

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D75/00**

**Penalty tax** – payment terms – reasonable excuse – Inland Revenue Ordinance (‘IRO’) section 82A.

Panel: Robert Wei Wen Nem SC (chairman), Kenneth Chow Charn Ki and Kenneth Graeme Morrison.

Date of hearing: 9 June 2000.

Date of decision: 25 October 2000.

The taxpayer was demanded for additional tax of \$1,000,000 for making incorrect tax returns. The taxpayer appealed against the additional tax assessments by asking for payment by instalments.

The taxpayer gave various reasons, including his accounting personnel kept on changing for the relevant years, for making incorrect tax returns.

**Held:**

1. The Board has no jurisdiction over payment terms.
2. The taxpayer has a duty to maintain true and correct accounts of his business to enable him to make correct returns. There is no excuse for him to say that he delegated the duty to his accounting staff, or that there were frequent changes in the staff, or that neither he nor his staff were qualified to handle accounts.

**Appeal dismissed.**

Case referred to:

D112/95, IRBRD, vol 11, 237

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Tang Ngan Ling for the Commissioner of Inland Revenue.

Taxpayer in person.

### Decision:

### Nature of appeal

1. Mr A (the Taxpayer) is appealing against the imposition upon him of additional tax assessed by way of penalty under section 82A of the IRO for making, without reasonable excuse, incorrect tax returns for the years of assessment 1989/90 to 1994/95 inclusive in respect of Company B (the Business).

### Facts agreed or not in dispute

2. The Taxpayer is a Chinese businessman from Company C. At all relevant times, he was the sole proprietor of the Business and also of Company D and a shareholder and director of Company E and of Company B.

3. The profits of the Business as reported by the tax returns of the Taxpayer for the years in question are summarised as follows:

<b>Year of assessment</b>	<b>Date of issue of return</b>	<b>Filing return</b>	<b>Basis period</b>	<b>Profits (loss) per return</b>
1989/90	2-4-1990	8-5-1990	Year ended 31-3-1990	(23,347)
1990/91	2-4-1991	17-7-1991	Year ended 31-3-1991	(457,534)
1991/92	1-4-1992	7-11-1992	Year ended 31-3-1992	2,070
1992/93	1-4-1993	9-10-1993	Year ended 31-3-1993	404,388
1993/94	2-5-1994	7-9-1994	Year ended 31-3-1994	(48,480)
1994/95	1-5-1995	14-6-1995	Year ended	(2,250)

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31-3-1995

4.
  - (1) The assessor issued tax computations allowing the losses for the years of assessment 1989/90 and 1990/91.
  - (2) The assessor made some technical adjustments and computed the assessable profits for the year of assessment 1991/92, which amounted to \$129,944. These assessable profits were completely set off by the losses brought forward from previous years.
  - (3) The assessor accepted the returned profits for the year of assessment 1992/93 and raised a profits tax assessment on the Business. No objection was lodged against it.
  - (4) The assessor did not allow the losses for the years of assessment 1993/94 and 1994/95.
5.
  - (1) The assessor commenced an investigation into the tax affairs of the Taxpayer. On 19 January 1996, the Taxpayer attended an interview with the assessors, during which he furnished information concerning his assets and liabilities and income and expenses.
  - (2) On 22 March 1996, the assessor raised assessments on the businesses of the Taxpayer, including the Business, for the year of assessment 1989/90. On the Business an assessment for estimated additional assessable profits of \$1,000,000 was raised. Objections were lodged against the assessments by the tax representative of the Taxpayer.
  - (3) On 20 March 1997, the assessor raised assessments on the businesses of the Taxpayer, including the Business, for the year of assessment 1990/91. The assessment raised on the Business was for estimated assessable profits of \$1,000,000. The tax representative lodged objections against the assessments.
  - (4) During 31 July 1997 to 2 February 1998, letters were exchanged between the Revenue and the Taxpayer through the tax representative concerning his assets and liabilities.
  - (5) On 8 February 1998, the assessor raised on the Taxpayer's businesses, including the Business, assessments for the year of assessment 1991/92. The assessment raised on the Business was for estimated assessable profits of \$1,100,000. Objections were lodged against the assessments by the tax

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representative.

