.11 above. No objection against any of these assessments was raised by the Taxpayer.

2.14 A tabulation of the differences between the profits included by the Taxpayer in the returns dated 30 March 1990 for the relevant years, refer sub-paragraph 2.6 above, and the agreed profits set out in the agreement dated 15 May 1991, refer sub-paragraph 2.11 above, is as follows:

<u>Year of Assessment</u>	<u>Returned Profits</u> \$	<u>Agreed Profits</u> \$	<u>Understated Profits</u> \$	<u>Tax Undercharged</u> \$
1984/85	20,000	90,000	70,000	10,500
1985/86	45,000	90,000	45,000	8,800
1986/87	65,000	170,000	105,000	24,700
1987/88	150,000	260,000	110,000	19,150
1988/89	Nil	260,000	260,000	40,300

2.15 On 7 August 1991 the Deputy Commissioner issued the notices required by sub-section 82A(4) of the Ordinance. The representations of the Taxpayer were set out in his letter dated 22 August 1991.

2.16 On 13 September 1991 notices of assessment and demand for additional tax under section 82A were issued as follows:

<u>Year</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
\$	9,000	8,000	22,000	17,000	36,000

2.17 On 12 October 1991 the Taxpayer lodged his notice of appeal, a synopsis of his grounds of appeal being:

2.17.1 Notwithstanding his explanations, the assessor insisted on the assets betterment statement approach. The investigation had caused him stress which prevented him from running his business whereby he was compelled to agree to the proposed computations.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 2.17.2 Because his business had suffered, his overdraft increased.
- 2.17.3 The additional tax of \$92,000 did not take into account the fact that he was a small struggling businessman susceptible to failure from unexpected circumstances.

### 3. Reasons for the Decision

- 3.1 The Board advised the Taxpayer, who was not represented, that:
- 3.1.1 His appeal was not against the assessments issued on 25 June 1991, refer sub-paragraph 2.13 above, as by operation of section 70 of the Ordinance, those assessments had become final.
- 3.1.2 It was for him to satisfy the Board that the assessments to additional tax should be set aside because he had a reasonable excuse for having filed incorrect returns and/or that the assessments themselves were excessive.
- 3.2 The Board proceeded to question the Taxpayer to endeavour to obtain both his explanations as to what had happened and also why the Board should either annul or reduce the assessments to additional tax.
- 3.3 In his answers to the Board the Taxpayer sought to convince the Board that the assessments issued on 25 June 1991 should be disregarded. He said:
- 3.3.1 He, himself, had no income in the years of assessment 1984/85 and 1985/86 although he himself had inserted \$20,000 and \$45,000 in the returns for those years, which he himself had signed on 30 March 1990. He also explained the basis on which he had reached those figures in his letter to the Commissioner of the same date, refer sub-paragraphs 2.6 and 2.7 above. In reply to questions from the Board he admitted that profits had been made by the sole proprietorship in each of these years.
- 3.3.2 He thought the returns were correct but he had no record. His returns were based on 1% of the then market value of the gold which, according to his memory, he had received from his customer in each of the relevant years. It was the Revenue who had looked into his assets and decided he had earned more. In this context it is relevant to record that the Revenue did not accept the basis on which the Taxpayer had calculated his profits as a correct or proper method for the calculation of profits.
- 3.3.3 He had been taxed twice in the year of assessment 1988/89. In this context it is important to note that there were two assessments raised on the Taxpayer for this year of assessment. However, that raised on 25 June 1991, refer sub-paragraph 2.13 above, was raised with respect to the sole proprietorship and based on the agreement of 15 May 1991, refer sub-paragraph 2.11 above,

## INLAND REVENUE BOARD OF REVIEW DECISIONS

and the other, a copy of which was before the Board, was raised with respect to the partnership based on its return.

- 3.3.4 At no time during the relevant years had the Revenue sent him any returns to complete, although they had his address from his salaries tax returns filed when he had been employed as a salesman.
- 3.4 When pressed to submit those matters which the Board was competent to consider, he said:
- 3.4.1 He was ignorant of the law. The Board does not accept this as a reasonable excuse for filing an incorrect return.
- 3.4.2 When he completed the returns, he completed them from memory based on the volume of his trading. Bearing in mind his statement that he had no business record, this has to be regarded as reckless conduct as opposed to a reasonable excuse.
- 3.4.3 He had never had an intention to evade tax. That he had been a Taxpayer was admitted by him, refer sub-paragraph 3.3.4 above. The Taxpayer is a comparatively young man and whilst the Board would not describe him as sophisticated or the sole proprietorship as a sophisticated business, he was clearly 'street wise'. The Board is unable to accept that a man of his age and acumen was not aware that trading profits are subject to tax. Further, whilst he admitted to watch television, when asked if he had seen that frequently screened Inland Revenue warning as to the need to obtain and maintain a Business Registration Certificate, he said that he did not watch that often.
- 3.4.4 When he agreed to the betterment profits, he did not expect such a large penalty. This is somewhat contradictory to a claim he also made during the appeal, namely that the explanation given to him as to penalty by the investigation officers was vague. The Board questioned him with respect to this allegation and his attention was drawn to the final paragraph of the agreement of 15 May 1991, refer sub-paragraph 2.12 above. His answer was that he had not read the agreement when he signed it. The Board is unable to accept this as the truth. To his own knowledge the Taxpayer had been under investigation since January 1990 and the matter was too important to him for it to be credible that he signed a document agreeing to the quantum and apportionment of profits on which assessments to tax were to be raised and which tax he would be obliged to pay without checking the figures, something which would cause him to read the next paragraph. The actual penalty imposed by the Deputy Commissioner for each of the relevant years, refer sub-paragraph 2.16 above, is actually less than the tax which would have been avoided if the investigation had not taken place, refer last column of sub-paragraph 2.14 above. The Board has frequently stated that in cases in which the Taxpayer has failed to keep proper accounts and file correct returns,

## INLAND REVENUE BOARD OF REVIEW DECISIONS

as is the case in this appeal, that, as a general rule, the penalty should be equal to the amount of tax which would have been undercharged, refer D4/89, IRBRD, vol 4, 172. The Board is satisfied that not only was the Taxpayer adequately advised as to the fact that the potential for penalties to be imposed existed but also that the penalties actually imposed are not excessive.

- 3.5 Finally, he appealed to the Board to cancel the relevant assessments as he was in financial difficulties. Unfortunately, the ability of a taxpayer to pay an assessment is not a matter for the Board but something which may influence the Commissioner in approving payment by installments. Nevertheless, the Board is obliged to record that, on the basis of a bank statement annexed by the Taxpayer to his notice of appeal, his bankers considered him good for an overdraft of some \$578,000 as at 30 September 1991, a month in which he had felt able to withdraw cash, permitted direct debits and issued cheques totalling \$125,791.89 whilst, during the same period, total credits to the account amounted to \$43,940. The Taxpayer did not claim to have received notice to repay or to have been required by his bank to reduce this overdraft.

#### 4. Decision

The Taxpayer has totally failed to establish that he had a reasonable excuse for filing incorrect returns or that the assessments to additional tax are excessive. Accordingly, this appeal fails.