

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D7/95

Penalty tax – husband and wife –failure to keep proper accounts and file correct tax returns – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Albert Ho Chun Yan and Gordon Macwhinnie.

Date of hearing: 14 November 1994.

Date of decision: 26 April 1995

The taxpayers were husband and wife who carried on various businesses. The taxpayers failed to file true and correct returns in respect of the profits which they made from their various businesses. Following an investigation the profits of the taxpayers were ascertained. Subsequently penalties of 100% in respect of one case, 74.8% in respect of a second case and 58.9% in respect of a third case were imposed. The taxpayers appealed to the Board of Review.

Held:

The penalties were not excessive. The financial position of the taxpayers is not relevant in considering the quantum of penalties.

Appeal dismissed.

Cases referred to:

D34/88, IRBRD, vol 3, 366

D71/91, IRBRD, vol 7, 1

Li Mak Sin Ming for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is one of three appeals by two taxpayers who are husband and wife against a number of additional tax assessments raised upon them under section 82A of the Inland Revenue Ordinance (the IRO) in respect of the failure by the two Taxpayers to notify the Commissioner of Inland Revenue of their respective chargeability to tax as required by section 51(2) of the IRO and for filing incorrect tax returns. At the time and date set for the hearing of the appeal the husband and the wife duly appeared before the Board and requested that their respective appeals be heard together. This was confirmed by the

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representative for the Commissioner. As the three appeals were heard at the same time it is convenient to set out all of the facts relating to the three cases as follows:

1. The wife carried on business as a retailer of snacks and candies with effect from September 1988. She also carried on business as a retailer of fashion commencing from December 1987 and ceasing in September 1989. The wife managed both businesses.
2. During the years of assessments 1988/89 to 1992/93 the husband was an employee of an organisation and was duly assessed to salaries tax.
3. In August 1988 the wife submitted a provisional profits tax return for the year of assessment 1988/89 in respect of the fashion business declaring that the business incurred a loss of \$52,522 for the period from 12 December 1987 to 30 June 1988.
4. In March 1989 the wife submitted a provisional profits tax return for the year of assessment 1988/89 in respect of the snacks and candies business declaring that the business incurred a loss of \$42,280 for the period from 1 September 1988 to 28 February 1989.
5. In November 1992 the assessor commenced an investigation into the tax affairs of the husband and the wife. On 21 December 1982, the husband and the wife attended an interview with the assessor at the Inland Revenue Department. During the interview the husband and the wife disclosed that no proper accounting records had been kept for the snacks and candies business, that the accounting records for the fashion business had been destroyed when the fashion business closed and that the husband carried on business giving part time lectures in addition to his employment.
6. Following the interview profits tax returns were issued to the husband and the wife respectively on 2 January 1993 as follows:

| | Years of Assessment |
|-----------------------------|----------------------------|
| Snacks and Candies Business | 1988/89 to 1991/92 |
| Fashion Business | 1988/89 to 1989/90 |
| Lecture Business | 1988/89 to 1991/92 |

7. On 5 February 1993 the wife submitted profits tax returns in respect of the snacks and candies business and the fashion business which showed the following particulars:

**Year of
Assess-**

**Returned
Profits/**

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| | ment | Basis Period | (Loss) (\$) |
|---------------------------|---------|-------------------------|----------------|
| Snacks & Candies Business | 1988/89 | 1-9-1988 to 31-3-1989 | 23,770.00 |
| | 1989/90 | year ended 31-3-1990 | 107,763.30 |
| | 1990/91 | year ended 31-3-1991 | 110,192.50 |
| | 1991/92 | year ended 31-3-1992 | 110,662.20 |
| Fashion Business | 1988/89 | 1-12-1987 to 31-12-1988 | 47,550.00 |
| | 1989/90 | 1-1-1989 to 30-9-1989 | 38,250.00 |

8. On 5 February 1993 the husband submitted blank returns for the years of assessment 1988/89 and 1989/90 and declared the following profits for 1990/91 and 1991/92 in respect of his lecture business:

| Year of Assessment | Returned Profits (\$) |
|-----------------------|--------------------------|
| 1990/91 | 36,000 |
| 1991/92 | 36,000 |

9. During the course of investigation, the husband and the wife submitted profits tax returns for the year of assessment 1992/93 in respect of the lecture business and the snacks and candies business which showed the following particulars:

| | Basis Period | Returned Profits (\$) |
|------------------------------|----------------------|-----------------------------|
| Snacks & Candies Business | year ended 31-3-1993 | 98,801 |
| Lectures Business | year ended 31-3-1993 | 36,000 |

10. By a letter dated 6 September 1993 the husband and the wife were asked to furnish further information with regard to their assets which they did.
11. The assessor was of the opinion that the known sources of income of the husband and the wife were insufficient to finance the mortgage repayments of property disclosed by them. Investigation by the assessor showed that the net assets of the husband and the wife had increased by \$1,029,330 during the period from 1 April 1986 to 31 March 1992. A statement of assets and liabilities was prepared and agreed by the wife and witnessed by the husband.

