

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D7/93

Penalty tax – quantum of penalty – whether 113% of the tax undercharged justified by the taxpayer's conduct – section 82A of the Inland Revenue Ordinance.

Panel: Howard F G Hobson (chairman), Roland Chow Kun Chee and Vincent To Wai Keung.

Date of hearing: 3 May 1993.

Date of decision: 24 May 1993.

The taxpayer was carrying on business in partnership with his wife. He under-declared his taxable income and following an investigation was assessed to additional tax. The Commissioner then imposed penalties under section 82A of a total of 113% of the tax undercharged. The taxpayer submitted that the quantum was excessive.

Held:

The taxpayer was not running a very sophisticated business and had cooperated during the investigation by the Inland Revenue Department. The quantum of 113% of the tax undercharged was excessive and the Board directed that the total penalties should be reduced to 100% of the tax undercharged.

Appeal allowed in part.

Cases referred to:

D63/87, IRBRD, vol 3, 55

D42/88, IRBRD, vol 3, 395

D43/88, IRBRD, vol 3, 405

Chan Wan Chun for the Commissioner of Inland Revenue.

Taxpayer represented by its precedent partner.

Decision:

The taxpayer, a partnership of Mr X and his wife, appealed against penalties imposed pursuant to section 82A of the Inland Revenue Ordinance following upon enquiry into the Taxpayer's financial affairs, preparation of an assets betterment statement (ABS),

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and agreement in August 1992 as to undeclared exigible profits of \$908,543 spread over the years of assessment 1983/84 to 1990/91. The latter led to the raising of assessments, additional assessments and revised assessments, as the case may be, (collectively ‘the additional assessments’). Whereafter the Commissioner gave notice of his intention to impose penalties in respect to which the Taxpayer submitted written representations. Having considered these the Commissioner gave notice of the following 82A assessments in January 1993:

<u>Year of Assessment</u>	<u>Tax Undercharged</u>	<u>Section 82A Additional Tax</u>	<u>Percentage of Tax Undercharged</u>
	\$	\$	
1983/84	32,091	38,000	118%
1984/85	29,563	35,000	118%
1985/86	26,926	32,000	119%
1986/87	34,218	41,000	120%
1987/88	31,831	36,000	113%
1988/89	23,644	25,000	106%
1989/90	19,482	19,000	98%
1990/91	<u>13,482</u>	<u>13,000</u>	<u>96%</u>
	<u>211,237</u>	<u>239,000</u>	<u>113%</u>

The Taxpayer’s grounds of appeal against these assessments simply drew attention to alleged omissions or discrepancies in the ABS, which he had signed on 28 August 1992.

At the hearing we explained to the Taxpayer’s representative that by virtue of section 70 the additional assessments had become final and conclusive, it was therefore beyond our jurisdiction to re-examine them with regard to his allegations of omissions and discrepancies. We therefore decided to treat the appeal as having been made solely against the section 82A assessments on the grounds that the Taxpayer had a reasonable excuse for filing incorrect returns and hence not liable to such assessments (section 82A(a) and section 82B(2)(a)) or if that ground failed then on the grounds that the penalty taxes imposed are excessive in the circumstances (section 82B(2)(c)). We believe that section 66(3) enables us to adopt that approach.

Background

The Taxpayer was established in Hong Kong in 1983 as a partnership originally comprising Mr X, his wife and two others who left the partnership in 1984. At all material times the nature of its business was importing raw materials from overseas passing

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them on to its branch in China (until 1989 when a China joint venture company, in which Mr X had a shareholding, was substituted) for the manufacture thereof a certain product. A small amount of the finished products were then returned to Hong Kong and exported to some countries, the large remainder being sold in China. Mr X's wife for some short time owned and operated a small shop retailing low cost clothing however as that business was unsuccessful it was closed down and evidently it was not material in the drawing up of the ABS. The ABS contains details of four units owned by Mr X during the relevant period of which one was sold to his daughter and another was let out. Mr X spent between 10 and 20 days each month at the China based factory. Mr X is 60 years of age, comes from a humble background and received only three years of formal schooling.

