

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D85/01

**Penalty tax** – submission of incorrect tax returns and failure to file any tax return for several years of assessment without reasonable excuse – serious case of understatement – repeat offender – the weight to be attached to a relevant factor depends on the facts of each particular case – the degree of lateness was the primary consideration for a late but correct return – 100% is the appropriate percentage for cases where the taxpayer has filed no return for a number of years – no reason to restrict citation of authorities to cases reported in the past four years as long as it is relevant – maximum penalty was 300% of the amount of tax undercharged or which would have been undercharged – penalty imposed ranged from 106.7% to 150% of the tax undercharged – sections 51(4)(a), 68(4), 82A, 82B(2)(c) and 82B(3) of the Inland Revenue Ordinance (‘IRO’).

Panel: Kenneth Kwok Hing Wai SC (chairman), Charles Chiu Chung Yee and Charles Graeme Large.

Date of hearing: 13 August 2001.

Date of decision: 5 October 2001.

The taxpayer, a private company incorporated in Hong Kong, understated assessable profits for five years of assessment from 1992/93 to 1996/97 and failed to file any tax return for two years of assessment between 1997/98 and 1998/99 within the time allowed even after repeated issuance of estimated assessments.

The taxpayer objected to the estimated assessments. Some of the objections were invalid because they were not accompanied by duly completed tax returns. Subsequently, upon negotiation with the Inland Revenue Department (‘IRD’), the taxpayer paid all the tax demanded under the revised assessments and additional assessments.

The total amount of profits understated was \$53,723,055. The percentage of profits understated to total profits after tax audit and investigation was 90.8%.

As a result, the Commissioner of Inland Revenue notified the taxpayer of his intention to impose additional tax under section 82A of the IRO, due to, without reasonable excuse:

1. making incorrect tax returns for the five years of assessment from 1992/93 to 1996/1997; and

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2. its failure to file any tax return for two years of assessment between 1997/98 and 1998/99 within the stipulated time.

The taxpayer appealed against the quantum of additional tax, which ranged from 106.7% to 150% of the tax undercharged, so imposed.

### **Held:**

1. Of the three possible grounds of appeal under section 82B of the IRO, the taxpayer relied only on the ground under section 82B(2)(c) that the Assessments were excessive having regard to the circumstances. The onus of proving that the Assessments were excessive was on the taxpayer: sections 68(4) and 82B(3) of the IRO.
2. Whilst ignorance of the law or lack of education was no excuse, it was a relevant consideration when assessing penalties. The weight to be attached to a relevant factor depended on the facts of each particular case. Having regard to the taxpayer's eight to nine digit turnover and seven to eight digit profits, the Board attached no weight to this factor. With turnover and profits at this level, the taxpayer should have employed or instructed a person or persons competent to handle its accounting and taxation matters: D65/00. The taxpayer had only itself to blame for its failure or refusal to do so. The one Mr F chosen by the taxpayer was clearly not competent as an accounting manager.
3. In the case of a late but correct return, the primary consideration was the degree of lateness. It may therefore be inappropriate to punish on the basis of 100% understatement of profits although this was technically correct. Compare the case of a taxpayer filing a correct return one day late with the case of another taxpayer filing the return on time but deliberately understating his profits by 90%. The percentage for the former was 100% whereas the percentage for the latter was only 90%, despite the fact that the latter was more culpable than the former.
4. There may of course be cases where 100% is the appropriate percentage, for example, cases where the taxpayer has filed no return for a number of years, whether or not followed by failure to notify chargeability in subsequent years. The Board therefore considered the first five years on the basis of a 78.4% understatement.
5. The submission of no deliberate scheme or system to conceal taxable income flew in the face of the agreed facts.

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6. Despite repeated written requests and demands, the taxpayer refused or failed to furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98. The taxpayer sought to put the blame for this in its First Representative. The Board was of the opinion that this was both irresponsible and reprehensible.
7. The taxpayer's solicitor did not supply the Board with the rates in past cases where the taxpayer did not appeal and for unreported decisions of the Board of Review.
8. Nor did the taxpayer's solicitor justify his proposition that 'the rates of additional tax charged is the highest and far exceeds the maximum that have ever been imposed for the past four years'.
9. In D36/00, the Board of Review, chaired by the current Chairman of the Board of Review, upheld a penalty of 150%.
10. The taxpayer's solicitor did not even attempt to justify the proposition that the additional tax in this case was out of line with reported decisions of the Board of Review. He neither cited all the reported decisions in the past four years nor a representative sample of all the reported cases.
11. The Respondent, the Commissioner of Inland Revenue, had access to all decisions of the Board of Review, reported or otherwise, and his or her representative should cite all cases relevant to a contention that additional tax was out of line with previous decisions.
12. The Board saw no reason to restrict citation of authorities to cases reported in the past four years. The existence of an earlier authority might explain why the taxpayer did not appeal in some cases or why some Board of Review decisions were not reported. Neither representative cited the 15 cases referred to by the Board of Review, which were not exhaustive and were relevant to the decision of the Board.
13. As the Respondent did not defend any of the Assessments with reference to the Commissioner's penalty policy, the Board expressed no view on the Commissioner's penalty policy.
14. This was a serious case of understatement, both in terms of the dollar amounts of the understated profit (\$19,707,693) and of the percentage of understatement (78.4%). Having understated profits at this level over a period of five years, the taxpayer could not reasonably expect much sympathy.

