

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D81/97

Penalty tax – incorrect salaries and individual tax returns – failure to disclose 93% of income over period of six years. Assets Betterment Statement – whether penalty tax of 110% excessive and unreasonable in the circumstances – section 82A of the Inland Revenue Ordinance.

Panel: Terence Tai Chun To (chairman), Kenneth Ku Shu Kay and Charles Graeme Large.

Date of hearing: 6 August 1997.

Date of decision: 6 November 1997.

During the relevant period, the taxpayer was a director and shareholder of a number of private as well as two investment companies in Hong Kong. On divers dates, he submitted salaries tax returns for the years of assessment 1987/88 to 1992/93 and tax returns (individuals) for the years of assessment 1993/94 and 1994/95. Upon investigation by the IRD, it was discovered that the taxpayer had failed to disclose almost HK\$13 million in income for this period. The Commissioner issued, to the taxpayer, additional assessments by way of an Assets Betterment Statement (ABS) in order to recover the outstanding payable tax. The taxpayer duly paid the said outstanding tax.

The Commissioner subsequently issued to the taxpayer notices of assessment and demand for additional tax (by way of penalty) under section 82A IRO. The said penalty amounted to 110% of his paid up tax for the relevant period. The taxpayer appealed to the Board under section 82B IRO arguing:

- (1) Certain items which had been included in the ABS, either:
 - (a) were not chargeable to tax;
 - (b) should not have been included in the Statement; or
 - (c) any penalty imposed should have been moderate.
- (2) In all the circumstances, the section 82A penalty was unreasonable and excessive.

Held:

- (1) It was well established from case law that an ABS was final and conclusive. By accepting the ABS, the items therein would also be taken to be agreed,

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and could not be contested at a later stage. In addition, by accepting the ABS, the taxpayer was taken to have accepted the eventuality of an additional tax (by way of penalty) to be imposed under section 82A IRO.

- (2) The taxpayer had understand approximately 93% of his true income covering a period of six years. There was no legitimate excuse for this. Although the normal penalty for cases involving omission of income was 100%, the severe understatement of income justified a higher penalty being imposed. In the circumstance, a penalty tax of 110% was neither excessive nor unreasonable.

Appeal dismissed.

Cases referred to:

D18/97, IRBRD, vol 2, 391
D42/88, IRBRD, vol 3, 395
D4/90, IRBRD, vol 5, 82

Wong Chee Kong for the Commissioner of Inland Revenue.
B K Ho, Counsel for the taxpayer.

Decision:

Summary of Facts

1. The Taxpayer, Mr A, is appealing against the imposition of the additional tax by way of penalty assessed upon him under section 82A of the Inland Revenue Ordinance (the IRO) for making incorrect salaries tax returns for the years of assessment 1987/88 to 1991/92 and tax return – individuals for the year of assessment 1993/94.
2. The Taxpayer had since November 1986 been employed by a firm of solicitors as a clerk in its conveyancing department.
3. The Taxpayer and his wife, Madam B were the sole shareholders and directors of Company C and Company D, both of which were investment companies. Both companies had been incorporated in Hong Kong and had been carrying on the business of property investment and dealing since 21 August 1987 and 21 December 1990 respectively.
4. During the relevant period, the Taxpayer and/or his wife had also been shareholder/s and or director/s of a number of private companies incorporated in Hong Kong.

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5. On divers dates, the Taxpayer submitted duly signed salaries tax returns for the years of assessment 1987/88 to 1992/93 and tax returns – individuals for the years of assessment 1993/94 and 1994/95. The returns showed the following income particulars of the Taxpayer:

Year of Assessment	Basis Period (Year Ended)	Date of Filing Return	Income per Return \$
1987/88	31-3-1988	30-11-1988	86,000
1988/89	31-3-1989	27-5-1989	99,000
1989/90	31-3-1990	6-6-1990	112,000
1990/91	31-3-1991	4-6-1991	126,000
1991/92	31-3-1992	19-6-1992	147,000
1992/93	31-3-1993	2-6-1993	164,000
1993/94	31-3-1994	23-9-1994	10,173,000
1994/95	31-3-1995	29-5-1995	183,500

6. In January 1993, the Inland Revenue Department (the IRD) commenced an investigation into the tax affairs of the Taxpayer. On 4 March 1993, the Taxpayer attended an interview with two investigation officers of the IRD. During the interview, the investigation officer explained to the Taxpayer the penalty provisions under the IRO.

During the interview, the Taxpayer stated that he had received neither salaries nor dividend from Company C and Company D though the former had provided him with director's quarters and other fringe benefits and that he had invested in properties with other friends through different limited companies. The Taxpayer also confirmed that the salaries tax returns filed by him were all correct but he needed some time to verify the accounting records of Company C.