- (6) On 26 March 1999, the assessor raised on the Taxpayer's businesses, including the Business, assessments for the year of assessment 1992/93. The assessment raised on the Business was for estimated additional assessable profits of \$1,200,000. Objections were lodged against the assessments by the tax representative.
- (7) On 4 June 1999, the Taxpayer accompanied by the tax representative attended an interview with the assessors. During the interview, the Taxpayer stated that he did not keep accounting records in respect of the Business and Company D. The assessors proposed to use the assets betterment method to quantify the assessable profits/income of the Taxpayer for the period from 1 April 1989 to 31 March 1995. The mechanism of an assets betterment statement was explained to the Taxpayer and the tax representative, and an assets betterment statement compiled by the assessor for the Taxpayer for the period in question (the ABS) was shown to the Taxpayer. The ABS showed betterment profits of \$8,765,720 and a discrepancy of \$8,691,893. The ABS was discussed in depth between the Taxpayer and the tax representative and the assessors. Claims were lodged by the Taxpayer for deductions from the ABS discrepancy in respect of the remittances from Company C and money held in trust for certain Chinese enterprises. The assessors told the Taxpayer that confirmations from the Chinese enterprises would not be conclusive evidence of the liabilities and that he had to show the movements of the liabilities which had to be matched with the corresponding accounting records of Company E.
- (8) On 9 September 1999, the Taxpayer and the tax representative attended another interview with the assessors to further discuss the ABS. After allowing deductions for remittances from Country C totalling \$2,484,604 and other deductions and adjustments, the betterment profits of the Business for the period in question were reduced to \$5,450,000. After further discussion and upon the advice of the tax representative, the Taxpayer accepted the sum of \$5,450,000 as the assessable profits of the Business for the period. The Taxpayer signed a settlement agreement in respect of the agreed assessable profits which were as follows:

<b>Year of assessment</b>	<b>Assessable profits</b>	<b>Profits (loss) already assessed</b>	<b>Additional assessable profits</b>	<b>Loss overclaimed</b>
	\$	\$	\$	\$
1989/90	900,000	(23,347)	900,000	23,347

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1990/91	900,000	(457,534)	900,000	457,534
1991/92	900,000	129,944	770,056	Nil
1992/93	900,000	404,388	495,612	Nil
1993/94	900,000	Nil	900,000	Nil
1994/95	<u>950,000</u>	<u>Nil</u>	<u>950,000</u>	<u>Nil</u>
	<u><u>5,450,000</u></u>	<u><u>53,451</u></u>	<u><u>4,915,668</u></u>	<u><u>480,881</u></u>

The Taxpayer confirmed and signed a copy of the note of the interview held on 9 September 1999.

- (9) On 20 September 1999, the assessor discussed with the tax representative over the telephone further adjustments to the ABS. The assessor found after further review that the assets and liabilities of the Business accounted for in the ABS were incomplete. Further necessary adjustments therefore had to be made. As a result, the betterment profits of the Business for the period were \$5,462,500, which exceeded the amount of betterment profits computed during the interview on 9 September 1999 by \$12,500.
- (10) On 20 September 1999 the assessor sent to the tax representative by fax the computation of assessable profits of the Business. He confirmed and signed on the computation, stating that he had explained to the Taxpayer the adjustments to the ABS for the period and that he was directed by the Taxpayer to confirm that he agreed to the adjustments to the ABS and did not have other claims for deduction. On behalf of the Taxpayer, the tax representative confirmed that the Taxpayer still accepted the settlement agreement for the Business that was signed by the Taxpayer on 9 September 1999.

6. On the basis of the agreement reached with the Taxpayer (see paragraph 5(8) above), the assessor raised, on 30 September 1999, for the years of assessment 1989/90 to 1994/95 inclusive, assessments or revised assessment (as the case may be) respectively on the Business.