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15. In the light of the taxpayer's eight to nine digit turnover and seven to eight digit profits, the Board had no sympathy with the taxpayer's apparent ignorance of law or with its apparent lack of accounting knowledge or experience.
16. The taxpayer overstated its expenses and understated its income.
17. The taxpayer partially mitigated the damage caused by its breaches of the law by giving the IRD limited co-operation.
18. However, the taxpayer was in serious default by failing or refusing to produce to the IRD any accounting records, with the exception of the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98; and furthermore during the investigation, the taxpayer aggravated its breaches by repeatedly alleging that it had filed correct returns.
19. The maximum penalty for which the taxpayer was liable was 300% of the amount of tax undercharged or which would have been undercharged.
20. The maximum previously imposed for late returns was much greater than 26.31% as contended by the taxpayer's solicitor.
21. The taxpayer was a repeat offender. Despite the 15 May 1997 additional tax assessment at 8.65% for late 1995/96 return, the taxpayer was still late in filing the return for the year of assessment 1996/97. The return for the year of assessment 1997/98 was not filed until 7 June 1999, more than six and a half months after the extended due date of 15 November 1998.
22. The taxpayer should have furnished a true and correct return.
23. The taxpayer made dubious claims in respect of its cost of sales in an attempt to understate its profits and this distinguished this case from cases where taxpayers filed true and correct returns out of time.
24. None of the Assessments for the years of assessment 1992/93 to 1997/98 was excessive.
25. However, the year of assessment 1998/99 was different from the year of assessment 1997/98 in two material respects:
  - (a) the first was that the taxpayer was again late, not filing the return until three and a half months had lapsed after the extended due date, despite an oral warning was given subsequently; and

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- (b) more significantly, the return was accepted by the IRD as true and correct and it did not rely on the \$39,413 difference which had already been adjusted in the return filed on 29 February 2000.
26. The additional tax for the year of assessment 1998/99 fixed in the rate of 106.7% was excessive and should be reduced to 20%: D63/96.

### **Appeal allowed in part.**

#### Cases referred to:

D58/87, IRBRD, vol 3, 11  
D68/95, IRBRD, vol 11, 93  
D25/97, IRBRD, vol 12, 204  
D100/97, IRBRD, vol 12, 544  
D10/98, IRBRD, vol 13, 108  
D125/98, IRBRD, vol 13, 574  
D133/98, IRBRD, vol 13, 619  
D150/98, IRBRD, vol 13, 704  
D177/98, IRBRD, vol 14, 62  
D26/99, IRBRD, vol 14, 288  
D31/99, IRBRD, vol 14, 341  
D41/99, IRBRD, vol 14, 437  
D112/99, IRBRD, vol 14, 642  
D91/99, IRBRD, vol 14, 598  
D81/97, IRBRD, vol 12, 475  
D13/99, IRBRD, vol 14, 174  
D118/99, IRBRD, vol 14, 673  
D138/99, IRBRD, vol 15, 61  
D36/00, IRBRD, vol 15, 356  
D4/84, IRBRD, vol 2, 94  
D24/85, IRBRD, vol 2, 190  
D34/88, IRBRD, vol 3, 336  
D42/88, IRBRD, vol 3, 395  
D53/88, IRBRD, vol 4, 10  
D52/93, IRBRD, vol 8, 372  
D24/96, IRBRD, vol 11, 467  
D55/00, IRBRD, vol 15, 542  
D65/00, IRBRD, vol 15, 610  
BR23/75, IRBRD, vol 1, 187

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D5/89, IRBRD, vol 4, 177  
D4/90, IRBRD, vol 5, 82  
D22/90, IRBRD, vol 5, 167  
D47/90, IRBRD, vol 5, 338  
D27/92, IRBRD, vol 7, 279  
D53/92, IRBRD, vol 7, 446  
D9/93, IRBRD, vol 8, 137  
D57/93, IRBRD, vol 9, 18  
D9/94, IRBRD, vol 9, 118  
D37/94, IRBRD, vol 9, 254  
D112/95, IRBRD, vol 11, 237  
D3/96, IRBRD, vol 11, 320  
D69/00, IRBRD, vol 15, 663  
D75/00, IRBRD, vol 15, 686  
D41/89, IRBRD, vol 4, 472  
D48/89, IRBRD, vol 4, 512  
D6/94, IRBRD, vol 9, 88  
D68/94, IRBRD, vol 9, 379  
D89/00, IRBRD, vol 15, 832  
D63/96, IRBRD, vol 11, 641

Ip Chui Wue Yun for the Commissioner of Inland Revenue.

Benny Y B Yeung of Messrs Cheng Yeung & Company, Solicitors, for the taxpayer.

### Decision:

1. This is an appeal against the following assessments (' the Assessments' ) all dated 16 February 2001 by the Commissioner of Inland Revenue, assessing the Taxpayer to additional tax under section 82A of the IRO in the following sums:

Year of assessment	Additional tax	Charge number
	\$	
1992/93	478,000	1-5024542-93-0
1993/94	1,032,000	1-5032368-94-4
1994/95	1,080,000	1-5055526-95-3
1995/96	932,000	1-3150795-96-4
1996/97	1,213,000	1-1151625-97-1
1997/98	3,543,000	1-2904951-98-7
1998/99	<u>2,197,000</u>	1-1111728-99-0
Total:	<u>10,475,000</u>	

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For the first five years, that is, the years of assessment 1992/93, 1993/94, 1994/95, 1995/96 and 1996/97, the relevant provision is section 82A(1)(a) of the IRO for making incorrect returns by understating profits.

For the remaining two years, that is, the years of assessment 1997/98 and 1998/99, the relevant provision is section 82A(1)(d) of the IRO for failing to comply with the requirements of the notices given to the Taxpayer under section 51(1) to furnish the profits tax returns within the time allowed.

### **The agreed facts**

2. Based on the agreed statement of facts, we make the following findings of fact.
3. The Taxpayer is appealing against the quantum of the additional tax imposed upon it under section 82A of the IRO. The Respondent assessed the Taxpayer to additional tax because he was of the opinion that the Taxpayer had, without reasonable excuse:
  - (a) made incorrect tax returns for the years of assessment 1992/93 to 1996/97 by omitting and understating profits chargeable to tax; and
  - (b) failed to comply with the requirements of the notices given to it under section 51(1) of the IRO to furnish the tax returns for the years of assessment 1997/98 and 1998/99 within the stipulated time.
4. In the written representation made in response to the section 82A(4) notice dated 22 December 2000 and in the statement of the grounds of appeal, the Taxpayer admitted that it does not have any reasonable excuse for the incorrect tax returns for the years of assessment 1992/93 to 1996/97 and for the late submission of returns for the years of assessment 1997/98 and 1998/99. The Taxpayer merely contended that the additional tax assessed is excessive in the circumstances of the case and that the Respondent did not take into account the mitigating factors.
5. The Taxpayer, Company A, was incorporated as a private company in Hong Kong in 1983. In the profits tax returns for the years of assessment 1992/93 and 1993/94, the Taxpayer described the nature of its business as ‘trading, import and export and etc’. In the profits tax returns for the years of assessment 1994/95 to 1998/99, the Taxpayer described the nature of its business as ‘manufacturing’. The products in which the Taxpayer dealt for all the relevant years were plastic toys and electrical appliances. The Taxpayer made up its accounts to 31 March every year.
6. The Taxpayer was solely managed by Mr B, the managing director. None of the other directors, including Mr B’s wife, brother-in-law and sons, was involved in the Taxpayer’s operations.