7. By a letter dated 1 November 1994, the investigation officer asked the Taxpayer to supply further information including his overseas bank accounts, overseas landed properties and fund movements in his accounts. The Taxpayer promised that he would give a reply in the following month. No reply was received from the Taxpayer in January 1995. It was not until 8 August 1995 when the Taxpayer attended another interview with the investigation officer that part of the information sought was made available.

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8. During the interview on 8 August 1995 in which the Taxpayer and his wife attended, the Taxpayer was reminded replies to certain written enquiries sent to him on 1 November 1994 and 10 April 1995 were still outstanding.

9. In the course of the investigation, the following protective additional salaries tax assessments were raised on the Taxpayer:

Year of Assessment	Date of Issue	Additional Assessable Income \$
1987/88	9-3-1994	500,000
1988/89	27-2-1995	1,000,000
1989/90	6-3-1996	5,000,000
1990/91	9-3-1996	3,000,000
1991/92	9-3-1996	7,000,000
1993/94	9-3-1996	762,542

The Taxpayer objected to all these additional assessments through his tax representatives.

10. By a letter dated 11 June 1996, the Taxpayer, through his tax representative, proposed to settle the investigation for the years of assessment 1987/88 to 1991/92 and the years of assessment 1993/94 and 1994/95 with discrepancies and omitted income in the following amounts:

Year of Assessment	Discrepancy & Omitted Income \$
1987/88	783,447
1988/89	738,625
1989/90	697,650
1990/91	2,628,021
1991/92	6,885,118

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1993/94	912,542
1994/95	<u>280,000</u>
Total	12,925,403 =====

11. On acceptance of the proposal, revised additional salaries tax assessments based on the proposed discrepancies and omitted income, with some minor adjustments, were issued to the Taxpayer on 2 August 1996 as follows:

Year of Assessment	Revised Additional Assessable Income \$
1987/88	783,447
1988/89	738,625
1989/90	697,650
1990/91	2,628,021
1991/92	6,885,118
1993/94	<u>932,542</u>
	12,665,403 =====

The Taxpayer paid the revised additional assessments without raising any objections.

12. The following is a comparative table of the Taxpayer's assessable income before and after investigation and the amount of tax undercharged in consequence of the incorrect salaries tax returns and tax returns-individuals submitted by the Taxpayer:

Year of Assessment	Income before Investigation \$	Income after Investigation \$	Income Understated \$	Tax Undercharged \$
1987/88	215,270	1,007,125	791,855	138,608
1988/89	268,500	1,007,125	738,625	121,954
1989/90	112,000	809,650	697,650	118,927

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1990/91	126,600	2,754,621	2,628,021	410,541
1991/92	147,000	7,032,118	6,885,118	1,051,469
1992/93	164,000	1,424,000	1,260,000	205,750
1993/94	10,173,000	11,105,542	932,542	139,881
1994/95	<u>183,500</u>	<u>463,500</u>	<u>280,000</u>	<u>55,025</u>
Total	11,389,870 =====	25,603,681 =====	14,213,811 =====	2,242,155 =====

13. On 5 August 1996, the Commissioner gave a notice under section 82A(4) of the IRO to the Taxpayer informing the latter of his intention to assess additional tax by way of penalty in respect of his making of incorrect salaries tax returns for the years of assessment 1987/88 to 1992/93 and tax returns – individuals for the years of assessment 1993/94 to 1994/95 (copy already with the Board).

14. Having considered and taken into account the Taxpayer's representations, the Commissioner decided to impose no additional tax in respect of the incorrect tax returns for the years of assessment 1992/93 and 1994/95, but issued on 9 October 1996 notices of assessment and demand for additional tax under section 82A of the IRO to the Taxpayer in respect of the following incorrect tax returns in the following amounts:

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as Percentage to Tax Undercharged
1987/88	138,608	187,000	135%
1988/89	121,954	164,000	135%
1989/90	118,927	161,000	135%
1990/91	410,541	314,000	76%
1991/92	1,051,469	1,238,000	118%
1993/94	<u>139,881</u>	<u>126,000</u>	90%
	1,981,380 =====	2,190,000 =====	110%

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15. By letter dated 7 November 1996, the Taxpayer, through his tax representative, gave notice of appeal to the Board of Review against the above assessments to additional tax under section 82B of the IRO (copy of the notice of appeal already with the Board).

The Taxpayer's Case

16. Mr B K Ho, Counsel for the Taxpayer, declared at the beginning of the hearing that he would abandon the original grounds of appeal filed with the Board and submitted therefor a new ground of appeal, that is, the section 82A additional assessment was unreasonable and excessive.

17. Mr Ho stated that he was not trying to re-open the Assets Betterment Statement. However, he cast doubt on the component parts of the whole Assets Betterment Statements.