These details have been taken from statements made by the Taxpayer to the Revenue or from the Commissioner's representative's statement of facts. Those facts were not disputed save that in a written response thereto the Taxpayer maintained the ABS understated the opening assets by \$87,300 (which as will be seen later would let out at \$51,300), omitted a subsequent liability of \$504,189.68 and failed to take into account property taxes. The Board questioned the Taxpayer in relation to the \$504,189.68 and was satisfied that this liability by its nature was offset by the value of the goods in respect to which it was incurred.

Without Reasonable Excuse

The only excuses offered for failing to complete the tax returns correctly were that (a) Mr X had very little formal education, (b) he had had difficulty recruiting or retaining staff capable of undertaking accounting work because the Taxpayer's business was small and (c) he had thought some of its income was sourced in China and not in Hong Kong.

In our view, the explanations at (a) and (b) do not constitute 'reasonable' excuses though it is conceivable that excuses of that kind if supported by credible evidence might have some bearing on whether any given penalties are 'excessive in the circumstances'.

As to the reason given at (c) if we were convinced that the Taxpayer had reasonable grounds for believing that the profits were not sourced in Hong Kong, as for example where professional advice had been given based on a thorough review of the Taxpayer's cross-border activities, that might well represent a reasonable excuse (see the remarks at page 58 in D63/87, IRBRD, vol 3, 55). However apart from the sweeping statement made in response to the Commissioner statutory warning of the possibility of 82A assessments being raised (that is after the ABS had been agreed and after the period for appealing against the additional assessments), no evidence was offered from which the Board could investigate this issue.

We therefore find that there were no reasonable excuse for filing incorrect returns.

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Excessive In The Circumstances

We now turn to the issue of whether the 82A assessments were excessive. During the course of the hearing, it transpired that an amount of \$51,300 (being the difference between the purchase price of \$87,300 for a unit and mortgage thereon of \$36,000) was not included in the 31 March 1983 opening estimate of the Taxpayer's assets. We were advised that this was deliberately omitted by the Revenue because the date of the registered assignment of the property was 11 April 1983, that is after 31 March 1983. However, at the hearing the Taxpayer's representative drew our attention to a copy of a provisional agreement for the purchase of the property at \$87,300 which indicated that a deposit of \$5,000 had been paid, a further \$21,190 was due on 15 December 1982 and the balance of \$61,110 was to be paid by 31 December 1992. We were also shown a receipt for the \$21,190 dated 14 December 1992. Taking into account the mortgage loan of \$36,000 the further amount payable on or before 31 December 1992 would be \$14,100. Although no receipt for this later figure was produced we believe it is fair to assume it was paid on 31 December 1992 or at any rate before 31 March 1993 and that the discrepancy of the date on the assignment is likely to be due to the solicitors handling the matter dating (possibly excusably) the document well after completion. We accept that we are precluded from reopening the additional assessments to take account of the \$51,300 and as pointed out by the Commissioner's representative in the larger picture of the \$908,543 the omission is not of a sizeable significance. However bearing in mind that the Commissioner's representative conceded that had the Commissioner been aware of the full facts the ABS itself and the additional assessments and consequently the 82A penalties would have been adjusted downwards, we believe that we can take this particular issue into account when considering whether the penalties were excessive.

Conclusion

Contrary to the submission of the Commissioner's representative the Taxpayer's representative did not strike us as a sophisticated person nor do we believe that running his business required a great deal of acumen. We do not consider this case to be particularly grave: for instance the ABS merely suggests an annual asset appreciation of about 10% to 12% above inflation over the eight years involved. Apart from a suggestion that the Taxpayer was late for interviews, he does not appear to have been uncooperative. Finally there was neither evidence nor suggestion that the Taxpayer had deliberately set out to evade tax. The foregoing are matters which should be taken into account when deliberating on the extent of 82A penalties (see for example D42/88, IRBRD, vol 3, 395 at page 402).

The total of all the penalties represents 113% of the undercharged tax. With the above remarks in mind and having regard to our conclusions concerning the omission of \$51,300 from the ABS, we direct that the total of the penalties be reduced to 100% of the tax undercharged for each year of assessment concerned, which direction is in line with the comments to be found in D43/88, IRBRD, vol 3, 405 and other reported decisions.