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7. Mr B is also the chairman (董事長) of Company A-Panyu and is a director of Company A-International and of Company C. Company A-Panyu was incorporated as a wholly owned foreign enterprise in Mainland China. Company A-International and Company C were incorporated as private companies in Hong Kong.

8. Company A-International manufactured electrical appliances and Company A-Panyu was its sub-contractor. The Taxpayer then purchased electrical appliances from Company A-International. The arrangement ceased some time in the year of assessment 1994/95 and thereafter the Taxpayer directly engaged Company A-Panyu as a sub-contractor.

9. Company C was beneficially owned as to 50% by Mr B and the other 50% by an Italian national, Mr D. It was set up in 1992 as a joint venture between Mr B and Mr D mainly to co-ordinate the manufacturing and export of plastic toys designed by Mr D. The manufacture of plastic toys required by Company C for export overseas was sub-contracted to the Taxpayer and Company C charged in its accounts the sub-contractor's charges paid to the Taxpayer. The Taxpayer then placed orders to Company A-Panyu which provided manufacturing support to the Taxpayer. The arrangement ceased some time in the year of assessment 1994/95. Company C ceased business in 1995 and the export of both plastic toys and electrical appliances was all done by the Taxpayer directly thereafter.

10. On divers dates, the IRD issued profits tax returns for the years of assessment 1992/93 to 1998/99 under section 51(1) of the IRO, requiring the Taxpayer to complete and submit them within one month. Under the block extension scheme, the time period was extended to 15 November each year for taxpayers who are represented. The Taxpayer was late and did not submit its profits tax returns within the extended time period for all the years of assessment 1992/93 to 1998/99. The date of issue of return, the extended due date, the date of submission of return and assessable profits reported by the Taxpayer for each year from the year of assessment 1992/93 to 1998/99 are tabulated below:

Year of assessment	Date of issue of return	Extended due date for submission of return	Date of submission of return	Assessable profits per return \$
1992/93	1-4-1993	15-11-1993	17-3-1994	355,772
1993/94	6-4-1994	15-11-1994	16-1-1995	342,561
1994/95	3-4-1995	15-11-1995	7-2-1996	37,021
1995/96	1-4-1996	15-11-1996	7-3-1997	700,018
1996/97	1-4-1997	15-11-1997	27-12-1997	4,003,740
1997/98	1-4-1998	15-11-1998	7-6-1999	24,837,159
1998/99	1-4-1999	15-11-1999	29-2-2000	12,864,076



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11. After the Taxpayer had failed to submit its profits tax returns for the years of assessment 1992/93 to 1998/99 within the extended time period, the assessor raised on the Taxpayer estimated assessments. The Taxpayer objected to the estimated assessments. Some of the objections were invalid because they were not accompanied by duly completed tax returns. After the Taxpayer had submitted its profits tax returns and had validated its objections, the assessor revised the estimated assessments or raised additional assessments per assessable profits shown on the profits tax returns. The Taxpayer paid all the tax demanded under the revised assessments and additional assessments.

12. On 11 April 1997, the Respondent sent the Taxpayer a notice of intention to assess additional tax under section 82A because the Taxpayer failed to comply with the requirements of the notice under section 51(1) to submit the profits tax return for the year of assessment 1995/96 within the extended time period. The Taxpayer through Messrs Anthony Y T Tse & Company ('the First Representative') submitted a written representation. On 15 May 1997, the Respondent issued to the Taxpayer under section 82A a notice of assessment and demand for additional tax of \$10,000. The additional tax of \$10,000 represented 8.65% of the tax undercharged in consequence of the Taxpayer's failure to comply with the notice under section 51(1). The Taxpayer did not appeal against the assessment and paid the additional tax.

13. Sometime in January 1999, the assessor commenced a tax audit and investigated the tax affairs of the Taxpayer and other related parties including Company A-International. It appeared to the assessor that the Taxpayer had been assessed at less than the proper amount for the years of assessment 1992/93 and 1993/94. On 26 March 1999, the assessor raised an additional estimated assessment of \$5,000,000 for the year of assessment 1992/93. On 16 March 2000, the assessor raised an additional estimated assessment of \$16,000,000 for the year of assessment 1993/94. The Taxpayer objected to these estimated assessments on the ground that it did not make the additional profits.

14. Particulars of the estimated assessments, additional assessments, objections, dates of submission of returns and assessable profits returned are summarised below.

<b>Year of assessment</b>	<b>Date of estimated assessment</b>	<b>Amount of estimated assessable profits</b> \$	<b>Date of objection</b>	<b>Date of submission of return</b>	<b>Assessable profits per return</b> \$
1992/93	26-11-1993 26-3-1999	130,000 5,000,000	23-12-1993 30-3-1999	17-3-1994	355,772
1993/94	29-11-1994 16-3-2000	400,000 16,000,000	28-12-1994 5-4-2000	16-1-1995	342,561
1994/95	8-1-1996	410,000	7-2-1996	7-2-1996	37,021
1995/96	28-11-1996	340,000	30-12-1996	7-3-1997	700,018

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	10-2-1997	170,000	7-3-1997		
1996/97	28-11-1997	780,000	24-12-1997	27-12-1997	4,003,740
1997/98	27-11-1998	4,410,000	22-12-1998	7-6-1999	24,837,159
	25-2-1999	2,210,000	23-3-1999		
	29-4-1999	10,000,000	29-5-1999		
1998/99	30-11-1999	7,290,000	29-12-1999	29-2-2000	12,864,076

15. On 27 January 1999, the assessor informed the Taxpayer that he was investigating its tax affairs. The Taxpayer appointed the First Representative as tax representative.