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12. Following negotiations on the basis of the increase in assets the assessor accepted the returned profits of the fashion business and the lecture business and the wife agreed to the following assessable profits in respect of the snacks and candies business:

| Year of Assessment | Agreed Assessable Profits |
|---------------------------|----------------------------------|
| | (\$) |
| 1988/89 | 53,770 |
| 1989/90 | 207,763 |
| 1990/91 | 312,187 |
| 1991/92 | 350,662 |
| 1992/93 | 220,000 |

13. On the basis of the profits agreed, the assessor issued the following profits tax assessments on 18 March 1994:

- (a) Snacks and Candies Business

| Year of Assessment | Assessable Profits |
|---------------------------|---------------------------|
| | (\$) |
| 1988/89 | 53,770 |
| 1989/90 | 207,763 |
| 1990/91 | 312,187 |
| 1991/92 | 350,662 |
| 1992/93 | <u>220,000</u> |
| | <u>1,144,382</u> |

- (b) Fashion Business

| Year of Assessment | Assessable Profits |
|---------------------------|---------------------------|
| | (\$) |
| 1988/89 | 47,550 |
| 1989/90 | <u>38,250</u> |
| | <u>85,800</u> |

- (c) Lectures Business

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| Year of Assessment | Assessable Profits (\$) |
|--------------------|----------------------------|
| 1990/91 | 36,000 |
| 1991/92 | 36,600 |
| 1992/93 | <u>36,000</u> |
| | <u>108,600</u> |

14. The following is a comparative table of the assessable profits in respect of the three businesses before and after investigation and the amount of tax undercharged:

(a) Snacks and Candies Business

| Year of Assessment | Profits before Investi- gation (\$) | Profits after Investigation (\$) | Profits Understated (\$) | Tax Undercharged (\$) |
|--------------------|--|--|--------------------------------|-----------------------------|
| 1988/89 | 0 | 53,770 | 53,770 | 8,334 |
| 1989/90 | 0 | 207,763 | 207,763 | 31,164 |
| 1990/91 | 0 | 312,187 | 312,187 | 46,828 |
| 1991/92 | 0 | 350,662 | 350,662 | 52,599 |
| 1992/93 | <u>98,801</u> | <u>220,000</u> | <u>121,199</u> | <u>18,180</u> |
| | <u>98,801</u> | <u>1,144,382</u> | <u>1,045,581</u> | <u>157,105</u> |

The percentage of profits understated to total profits assessed after investigation was 91.4%.

(b) Fashion Business

| Year of Assessment | Profits before Investi- gation (\$) | Profits after Investigation (\$) | Profits Understated (\$) | Tax Undercharged (\$) |
|--------------------|--|--|--------------------------------|-----------------------------|
| 1988/89 | 0 | 47,550 | 47,550 | 7,370 |
| 1989/90 | <u>0</u> | <u>38,250</u> | <u>38,250</u> | <u>5,737</u> |
| | <u>0</u> | <u>85,800</u> | <u>85,800</u> | <u>13,107</u> |

The percentage of profits understated to total profits assessed after investigation was 100%.

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(c) Lectures Business

| Year of Assessment | Profits before Investi- gation (\$) | Profits after Investigation (\$) | Profits Understated (\$) | Tax Undercharged (\$) |
|-------------------------------|--|---|---|--------------------------------------|
| 1990/91 | 0 | 36,000 | 36,000 | 5,400 |
| 1991/92 | 0 | 36,600 | 36,600 | 5,490 |
| 1992/93 | <u>0</u> | <u>36,000</u> | <u>36,000</u> | <u>5,400</u> |
| | <u>0</u> | <u>108,600</u> | <u>108,600</u> | <u>16,290</u> |

15. (a) On 9 May 1994, the Commissioner of Inland Revenue gave notice to the wife of his intention to assess additional tax by way of penalty in respect of the failure by the wife to comply with the requirements of section 51(2) of the snacks and candies business and the fashion business and for making an incorrect return in respect of the snacks and candies business.

(b) On 9 May 1994, the Commissioner gave notice to the husband of his intention to assess additional tax by way of penalty in respect of the failure by the husband to comply with the requirements of section 51(2) of the IRO in respect of the lectures business.