- (a) The Assets Betterment Statement started off with a bank balance of \$586. It was unrealistic. Upon the Taxpayer's return from Country E, his bank balance shown in the Assets Betterment Statement should be \$3,500,000. If that was the case, the total discrepancies would be correspondingly reduced by \$3,500,000.
- (b) The Taxpayer alleged that \$4,000,000 included in the Assets Betterment Statement were in fact money belonging to a third party that is Mr F for investment purposes. The discrepancies would be further reduced if these \$4,000,000 were taken off.
- (c) Bonuses in the sum of \$1,520,00 received by the Taxpayer had been taxed at source in the hands of Law Firm G and therefore should come off from the total discrepancies.
- (d) There was a sum of \$2,100,000 being the proceeds of sale of furniture and fixtures of Property H which should be treated as capital gain. These \$2,100,000 should therefore not be taken into account in the Assets Betterment Statement.
- (e) The Taxpayer's share of profits after tax from the sale of two houses in District I amounted to \$585,240. As tax on these profits had been withheld by the Taxpayer's joint venture partner, they should not form part of the Assets Betterment Statement.

The amounts mentioned in (a) (b) (c) (d) and (e) came up to a total of \$11,705,240.

18. Mr Ho submitted that these items which should not have been chargeable to tax had been included in the Assets Betterment Statement and that the Taxpayer agreed to the

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inclusion of these items because he wanted to bring to an end the investigation into his tax affairs which had been a mental torture to him and his wife.

These items formed the basis of the revised additional assessments on the Taxpayer. Tax in respect of these assessments had been paid.

19. Mr Ho further submitted that even if section 82A penalty were to be imposed on items (a) and (b), it should be moderate.

As to items (c) (d) and (e), Mr Ho made a strong plea that they should not be subject to any further penalty under section 82A of the IRO. These items should not have been included in the Assets Betterment Statement in the first place. The Taxpayer had already paid tax on them under the revised additional assessments. It would be totally unfair that the Taxpayer should be required to pay further tax on them by way of penalty under section 82A.

The Commissioner's Case

20. Mr Wong Chee Kong, senior assessor, represented the Commissioner. Mr Wong read out his written submission which he handed to the Board. His submission was lengthy and we will try to make a summary of it as best we can.

21. Mr Wong began by stating that the Taxpayer was appealing against the additional tax of \$2,190,000 imposed upon him under section 82A of the IRO for making incorrect salaries tax returns for the years of assessment 1987/88 to 1991/92 and tax return-individuals for the year of assessment 1993/94.

22. Mr Wong first drew the Board's attention to the tax returns submitted by the Taxpayer for the relevant years of assessments as follows:

Year of Assessment	Income per Return \$
1987/88	86,000
1988/89	99,000
1989/90	112,000
1990/91	126,000
1991/92	147,000
1992/93	164,000

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1993/94	10,173,000
1994/95	183,500

23. In January 1993, the IRD commenced an investigation into the tax affairs of the Taxpayer which lasted more than three years.

24. An Assets Betterment Statement was finally agreed by the Taxpayer in June 1996 which showed discrepancies of \$12,925,403. This Assets Betterment Statement should be final and conclusive by virtue of the IRO.

25. Mr Wong pointed out that a very substantial portion of the understated returns represented undisclosed drawings of remuneration from the companies in which the Taxpayer had complete control or interest.

26. He then went on to remind the Board of the general rule established in Board of Review cases for assessing penalties which was that the starting point should be 100% of the tax undercharged.

27. Regarding the Taxpayer, Mr Wong said that the Taxpayer was not an unsophisticated person. He was employed in a solicitor firm. He dealt in property and engaged in joint ventures with friends and through some corporate vehicles.

28. The Taxpayer had not fully co-operated with the IRD throughout the investigation, for example, he left the IRD to find out his investments in private companies. In the course of investigation, the IRD had to issue estimated assessments to force progress. It was not until then that the Taxpayer decided to agree to the Assets Betterment Statement.

29. Mr Wong further submitted that for a person to declare a return of only 7% of his true income was strong evidence of a deliberate intention to evade tax. It was difficult to accept that the Applicant had no knowledge of any irregularities.

30. The additional tax assessed on the Taxpayer was 110% of the total tax undercharged. The IRD had already agreed not to impose penalty in respect of (i) bonuses of \$1,800,000 received from Law Firm G and (ii) director's fees of \$1,260,000 received from Company J for the year of assessment 1992/93.

31. Mr Wong submitted that the additional tax imposed was not excessive. He asked the Board to dismiss the appeal.

Reasons for Decision

32. The Taxpayer's new ground of appeal before the Board was that the section 82A penalty was unreasonable and excessive.

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33. This new ground of appeal replaced the statement of grounds of appeal previously filed with the Board.