16. On 8 March 1999, the assessor interviewed the Taxpayer. Prior to the interview, the assessor requested the First Representative to produce for examination the Taxpayer's accounting books and records.

17. On 8 March 1999, the assessor visited the office of the Taxpayer located at Address E and interviewed Mr B and Mr F, the accounts manager of the Taxpayer in the presence of Ms G of the First Representative. Mr B did not produce for examination any accounting books and records of the Taxpayer. Mr B and Mr F stated the following to the assessor:

- (a) The Taxpayer's profits tax returns and the attached financial statements and supporting schedules for the years of assessment 1992/93 to 1996/97 were correct.
- (b) The Taxpayer had not yet finalised its accounts for the year of assessment 1997/98. In the year of assessment 1997/98, the Taxpayer had a turnover of around \$140,000,000 and a profit of around \$10,000,000.

18. As Mr B estimated that the profit of the Taxpayer for the year of assessment 1997/98 was greater than the total profit assessed under the first and second estimated assessments, the assessor requested and Mr B agreed during the meeting on 8 March 1999 to place a deposit with the Respondent to cover any possible profits tax liability. On 10 March 1999, the Taxpayer wrote a cheque for \$1,000,000 payable to the Government of the Hong Kong Special Administrative Region.

19. By a letter dated 12 March 1999, the assessor requested the Taxpayer to furnish within 30 days its accounting books and records, together with the supporting documents, covering the period 1 April 1992 to 31 March 1998. The Taxpayer did not respond to the assessor's request.

20. On 29 April 1999, in the absence of return, the assessor raised the third additional estimated assessment of \$10,000,000 on the Taxpayer for the year of assessment 1997/98. The objection on behalf of the Taxpayer by the First Representative was invalid because a completed tax return was not submitted.

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21. On 7 June 1999, the First Representative on behalf of the Taxpayer submitted the profits tax return for the year of assessment 1997/98. The profits per audited accounts were \$26,200,767 and the assessable profits returned were \$24,837,159. On 15 June 1999, the assessor raised on the Taxpayer the fourth additional assessment of \$8,217,159 for the year of assessment 1997/98, being the difference between the assessable profits returned and the aggregate of profits assessed under the previous three estimated assessments. The Taxpayer did not object to the assessment and paid the tax.

22. While the Taxpayer had submitted its profits tax return for the year of assessment 1997/98, it did not produce for the assessor's examination any of its accounting books and records. The assessor reminded the First Representative to produce the Taxpayer's accounting books and records.

23. On 12 July 1999, the First Representative produced the Taxpayer's accounting books and records for the year of assessment 1997/98 to the assessor.

24. On 18 August 1999, the assessor issued a notice under section 51(4)(a) to the Taxpayer requiring the production within 14 days of accounting books and records covering the years of assessment 1992/93 to 1996/97. The Taxpayer ignored the assessor's notice and did not produce the accounting books and records within the stipulated time.

25. On 30 November 1999, the assessor raised on the Taxpayer in the absence of return an estimated assessment of \$7,290,000 for the year of assessment 1998/99. On 29 December 1999, the Taxpayer through the First Representative lodged an objection which was invalid because it did not submit the profits tax return for the year of assessment 1998/99. The grounds of objection were that 'the assessment was estimated only' and the Taxpayer 'had not earned such profit during the year'. The Taxpayer said that the accounts, tax computation and supporting schedules would be submitted to the IRD by 31 January 2000. However, by 31 January 2000, the Taxpayer failed to submit the profits tax return for the year of assessment 1998/99.

26. On 6 January 2000, the First Representative produced to the assessor the Taxpayer's general ledger for the year of assessment 1996/97.

27. On 11 January 2000, at the IRD's office, the assessor interviewed Mr B in the presence of Mr H of the First Representative. During the interview, the assessor reminded Mr B that the extended time period to 15 November 1999 for the submission of the return for the year of assessment 1998/99 had already expired and that the Taxpayer had not yet furnished its profits tax return. The assessor pointed out that the Taxpayer had persistently failed to submit its profits tax returns within the stipulated time periods for a number of consecutive years starting from the year of assessment 1992/93 and that the Respondent took a very serious view of the offences repeatedly committed by the Taxpayer.

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28. During the interview on 11 January 2000, the assessor told Mr B of the audit findings after his investigation of the Taxpayer's and other related parties' affairs for the years of assessment 1996/97 and 1997/98:

- (a) Mr B was challenged on the correctness of the sub-contracting fees charged in the accounts for the year of assessment 1996/97, an amount of \$1,000,000 per month totalling \$12,000,000 for the whole year. Mr B was asked to provide documentary evidence to show that Company A-Panyu was paid the sub-contracting fees for the year of assessment 1996/97 because the fees had been credited to the director's current account in the books of the Taxpayer.
- (b) Mr B was shown a schedule prepared by Company C in which it was recorded that sub-contractor's charges of \$16,802,112 were paid to the Taxpayer for the year ended 31 December 1994. Mr B was asked to explain the omission of this income in the Taxpayer's accounts. Mr B did not give an immediate answer but agreed to follow up the matter.
- (c) Mr B was asked to explain why the net deposits into the respective bank accounts exceeded the reported turnover of the Taxpayer for the years of assessment 1993/94 to 1996/97 and of the reported turnover of Company A-International for the year of assessment 1993/94. Mr B was shown an analysis of bank deposits. The details of excess bank deposits identified for the Taxpayer are as follows:

	<b>1993/94</b>	<b>1994/95</b>	<b>1995/96</b>	<b>1996/97</b>
	\$	\$	\$	\$
Net bank deposit	117,118,091.41	63,959,475.23	105,374,665.83	108,014,372.35
Reported income	<u>38,734,379.69</u>	<u>39,045,483.11</u>	<u>64,370,317.93</u>	<u>100,199,713.97</u>
Excess deposit	<u><u>78,383,711.72</u></u>	<u><u>24,913,992.12</u></u>	<u><u>41,004,347.90</u></u>	<u><u>7,814,658.38</u></u>

- (d) Mr B reaffirmed that the Taxpayer did not make incorrect profits tax returns by omitting or understating income. He agreed to follow up the various matters raised by the assessor during the interview.

