

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D73/88

Penalty assessment – whether penalty excessive – lack of familiarity with accounting matters – comparison with other penalties – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Raphael Chan Cheuk Yuen and David Wong Shou Yeh.

Date of hearing: 12 January 1989.

Date of decision: 8 March 1989.

The taxpayer owned a trading business which sold goods by way of hire purchase. Over a number of years, she failed to notify the IRD that she was subject to profits tax. Finally, she voluntarily asked for profits tax returns to be issued to her, but in those returns she understated her profits by 32%. Finally, the taxpayer agreed to assessments based on an assets betterment statement.

The Commissioner assessed penalties equal to an average of 47% of the maxima permitted. The taxpayer appealed.

The taxpayer explained that she had little knowledge of accounting matters and had therefore not kept proper accounts. She had found it difficult to calculate profits from her hire purchase transactions, particularly because her business had expanded and her profits were reinvested into the business. It was only after she ceased business that she was able to know what profits she had made.

Held:

The penalties were excessive and would be reduced to 33.3% of the maxima permitted.

- (a) This is a serious case where the taxpayer had failed totally to comply with her obligations. However, there was no fraudulent intent on her part, she had been frank and honest before the Board, and this case was not substantially worse than many other cases before the Board where lower penalties had been imposed.
- (b) There is no reason why proper accounts could not have been kept, especially since the taxpayer had been able to keep accounts for the purpose of

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collecting instalments from her customers. It should have been apparent to the taxpayer that she was making substantial profits.

Appeal allowed in part.

Raymond Ng for the Commissioner of Inland Revenue.  
Taxpayer in person.

### Decision:

This is an appeal against the amount of penalty imposed by the Commissioner upon the Taxpayer under section 82A of the Inland Revenue Ordinance. The facts are as follows.

1. The Taxpayer was the sole owner of a trading business ('the business') which commenced trading in 1968 and ceased in 1981. The business consisted of dealing in electrical appliances which were sold on hire purchase. The business was managed either by the Taxpayer's husband or by herself and her husband jointly.
2. The Taxpayer submitted a profits tax return for the business for the year of assessment 1972/73 declaring an assessable profit of \$10,983. By letter dated 15 January 1973, the assessor informed the Taxpayer's husband that, since the income derived by him and his wife was considerably less than the threshold for the payment of tax by them, he would not be asked to make further profits tax returns annually but that he must inform the assessor if in the future the annual profits of the business were to exceed \$19,000 in any year.
3. On 2 August 1977, a profits tax return for the year of assessment 1976/77 was issued and returned on 24 August 1977 showing a profit of \$2,456. By a letter dated 4 November 1977, the assessor informed the Taxpayer that she should notify the assessor if the annual profits of the business were to exceed \$30,000 at any time.
4. On 28 August 1981, a profits tax return for the year of assessment 1980/81 was issued to the Taxpayer at her last known business address but was returned intact with a statement that no such business existed at the stated address.
5. By letter dated 22 March 1982, the Taxpayer notified the Inland Revenue Department of the cessation of the business on 30 October 1981 and provided her correspondence address. The profits tax return for the year of assessment 1980/81 was redirected to her on 17 May 1982 and was filed by her on 15 June 1982 showing assessable profits of \$14,012, but without any supporting

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accounts. By letter dated 28 September 1982, the assessor requested the Taxpayer to provide accounts. On 19 October 1982, the Taxpayer submitted a profit and loss account for the period from 1 April 1981 to 30 October 1981 showing a net profit of \$1,412.

6. By letter dated 8 November 1982, the Taxpayer requested profits tax returns for the basis periods from 1 April 1977 up to 31 March 1981 and profits tax returns for the years of assessment 1977/78 to 1979/80 were issued to her on that day.
7. On 20 December 1982, the Taxpayer accompanied by her tax representative attended an interview with the assessors during which her tax affairs were reviewed.
8. On 8 February 1983, the Taxpayer's husband accompanied by the tax representative was interviewed by the assessors. The husband stated that no proper books and records had been kept for the business and that the representative was reviewing the tax affairs.
9. On 26 February 1983, the Taxpayer's husband submitted to the Revenue the following tax returns for the business:
  - (a) Completed profits tax returns for the years of assessment 1977/78 to 1979/80.
  - (b) Estimated profit and loss accounts with net profits as follows:

	\$
1976/77	8,308
1977/78	135,715
1978/79	181,190
1979/80	550,903
1980/81	<u>827,432</u>
Total	<u>\$1,703,548</u>

- (c) Reconciliation of business profits for period 1 April 1976 to 4 February 1981 with profits of \$1,677,851.
10. On 11 March 1983, the assessor raised an estimated assessment on the Taxpayer for the year of assessment 1976/77 in an amount of \$100,000. Objection was duly lodged against this assessment on the grounds that it was excessive and not in accordance with the revised profit figure of \$8,308 submitted to the Revenue on 26 February 1983.

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11. On 14 March 1983, the Taxpayer's husband called at the Inland Revenue Department to submit the financial statements for the business for the period from 1 April 1976 up to 4 February 1981. Upon the assessor's request, the representative furnished, on 7 April 1983, further schedules in support of the reconciliation statement and the reason for selecting 4 February 1981 as the date of termination of the business.
12. On 23 March 1984, the assessor raised an estimated assessment on the Taxpayer for the year of assessment 1977/78 in an amount of \$550,000 and an objection was filed on the grounds that it was excessive and not in accordance with the revised profit of \$135,715 submitted to the Revenue on 26 February 1983.
13. On 15 March 1985, the assessor raised an estimated assessment on the Taxpayer for the year of assessment 1978/79 in an amount of \$550,000 and objection was lodged on the grounds that it was excessive and not in accordance with the revised profit of \$181,190 submitted to the Revenue on 26 February 1983.
14. On 31 January 1986, the Taxpayer and her husband together with the tax representative went to the Inland Revenue Department and were shown an assets betterment statement prepared by the assessors. The Taxpayer agreed to this statement and signed the same.
15. Based on the assets betterment statement agreed by the Taxpayer, the assessor on 18 February 1986 raised revised assessments for the years of assessment 1976/77 to 1980/81 as follows:

<u>Year of Assessment</u>	<u>Assessable Profits</u> \$	<u>Tax Payable</u> \$
1976/77	166,181	24,927
1977/78	290,748	43,612
1978/79	369,028	55,354
1979/80	702,419	105,362
1980/81	<u>964,270</u>	<u>144,640</u>
Total	<u>\$2,492,646</u>	<u>\$373,895</u>

16. The assessor had information that the Taxpayer might be leaving Hong Kong for good and on 21 February 1986 issued new assessments which replaced the assessments issued three days earlier and which were identical in all respect save and except that the date for payment of the tax was now immediate.

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17. On 24 March 1986, the Commissioner exercised his power under section 82A(4A) of the Inland Revenue Ordinance and issued the following penalty tax assessments on the Taxpayer:

<u>Year of Assessment</u>	<u>Penalty Assessment</u> \$	<u>Penalty as Percentage of Tax Liability</u>
1976/77	37,400	150%
1977/78	65,400	150%
1978/79	76,300	138%
1979/80	158,000	150%
1980/81	<u>193,400</u>	<u>134%</u>
Total	<u>\$530,500</u>	<u>142%</u>

18. The Taxpayer appealed against these penalty tax assessments.

At the hearing of the appeal, the Taxpayer was represented by her husband and she also appeared herself and contributed to the proceedings.

### Taxpayer's submissions

The husband and the Taxpayer submitted that the penalty tax assessments were excessive and should either be cancelled altogether or substantially reduced. They said that they had themselves voluntarily asked the Inland Revenue Department to issue returns for the years in question when they wrote to the Department on 8 November 1982. They pointed out that they had duly filed all the returns when requested and had fully co-operated with the Inland Revenue Department in their enquiries when the tax returns and accounts were not accepted. They submitted that they had no knowledge of accounting matters, had not kept proper records and accounts, and had encountered difficulty in calculating their profits because the nature of the business was hire purchase. They submitted that it was not possible for a hire purchase trader to know what profits were earned until after the business had closed and all moneys had been collected from all customers. They said that, during the continuance of the business, it had been successful and had been expanding which meant that they had to contribute additional capital to the business and had not had any profits.