7. The following table shows the assessable profits before and after investigation and the amounts of profits understated and tax undercharged:

Year of assessment	Assessable profits (loss) before investigation	Assessable profits after investigation	Profits understated	Loss overclaimed	Tax undercharged
	\$	\$	\$	\$	\$
1989/90	(23,347)	900,000	900,000	(23,347)	135,000
1990/91	(457,534)	900,000	900,000	(457,534)	135,000
1991/92	129,944	900,000	770,056	Nil	135,000
1992/93	404,388	900,000	495,612	Nil	126,983

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1993/94	Nil	900,000	900,000	Nil	135,000
1994/95	<u>Nil</u>	<u>950,000</u>	<u>950,000</u>	<u>Nil</u>	<u>142,500</u>
	<u>53,451</u>	<u>5,450,000</u>	<u>4,915,668</u>	<u>(480,881)</u>	<u>809,483</u>

The percentage of profits understated and loss overclaimed to profits assessed after investigation is 99%.

8. On 12 November 1999, the assessor interviewed the Taxpayer and the tax representative when the Taxpayer proposed to compound his offence of making incorrect tax returns in respect of the Business for the period in question. The assessor indicated to the Taxpayer that in his opinion a reasonable amount of penalty would be in the region of \$1,000,000.

9. By a letter dated 26 November 1999 and addressed to the assessor, the Taxpayer requested to pay the penalty of \$1,000,000 by ten monthly instalments of \$100,000 each from December 1999, stating that he was not trying to escape paying the penalty, that he truly lacked the ability to pay it all at once and that he asked the Revenue to show generosity in dealing with his case.

10. On 30 November 1999 the assessor wrote to the Taxpayer in reply, informing him that the penalty could not be paid by instalments.

11. On 23 December 1999, by a notice under section 82A(4) of the IRO, the Commissioner informed the Taxpayer of her intention to assess additional tax in respect of his making of incorrect returns for the Business.

12. By a letter dated 12 January 2000, the Taxpayer submitted written representations to the Commissioner. The representations were to the following broad effect:

12.1 ‘ One of the reasons for the making of such incorrect tax returns is my personal negligence which I cannot deny. As I am not familiar with book keeping, I fully relied on my accounting staff to manage all my accounting records. Unfortunately, the personnel who worked for me at that period were not well qualified. That is why my accounting records were not complete and clear enough to give true and correct data for your investigation.’

12.2 ‘ Some Chinese traders deposited their money with persons who could be trusted. I am one of them to have such kind of deposits. Further, some of the deposits belonged to my family members living in Country C. My accounting staff could not record the transactions correctly.’

12.3 ‘ I did not intentionally made such incorrect tax returns. But, as I cannot provide any evidence to prove the truth, I am ready to accept and

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pay the tax undercharged ie \$809,483. However, as for the additional tax, I cannot afford to pay a heavy additional tax. A penalty of \$1,000,000 is really a very big amount to me. I hope you will treat this case generously and levy a light penalty that is affordable and realistic.'

13. Having considered and taken into account the Taxpayer's representations, the Commissioner on 14 February 2000 issued to the Taxpayer in respect of the Business for the period in question notices of assessment and demand for additional tax under section 82A of the IRO as follows:

<b>Year of assessment</b>	<b>Tax undercharged</b>	<b>Section 82A additional tax</b>	<b>Additional tax as percentage of tax undercharged</b>
	\$	\$	
1989/90	135,000	168,000	124%
1990/91	135,000	168,000	124%
1991/92	135,000	168,000	124%
1992/93	126,983	160,000	126%
1993/94	135,000	168,000	124%
1994/95	<u>142,500</u>	<u>168,000</u>	118%
Total	<u>809,483</u>	<u>1,000,000</u>	124%

### Grounds of appeal

14. By a letter dated 9 March 2000, the Taxpayer gave notice of appeal to the Board of Review against the additional tax assessments in question. The notice of appeal is to the effect that, since it seems that his representations dated 12 January 2000 asking for a lighter penalty have not been taken into consideration, the only way is for him to accept this assessment and ask the Board to kindly consider his difficulty and generously approve his proposal to pay the sum (of \$1,000,000) by six instalments payable every two months as from 16 March 2000.

15. The notice of appeal was accompanied by a statement of grounds of appeal which is to the following effects:

15.1 ' During the years 1989 to 1995, our accounting personnel kept on changing. It was very easy to get jobs during that period. This is the main reason why the account books have so many mistakes and data were wrongly recorded.'