29. On 17 January 2000, the Taxpayer appointed Messrs Tony Kwok Tung Ng & Company ('the Second Representative') as tax representative.

30. On 26 January 2000, the Second Representative informed the assessor that the Taxpayer had appointed their firm to audit the accounts for the year of assessment 1998/99.

31. On 29 February 2000, the Second Representative submitted on behalf of the Taxpayer the profits tax return for the year of assessment 1998/99. The profit per the audited accounts was

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\$27,577,206. The Taxpayer claimed that its profits were only partly chargeable to Hong Kong profits tax and the portion of profits derived from Hong Kong in the year of assessment 1998/99 assessable was a sum of \$12,864,076. On 23 March 2000, the assessor issued to the Taxpayer an additional profits tax assessment of \$5,574,076 for the year of assessment 1998/99 which was the difference between the assessable profits returned and the profits previously estimated and assessed. The Taxpayer did not object to the assessment and paid the tax.

32. On 27 April 2000, the Second Representative submitted:

- (a) analyses of the sums deposited into the Taxpayer's bank accounts for the years of assessment 1994/95 and 1995/96;
- (b) revised manufacturing, trading and profit and loss accounts of the Taxpayer and of Company A-International for the years of assessment 1992/93 to 1996/97; and
- (c) calculations showing the understated assessable profits and resulting profits tax liabilities of the Taxpayer and of Company A-International.

In the revised accounts for the year of assessment 1996/97, the Second Representative substituted a total factory cost of \$34,353,525 incurred by Company A-Panyu and manufacturing expenses of \$1,659,470 paid by the Taxpayer in Hong Kong (totalling \$36,012,995) in lieu of total sub-contracting charges claimed in the accounts of the Taxpayer of \$49,793,304, thus reducing the cost of sales in the accounts of the Taxpayer by \$13,780,309 (\$49,793,304 minus \$36,012,995). Relying on the guidelines of Departmental Interpretation and Practice Note No 21, the Second Representative proposed and the assessor conceded that the profits of the Taxpayer be apportioned on a 50:50 basis. Revised profits of the Taxpayer for the relevant years were prepared on this basis for consideration of the assessor.

<b>Year of assessment</b>	<b>Assessable profits/(loss)</b>	<b>Profits assessed</b>	<b>Additional assessable profits</b>
	\$	\$	\$
1994/95	1,144,201	37,021	1,107,180
1995/96	3,228,662	700,018	2,528,644
1996/97	<u>9,015,041</u>	<u>4,003,740</u>	<u>5,011,301</u>
Total	<u><u>13,387,904</u></u>	<u><u>4,740,779</u></u>	<u><u>8,647,125</u></u>

33. On 28 April 2000, at the IRD's office, the assessor interviewed Mr B in the presence of Mr F and Mr Samuel Chiu (' Mr Chiu ') of the Second Representative. During the interview, the Second Representative submitted analyses of the sums deposited into the Taxpayer's bank accounts for the year of assessment 1996/97. Having examined the bank deposit analysis, the assessors requested a breakdown of the director's current account with the Taxpayer for all the relevant years. The assessor told the Second Representative that the proposal submitted by them

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on 27 April 2000 was unacceptable because it did not take into account as profits the unexplained excess bank deposits, the sums credited into the director's current account with the Taxpayer and the omitted income received from Company C. Mr B insisted that the transactions by the Taxpayer were correctly recorded and all income was reflected in the accounts already.

34. On 17 May 2000, the Second Representative submitted analyses of sums credited to the director's current account for the years of assessment 1993/94 to 1996/97, analyses of bank deposits of Company A-International for the years of assessment 1994/95 and 1995/96, revised manufacturing, trading and profit and loss accounts of the Taxpayer and of Company A-International for the years of assessment 1992/93 to 1996/97 and calculations showing the understated assessable profits and resulting profits tax liabilities of the Taxpayer and of Company A-International. The Second Representative reported that their analyses of the bank deposits include the following:

- (a) For the year of assessment 1994/95, sub-contracting income of \$22,159,903 from Company C was deposited in the bank accounts of the Taxpayer. This partly explained the excess of bank deposits over reported turnover. The Second Representative stated in a covering letter submitted with the analyses that, for the sake of an amicable settlement of the case, the Taxpayer agreed to offer the amounts for assessment of tax in Hong Kong.
- (b) For the year of assessment 1995/96, the Second Representative identified \$875,267 being sale proceeds omitted from the books. In addition, amounts totalling \$5,664,438 deposited in the bank accounts and credited to the director's current account with the Taxpayer were not identified. The Second Representative agreed that these amounts should be treated as omitted income of the Taxpayer.
- (c) The Second Representative claimed and the assessor conceded that 50% of the profits of the Taxpayer for the relevant years were derived from operations inside Hong Kong and that the following additional assessable profits of the Taxpayer were chargeable to profits tax.

Year of assessment	Assessable profits/(loss)	Profits assessed	Additional assessable profits
	\$	\$	\$
1994/95	2,252,196	37,021	2,215,175
1995/96	3,882,632	700,018	3,182,614
1996/97	<u>9,015,041</u>	<u>4,003,740</u>	<u>5,011,301</u>
Total	<u>15,149,869</u>	<u>4,740,779</u>	<u>10,409,090</u>

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35. Having reviewed the facts again, the assessor informed Mr Chiu on 19 June 2000 that in the proposal submitted by the Second Representative on 17 May 2000, the dubious sub-contracting fees for the year of assessment 1997/98 had not been added back and that the omitted incomes from Company C for the year of assessment 1992/93 had not been included as assessable profits.