34. The Taxpayer was present at the hearing throughout. He did not choose to give evidence.

Before the Board there were 4 bundles of documents, namely:

- (1) The Board's Bundle,
- (2) The IRD Evidence Bundle,
- (3) The IRD Case Bundle and
- (4) The Taxpayer/TP Bundle.

35. The statement of facts has been agreed between the IRD and the Taxpayer.

36. The Taxpayer was a conveyancing clerk in a solicitors firm in charge of the conveyancing department. He was at the material times, a director and shareholder in many private companies. He participated in joint ventures and property dealings and had the benefit of professional advice throughout.

37. Mr Ho, Counsel for the Taxpayer, submitted that certain items comprising bonuses, deductions and profits (slightly over \$4,000,000) which were not chargeable to tax had been included in the Assets Betterment Statement.

38. He further submitted that according to the Taxpayer's wife, the Taxpayer agreed to the inclusion of those items because the Taxpayer wanted to bring to an end the investigation into his tax affairs which had been a mental torture to him and his wife. Counsel urged the Board to treat the Taxpayer's conduct as a strong mitigating factor and reduce the section 82A assessment accordingly. In support of his submission, Mr Ho supplied a list of authorities:

Section 26 (b)/IRO,
Case A9 1991,
Case A51 1991 and
Case F25 1996

39. The IRD investigation commenced on 4 March 1993 and it was not until June 1996 that the Taxpayer agreed, rather belatedly, to the Assets Betterment Statement. Throughout the investigation, the Taxpayer could have shown less prevarication in its response to the investigation officer.

40. Based on the Assets Betterment Statement, assessments were made and the Taxpayer had paid tax on them.

41. The Inland Revenue Department issued additional assessments under section 82A.

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42. It has been well established in previous decisions of the Board (D18/87, IRBRD, vol 2, 391, D42/88, IRBRD, vol 3, 395, D4/90, IRBRD, vol 5, 82) that the Assets Betterment Statement upon which assessment is made is final and conclusive for all purposes of the IRO. By deliberately including the various items in the Assets Betterment Statement the Taxpayer was saying that those items were chargeable to tax. He cannot now be heard to say that those items were in fact not chargeable to tax. By agreeing to the Assets Betterment Statement, the Taxpayer must be taken to accept the eventuality of an additional tax to be imposed under section 82A.

43. The maximum penalty under section 82A is three times the amount of tax undercharged or evaded. The normal penalty in cases involving omission of income discovered following the IRD's investigation into the affairs of a taxpayer is 100% of the tax undercharged.

44. This is a bad case of understatement of income which covered a period of six years. The amount of understated income discovered after investigation amounted to \$14,213,811, that is, about 93% of the true income having been understated. There was no legitimate excuse for this.

45. There remains for us to deal with Mr Ho's list of authorities:

Section 26 (b) of IRO,
Case A9 1991,
Case A51 1991 and
Case F25 1996.

(a) Section 26 (b)

This section is concerned exclusively with double taxation of profits.

The case before the Board was in connection with salaries tax.

Section 26(b) was simply irrelevant to the present case.

(b) Case A9 1991

This case concerns a wife making an inadvertent mistake when she signed the tax return, omitting to include her taxable emoluments.

The Commissioner conceded that her omission had been a mistake and not an intentional attempt to evade tax. Because of the Commissioner's concession, the Board let the wife off with a warning.

In the case before us, there was no question of a similar mistake being made. The Taxpayer had throughout been professionally advised.

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We do not find that this case is of much help to the Taxpayer.

(c) Case A51 1991

This case concerns an Assets Betterment Statement accepted by the Taxpayer. The grounds of appeal against a section 82A penalty were misconception between capital and expenditure, poor knowledge of accounting and lack of time spent on internal office administration and records.

The Board dismissed the appeal, having found that the imposition by the Commissioner of a penalty amounting to 134% of the tax undercharged not being excessive.

We find it difficult to understand how this case can be of help to the Taxpayer.

(d) Case F25 1996

This case concerns an employee of Company A and Company B.

In his salaries tax return, he declared his income from Company A. He did not declare his income from Company B although he indicated that he was also employed by Company B. He informed the IRD that he was waiting for the precise figures in respect of his earnings from Company B.

The Commissioner imposed an additional tax penalty in the sum of \$2,500 representing 9.84% of the tax undercharged.

The Board reduced the penalty to \$1,270. The reasons given were that the employee had no intention to evade his tax liability and the case arose out of a misunderstanding of his basic duty.

This case cannot be of much relevance because the Taxpayer in the case before us could not have a misunderstanding of his basic duty to make a correct return, particularly when he had professional advice throughout.

46. In all the circumstances, we find that the penalty imposed by the Commissioner was reasonable and not excessive. We therefore dismiss this appeal.