16. By the letter dated 31 May 1994 the husband and the wife made written representations to the Commissioner. Having considered and taken into account the representations the Commissioner issued on 11 July 1994 the following notices of assessment and demand for the additional tax by way of penalty under section 82A of the IRO:

(a) Snacks and Candies Business

| Year of Assessment | Tax Undercharged (\$) | Section 82A Additional Tax (\$) | Additional Tax as Percentage of Tax Undercharged |
|-------------------------------|--------------------------------------|--|---|
| 1988/89 | 8,334 | 9,600 | 115.2% |
| 1989/90 | 31,164 | 33,700 | 108.1% |
| 1990/91 | 46,828 | 47,500 | 101.4% |
| 1991/92 | 52,599 | 50,100 | 95.2% |
| 1992/93 | <u>18,180</u> | <u>16,200</u> | 89.1% |
| | <u>157,105</u> | <u>157,100</u> | 100.0% |

(b) Fashion Business

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| Year of Assessment | Tax Undercharged (\$) | Section 82A Additional Tax (\$) | Additional Tax as Percentage of Tax Undercharged |
|--------------------|--------------------------|---------------------------------------|--|
| 1988/89 | 7,370 | 5,500 | 74.6% |
| 1989/90 | <u>5,737</u> | <u>4,300</u> | 75.0% |
| | <u>13,107</u> | <u>9,800</u> | 74.8% |

(c) Lectures Business

| Year of Assessment | Tax Undercharged (\$) | Section 82A Additional Tax (\$) | Additional Tax as Percentage of Tax Undercharged |
|--------------------|--------------------------|---------------------------------------|--|
| 1990/91 | 5,400 | 3,600 | 66.7% |
| 1991/92 | 5,490 | 3,200 | 58.3% |
| 1992/93 | <u>5,400</u> | <u>2,800</u> | 51.9% |
| | <u>16,290</u> | <u>9,600</u> | 58.9% |

17. By letter dated 1 August 1994, the husband and wife gave notice of appeal to the Board of Review against the assessments to additional tax. Both the husband and the wife addressed the Board. The husband explained that the lectures which he gave were private lessons with no fixed salaries and the income depended on the number of students which he taught.

With regard to the wife's case they said that they worked very hard everyday and were very busy and were not familiar with tax law in Hong Kong. They said that they did not intend to evade tax. They submitted that since the interview with the Revenue they had been cooperative. They said that in view of their present financial position it was not possible to pay the whole of the penalties which had been imposed upon them.

The representative for the Commissioner submitted that the penalties were not excessive. She pointed out that the starting point for assessing penalties in cases of this nature is an amount equal to the tax understated. (D34/88, IRBRD, vol 3, 366).

The representative for the Commissioner said that financial difficulties of the Taxpayer was not a relevant consideration and cited D71/91, IRBRD, vol 7, 1.

With regard to the question of cooperation by the Taxpayer the representative for the Commissioner pointed out that the Commissioner had taken this into account when assessing the penalties. She pointed out that the penalties in the fashion business and the lectures business were lower because the profits tax

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returns submitted for these two businesses had been accepted by the assessor whereas the snacks and candies business had not.

Having heard the submissions by the parties we find that the penalties imposed in all three appeals before us are not excessive. It is the duty of each and every taxpayer in Hong Kong to inform the Commissioner of their liability to tax and to file true and correct tax returns. The system of taxation in Hong Kong is simple and effective only if taxpayers fulfil their obligations in accordance with the IRO. The system of low taxation in Hong Kong is dependent upon an honour system by taxpayers. In the present case the husband has failed in his obligations under the IRO.

It has been stated on many occasions by previous Boards of Review that failure by taxpayers to fulfil their obligations under the IRO will lead to penalties equal to approximately the amount of tax involved. In more serious cases or less serious cases the quantum of the penalty will be adjusted accordingly. In the three cases being heard simultaneously before us the Commissioner has followed the norm in respect of one case and has reduced the amount in respect of the other two cases. The basis for the reduced amounts is because of the cooperation by the husband and the wife in making full disclosure of their taxable income.

In the course of the case both the husband and the wife and the representative for the Commissioner made reference to the husband and the wife selling certain property at a profit and that the funds may or may not have been available for payment of tax. It is well accepted that the ability of a taxpayer to pay penalties is not valid consideration to take into account when assessing the quantum of the penalties. The quantum of the penalties is based on what the Taxpayers may or may not have done at the time when they were required to file their tax returns and on the cooperation which they may or may not have given subsequently. Accordingly we have not taken the financial position of the Taxpayers into account in anyway when reaching our decision in this case.

For the reasons given we dismiss this appeal and confirm the penalty tax assessments raised by the Commissioner.