36. On 24 July 2000, the assessor followed up the matters in paragraph 35 with Mr Chiu. In response to his request, the assessor sent Mr Chiu and Mr B a draft computation of assessable profits of the Taxpayer and of Company A-International. The assessor, while recognizing that 50% of the profits were derived from Hong Kong and were chargeable to profits tax, incorporated, inter alia, the following adjustments.

- (a) The Taxpayer's reported cost of sales for the year of assessment 1997/98 was reduced by \$16,537,883. The adjustment was to disallow sub-contracting fees to the extent of \$12,537,883 which were not paid and sub-contracting fees of \$4,000,000 which were found to be dubious and without any documentary support. The Taxpayer's profits were increased to \$42,738,650. The manufacturing profits were then apportioned on a 50:50 basis and the resulting assessable profits became \$21,151,286. As the disallowance of sub-contracting fees would not result in assessable profits being greater than the returned profits of \$24,837,159, the disallowance was accepted by the Taxpayer.
- (b) The Taxpayer's unexplained bank deposits of \$6,539,705 for the year of assessment 1995/96 and unexplained bank deposits of \$377,143 and omitted interest income of \$370,659 for the year of assessment 1996/97 were added back as chargeable profits. The cost of sales for the year of assessment 1996/97 was revised to \$76,925,217 after applying the reduction of \$13,780,309 as stated in paragraph 32. The gross profit to turnover ratio for the year of assessment 1996/97 was also applied to project the profits for other years of assessment 1992/93 to 1995/96 as the Taxpayer did not furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98. Having regard to the close trading relationship between the Taxpayer and Company A-International for the years of assessment 1992/93 and 1993/94 and in the absence of accounting records, their aggregate understated gross profits for these two years were apportioned between the Taxpayer and Company A-International in accordance with the original reported gross profits.
- (c) The profits resulting from the sums received from Company C for the years of assessment 1992/93 to 1994/95 were included as chargeable profit of the Taxpayer.

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- (d) Interest expenses of \$218,357 for the Taxpayer under overdraft facilities secured by directors' deposits were added back.

37. On 4 August 2000, the Second Representative submitted revised proposals on behalf of the Taxpayer and of Company A-International agreeing the revised assessable profits for the years of assessment 1992/93 to 1998/99 and for the years of assessment 1992/93 to 1995/96 respectively. These proposals largely followed the assessor's draft computation of assessable profits passed to My Chiu on 24 July 2000 as stated in paragraph 36. The following is a summary of the proposed assessable profits and returned assessable profits of the Taxpayer:

Year of assessment	Revised assessable profit agreed \$	Assessable profit per return \$	Discrepancies \$
1992/93	2,176,832	355,772	1,821,060
1993/94	4,273,962	342,561	3,931,401
1994/95	4,400,983	37,021	4,363,962
1995/96	4,714,759	700,018	4,014,741
1996/97	9,580,269	4,003,740	5,576,529
1997/98	21,151,286	24,837,159	(3,685,873)
1998/99	<u>12,903,489</u>	<u>12,864,076</u>	<u>39,413</u>
Total	<u>59,201,580</u>	<u>43,140,347</u>	<u>16,061,233</u>

38. On 10 October 2000, revised profits tax assessments for the years of assessment 1992/93, 1993/94 and 1997/98 and additional profits tax assessments for the years of assessment 1994/95 to 1996/97 in accordance with the proposed assessable profits stated in paragraph 37 were issued to the Taxpayer. Additional assessment for the year of assessment 1998/99 was not raised on the Taxpayer as the discrepancy of \$39,413 representing non-deductible overdraft interest had already been adjusted in the profits tax return filed on 29 February 2000.

39. The Taxpayer's assessable profits before and after tax audit were:

Year of assessment	Profits before tax audit and investigation \$	Profits after tax audit and investigation \$	Profits understated \$
1992/93	355,772	2,176,832	1,821,060
1993/94	342,561	4,273,962	3,931,401
1994/95	37,021	4,400,983	4,363,962
1995/96	700,018	4,714,759	4,014,741
1996/97	4,003,740	9,580,269	5,576,529
1997/98	0	21,151,286	21,151,286 (Note)
1998/99	<u>0</u>	<u>12,864,076</u>	<u>12,864,076 (Note)</u>
Total	<u>5,439,112</u>	<u>59,162,167</u>	<u>53,723,055</u>



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The percentage of profits understated to total profits after tax audit and investigation is 90.8%.

Note: The profits understated for the years of assessment 1997/98 and 1998/99 represent profits which were not reported within the time allowed under section 51(1) of the IRO.

40. On 12 December 2000, the Respondent gave notice to the Taxpayer of his intention to assess additional tax under section 82A(4) in respect of the Taxpayer's offences committed by:

- (a) making incorrect tax returns for the years of assessment 1992/93 to 1996/97; and
- (b) failure to comply with the requirements of the notices given to him under section 51(1) of the IRO to furnish the tax returns for the years of assessment 1997/98 and 1998/99 within the time allowed.

41. By a letter dated 22 December 2000, the Second Representative submitted on behalf of the Taxpayer written representations to the Respondent. Having considered and taken into account the Taxpayer's representations, the Respondent issued on 16 February 2001 the following notices of assessment and demand for additional tax under section 82A of the IRO:

<b>Year of assessment</b>	<b>Tax undercharged</b>	<b>Additional tax under section 82A</b>	<b>Additional tax as percentage of tax undercharged</b>
	\$	\$	%
1992/93	318,685	478,000	150
1993/94	687,995	1,032,000	150
1994/95	720,054	1,080,000	150
1995/96	662,433	932,000	140.7
1996/97	920,127	1,213,000	131.8
1997/98	3,140,965	3,543,000	112.8
1998/99	<u>2,058,252</u>	<u>2,197,000</u>	106.7
Total	<u>8,508,511</u>	<u>10,475,000</u>	123.1

42. By a letter dated 14 March 2001, the Taxpayer through Messrs Cheng, Yeung & Company ('the Third Representative') gave notice of appeal to the Board of Review against the above assessments to additional tax.