15.2 ' Most of the deposits belong to my Chinese partners and family members in Country C. As I do not know much about accounting and keeping records, I failed to show evidence in support of my statement. The

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assessor therefore treated all the unidentified deposits as my earnings and levied against me a sum for tax undercharged and also additional tax of \$1,000,000.'

16. Enclosed with the statement of grounds of appeal was a copy of the written representations which the Taxpayer sent to the Commissioner (see paragraph 12 above). We shall treat the representations as an extension of the statement of grounds of appeal in so far as it is possible to do so. We shall also include the statements in the notice of appeal (see paragraph 14 above) in our considerations.

### Reasons for decision

17. The penalty (additional tax) assessments under appeal were raised on the Taxpayer for making incorrect tax returns, without reasonable excuse, for the years of assessment 1989/90 to 1994/95 inclusive in respect of the Business (Company 3). If he can prove the existence of a reasonable excuse for his failure to make correct tax returns, he is not liable to penalty. We can find no such excuse.

18. He has a duty under the IRO to maintain true and correct accounts of his business to enable him to make correct returns. In our view, it is no excuse for him to say that he delegated that duty to his accounting staff (see D112/95) or that there were frequent changes in the staff, or that neither he nor his staff were well qualified to handle accounts (see paragraphs 12 and 15 above).

19. At the hearing of this appeal, the Taxpayer without prior notice made the allegation that he had been told by an assessor to sign the settlement agreement in respect of the assessable profits of the Business for the six years in question and that he therefore signed the settlement agreement without being given an explanation of what was happening nor time to consider the same.

19.1 We find it hard to believe that an experienced businessman such as the Taxpayer could have just signed, as he was told, an agreement with the Revenue admitting the understatement of assessable profits of over \$4,900,000 without ascertaining what he was signing.

19.2 Furthermore, the allegation is inconsistent with the Taxpayer's previous statements and behaviour:

(i) On 9 September 1999, the Taxpayer signed the settlement agreement after it was vetted by his tax representative.

(ii) On 30 September 1999, the assessor, pursuant to the settlement agreement, raised assessments of profits tax on the Business for the



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six years in question (see paragraphs 6 and 7 above) to which the Taxpayer lodged no objection. The assessments therefore are final and conclusive under section 70 of the IRO.

- (iii) On 12 January 2000, the Taxpayer stated in his written representations to the Commissioner that he was ready to accept and pay the tax undercharged, ie \$809,483.
- (iv) On 9 March 2000, the Taxpayer filed his notice of appeal together with the statement of grounds of appeal. In neither document did the Taxpayer raise any ground relating to the signing of the settlement agreement in respect of the assessable profits.

20. In our view it is not open to the Taxpayer to challenge the validity of the settlement agreement because: (1) the assessments of assessable profits raised on 30 September 1999 are final and conclusive and (2) in any event we will not allow under section 66(3) of the IRO the addition of a new ground of this nature at this late stage.

21. As for quantum, neither the notice of appeal nor the statement of grounds of appeal plead in terms that the penalty of \$1,000,000 is excessive. The notice of appeal asks only for payment by six instalments payable every two months as from 16 March 2000. The Board of Review has no jurisdiction over any question of payment terms which is a matter between the Taxpayer and the Revenue and can only be resolved by negotiation between the two parties. However, it seems that the matter is now only of academic interest. From the information contained in a letter dated 14 June 2000, addressed to the Clerk to the Board of Review and copied to the Taxpayer, it appears that the Taxpayer has sold a property and that arrangements have been made between him and the Revenue to apply part of the proceeds of sale to pay the outstanding penalty amounting to \$496,000.

22. Before we leave this case, we should add that efforts were made during the hearing to find, without success, mitigating circumstances to reduce the amount of penalty. In particular, we could find no real evidence of co-operation on the part of the Taxpayer. Ms Tang, the Commissioner's representative, told us (and we accept) that the Taxpayer offered no assistance in tracing the missing links, leaving the Revenue officers to go the full length of the investigation which lasted a total period of three years and seven months.

23. On the whole, we cannot say that the penalty of \$1,000,000 is a small sum, nor can we say that it is so large that it is excessive. It is 124% of the tax undercharged. Depending on circumstances, awards of over 100% are from time to time made (see D112/95, for example).

24. It follows that this appeal is dismissed and that the additional tax assessments in question are hereby confirmed.

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