The husband and the Taxpayer also complained that they had not had an opportunity of addressing the Commissioner with regard to the imposition of penalties because he had invoked the provisions of section 82A(4A) of the Inland Revenue Ordinance. Under this provision, he had imposed the penalties without giving any prior notice to the Taxpayer. The Taxpayer did not challenge the information which the

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Commissioner had stated that he had had to the effect that the Taxpayer was leaving Hong Kong for good.

### Commissioner's submission

The representative for the Commissioner submitted that the penalties had been imposed because the Taxpayer had filed an incorrect tax return for the year of assessment 1976/77 and had failed to notify the Commissioner in writing that she was chargeable to tax for the years of assessment 1977/78 to 1980/81 within the period prescribed under section 51(2) of the Inland Revenue Ordinance. It was submitted that the penalties were not excessive in all of the circumstances. It was pointed out that it was not necessary for the Taxpayer to wait until after the business had closed before she could assess the profits of the business. It was further pointed out that the total profits of \$1,703,548, which was the amount returned by the Taxpayer, had been subsequently increased to \$2,492,646 after the investigation by the Inland Revenue Department officers, and this was 46% higher than the amount submitted by the Taxpayer. The representative said that the Taxpayer had understated her true profits to an appreciable extent and that the Inland Revenue Department had been unnecessarily burdened with extra efforts when it was forced to enquire into her affairs to ascertain what was her real profit.

The Commissioner's representative confirmed in his submission that, when the Commissioner was considering the penalties, he had information that the Taxpayer was about to leave Hong Kong. In view of this, he had decided to invoke the provisions of section 82A(4A) of the Inland Revenue Ordinance and issue immediate penalty assessments without issuing a letter of intent which he would normally have done.

### Conclusion

The penalties which the Commissioner has imposed in this case are 47% of the maximum penalty permitted under the law and 142% of the amount of the tax involved. The magnitude of the penalties is significant and indicates that the Commissioner took a very severe view of this case.

With due respect, we are not able to find on the facts before us that this case is substantially worse than many other cases which have come before other Boards of Review where lower penalties have been imposed. It is a serious case, and the Taxpayer and her husband have totally failed in their obligations under the Inland Revenue Ordinance to maintain true and proper accounts of their business and to file correct tax returns. However, there is no evidence of fraudulent intent. The husband and the Taxpayer both appeared before us and made submissions. It was not necessary for them to give evidence because they substantially accepted as being true and correct the statement of facts which the Commissioner's representative had prepared. They both appeared to be frank and open in their submission. In substantially accepting the facts as prepared by the Inland Revenue Department, they did not seek to deny any of the facts other than in relation to difficulties in understanding English.

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The Taxpayer and her husband appeared to be under the naive impression that an expanding business was not profitable because the proprietor did not receive any profit. This is a totally erroneous but not uncommon point of view. It is likewise totally erroneous to believe that proper accounts cannot be prepared and profits determined for an ongoing hire purchase business. It must be taken into account that the Taxpayer and her husband were able to keep accounts adequate for their own purposes in recording and controlling very many small hire purchase accounts. They were able to collect instalments and account for them and they should have been able to maintain adequate profit and loss accounts. Also, it was not a small business but a successful business whose annual turnover, according to the Taxpayer's own financial statements, rose from \$1,392,255 in the year 1976/77 to \$8,137,323 in the year 1980/81. It should have been apparent to both the Taxpayer and her husband that they were making substantial profits. Indeed, according to their own calculations when they filed their tax returns in February 1983, their profits for the last two years in question were \$550,903 and \$827,432 respectively.

After bearing in mind all of the facts, we feel that an appropriate penalty in this case would be an amount equal to the tax which was undercharged, namely, \$373,895. Accordingly we order that the amounts of the additional assessments be reduced as follows:

<u>Year of Assessment</u>	<u>Penalty Assessment as Assessed by Commissioner</u> \$	<u>Amount of Reduced Penalty Assessment</u> \$
1976/77	37,400	24,927
1977/78	65,400	43,612
1978/79	76,300	55,354
1979/80	158,000	105,362
1980/81	<u>193,400</u>	<u>144,640</u>
Total	<u>\$530,500</u>	<u>\$373,895</u>