### **The appeal hearing**

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43. At the hearing of the appeal, the Taxpayer was represented by Mr Benny Y B Yeung of the Third Representative together with Mr Chiu of the Second Representative. The Respondent was represented by Mrs Ip Chui Wue-yun.

44. Mr Benny Y B Yeung called Mr B and Mr F to give oral evidence. Mrs Ip Chui Wue-yun called Mr Yip Chi-chuen, one of the assessors in the investigation into the Taxpayer's case, as a witness.

45. Mr Benny Y B Yeung supplied us with two bundles of authorities containing copies of the following Inland Revenue Board of Review Decisions. His citation was incomplete in that neither the volume number nor the page number of the report were quoted and we were obliged to find and supply them, as in the following list:

- (a) D58/87, IRBRD, vol 3, 11
- (b) D68/95, IRBRD, vol 11, 93
- (c) D25/97, IRBRD, vol 12, 204
- (d) D100/97, IRBRD, vol 12, 544
- (e) D10/98, IRBRD, vol 13, 108
- (f) D125/98, IRBRD, vol 13, 574
- (g) D133/98, IRBRD, vol 13, 619
- (h) D150/98, IRBRD, vol 13, 704
- (i) D177/98, IRBRD, vol 14, 62
- (j) D26/99, IRBRD, vol 14, 288
- (k) D31/99, IRBRD, vol 14, 341
- (l) D41/99, IRBRD, vol 14, 437
- (m) D112/99, IRBRD, vol 14, 642
- (n) D91/99, IRBRD, vol 14, 598
- (o) D81/97, IRBRD, vol 12, 475

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- (p) D13/99, IRBRD, vol 14, 174
- (q) D118/99, IRBRD, vol 14, 673
- (r) D138/98 [an error for D138/99], IRBRD, vol 15, 61
- (s) D36/00, IRBRD, vol 15, 356

46. Mrs Ip Chui Wue-yun cited the following authorities:

- (a) D4/84, IRBRD, vol 2, 94
- (b) D24/85, IRBRD, vol 2, 190
- (c) D34/88, IRBRD, vol 3, 336
- (d) D42/88, IRBRD, vol 3, 395
- (e) D53/88, IRBRD, vol 4, 10
- (f) D52/93, IRBRD, vol 8, 372
- (g) D24/96, IRBRD, vol 11, 467
- (h) D82/97, IRBRD, vol 12, 475
- (i) D31/99, IRBRD, vol 14, 341
- (j) D55/00, IRBRD, vol 15, 542
- (k) D65/00, IRBRD, vol 15, 610

### **Our decision**

47. Of the three possible grounds of appeal under section 82B(2) of the IRO, the Taxpayer relied only on the ground under section 82B(2)(c) that the Assessments were excessive having regard to the circumstances. The onus of proving that the Assessments are excessive is on the Taxpayer [sections 68(4) and 82B(3) of the IRO].

48. Neither Mr B nor Mr F impressed us as a credible witness and we reject their testimonies.

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49. We find Mr Yip Chi-chuen a truthful witness and we accept his evidence.

### **Ignorance of law and lack of education**

50. Mr Benny Y B Yeung accepted that:

‘ it is not a reasonable excuse that the managing director had no accounting background as was the fact he relied on others who did not have sufficient expertise’ ;

but contended that:

‘ whilst ignorance of the law and lack of education is no excuse, it is a relevant consideration when assessing penalties’ , citing D58/87.

51. The weight to be attached to a relevant factor depends on the facts of each particular case. Having regard to the Taxpayer’s eight to nine digit turnover [paragraph 28(3)] and seven to eight digit profits (paragraph 39), we attach no weight to this factor. With turnover and profits at this level, the Taxpayer should have employed or instructed a person or persons competent to handle its accounting and taxation matters, D65/00. The Taxpayer has only itself to blame for its failure or refusal to do so. Mr F is clearly not competent as an accounting manager.

### **Percentage of profits understated for late returns**

52. While Mr Benny Y B Yeung accepted that the table in paragraph 39 is arithmetically correct, he submitted that the percentage of 90.8% was distorted because it took into account the understatements for the last two years where the penalty was for late returns; and that the percentage of profits understated to total profits after tax audit and investigations for the first five years was 78.4%.

53. In the case of a late but correct return, the primary consideration is the degree of lateness. It may therefore be inappropriate to punish on the basis of 100% understatement of profits although this is technically correct. Compare the case of a taxpayer filing a correct return one day late with the case of another taxpayer filing the return on time but deliberately understating his profits by 90%. The percentage for the former is 100% whereas the percentage for the latter is only 90%, despite the fact that the latter is more culpable than the former.

54. There may of course be cases where 100% is the appropriate percentage, for example, cases where the taxpayer has filed no return for a number of years, whether or not followed by failure to notify chargeability in subsequent years.

55. We therefore considered the first five years on the basis of a 78.4% understatement.

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### **Whether deliberate scheme or system to conceal taxable income**

56. Mr Benny Y B Yeung submitted that there was:

- ‘ no suggestion that the Taxpayer had embarked upon any deliberate scheme or system to conceal its taxable income’ ; and that
- ‘ analysis of what the understated profit will see that they mainly concern with apportionment of income between Company A-Panyu and the Taxpayer’ .

57. This submission flies in the face of the agreed facts.

#### Year of assessment 1992/93

- (a) As the Taxpayer did not furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98, the gross profit to turnover ratio for the year of assessment 1996/97 was applied to project the profit [paragraphs 36(2) and 37].
- (b) In the absence of accounting records, the aggregate understated gross profits for the Taxpayer and Company A-International were apportioned between them in the amounts of gross profit reported [paragraphs 36(2) and 37].
- (c) The profit resulting from the sums received from Company C was included as chargeable profit [paragraphs 36(3) and 37].

#### Year of assessment 1993/94

- (a) Net bank deposits exceeded reported income by \$78,383,711.72 [paragraph 28(3)].
- (b) As the Taxpayer did not furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98, the gross profit to turnover ratio for the year of assessment 1996/97 was applied to project the profit [paragraphs 36(2) and 37].
- (c) In the absence of accounting records, the aggregate understated gross profits for the Taxpayer and Company A-International were apportioned between them in the amounts of gross profit reported [paragraphs 36(2) and 37].

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- (d) The profit resulting from the sums received from Company C was included as chargeable profit [paragraphs 36(3) and 37].

### Year of assessment 1994/95

- (a) Company C recorded sub-contractor's charges of \$16,802,112 paid to the Taxpayer for the year ended 31 December 1994. This income was omitted in the Taxpayer's accounts [paragraph 28(2)].
- (b) Net bank deposits exceeded reported income by \$24,913,992.12 [paragraph 28(3)].
- (c) As the Taxpayer did not furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98, the gross profit to turnover ratio for the year of assessment 1996/97 was applied to project the profit [paragraphs 36(2) and 37].
- (d) The profit resulting from the sums received from Company C was included as chargeable profit [paragraphs 36(3) and 37].

### Year of assessment 1995/96

- (a) Net bank deposits exceeded reported income by \$41,004,347.9 [paragraph 28(3)].
- (b) Unexplained bank deposits of \$6,539,705 were added back as chargeable profit [paragraphs 34(2), 36(1) and 37].
- (c) As the Taxpayer did not furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98, the gross profit to turnover ratio for the year of assessment 1996/97 was applied to project the profit [paragraphs 36(2) and 37].

### Year of assessment 1996/97

- (a) Sub-contracting fees of \$1,000,000 per month totalling \$12,000,000 for the whole year were charged to Company A-Panyu but credited to the director's current account with the Taxpayer [paragraph 28(1)].
- (b) Net bank deposits exceeded reported income by \$7,814,658.38 [paragraph 28(3)].

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- (c) The Second Representative submitted revised accounts reducing the cost of sales by \$13,780,309 [paragraph 32].
- (d) Unexplained bank deposits of \$377,143 and omitted interest income of \$370,143 were added back as chargeable profit [paragraphs 36(1) and 37].
- (e) The cost of sales was reduced by \$13,780,309 [paragraphs 36(2) and 37].

### **Level of co-operation**

58. Mr Benny Y B Yeung submitted that the Taxpayer did co-operate with the IRD during the investigation; that the Taxpayer showed good faith in changing its tax representative; that the Taxpayer demonstrated goodwill by promptly paying a deposit of \$1,000,000 to the IRD; and that the investigation was concluded in 18 months or around six months after the appointment of the Second Representative.

59. The \$1,000,000 deposit was tendered on 10 March 1999. The extended due date for the return for the year of assessment 1997/98 was 15 November 1998 and had the Taxpayer reported the correct amount of profit, that is, \$21,151,286, by the extended due date, the tax thereon would have been \$3,140,965.

60. We accept that concluding the investigation in around 18 months or around six months after the appointment of the Second Representative evidences some co-operation by the Taxpayer; but that co-operation was limited.

61. Despite repeated written requests and demands, the Taxpayer refused or failed to furnish any records other than the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98. The Taxpayer sought to put the blame for this on the First Representative. In our opinion, this is both irresponsible and reprehensive.

- (a) The assessor's demand dated 18 August 1999 for production of records was issued under section 51(4)(a) of the IRO.
- (b) The Second Representative was appointed in January 2000.
- (c) Had the Taxpayer, as advised by the Second Representative, intended to be truly co-operative, the Taxpayer would and should have taken prompt steps to comply with the outstanding statutory notice dated 18 August 1999.
- (d) The Taxpayer remained in default throughout.

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- (e) It is an agreed fact that ‘the Taxpayer ignored the assessor’s notice...’ (paragraph 24).
- (f) The investigation was concluded by projecting the gross profit to turnover ratio for the year of assessment 1996/97 to the four preceding years and by aggregating the understated gross profits of the Taxpayer and of Company A-International for the years of assessment 1992/93 and 1993/94 and apportioning them in accordance with the amounts of gross profit reported.

62. At the meeting on 8 March 1999, Mr B and Mr F alleged that the profits tax returns and the attached financial statements and supporting schedules for the years of assessment 1992/93 to 1996/97 were correct. Mr B alleged at the interview on 11 January 2000 that the Taxpayer did not make incorrect profits tax returns by omitting or understating income. At the meeting on 28 April 2000, in response to the assessor’s explanation as to why the proposal submitted on the previous day was unacceptable to the assessor, Mr B insisted that the transactions were correctly recorded and that all income was already reflected in the accounts, while continuing to ignore the notice dated 18 August 1999.

### **Whether penalty highest in past four years**

63. Mr Benny Y B Yeung contended that:

‘A review of the reports from 1997 to 2000 of decisions in recent years appealed to the Board of Review show that the rates of additional tax assess for ... cases of incorrect of returns of profits tax ranged from **48.77%** to **150%** of tax undercharged.

... the rates of additional tax charged is the highest and far exceeds the maximum that have ever been imposed for the past four years’ .

64. The second part of the contention does not follow from the first. The rates in the Taxpayer’s case range from 131.8% to 150%.

65. Mr Benny Y B Yeung did not supply us with the rates in cases where the taxpayer did not appeal and for unreported decisions of the Board of Review.

66. Mr Benny Y B Yeung did not justify his proposition that ‘the rates of additional tax charged is the highest and far exceeds the maximum that have ever been imposed for the past four years’ . In D36/00, the Board of Review, chaired by the current Chairman of the Board of Review, upheld a penalty of 150%.



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67. Mr Benny Y B Yeung did not even attempt to justify the proposition that the additional tax in this case is out of line with reported decisions of the Board of Review. He neither cited all the reported decisions in the past four years nor a representative sample of all the reported cases.

68. The Respondent, the Commissioner of Inland Revenue, has access to all decisions of the Board of Review, reported or otherwise, and his or her representative should cite all cases relevant to a contention that additional tax is out of line with previous decisions.

69. We see no reason to restrict citation of authorities to cases reported in the past four years. The existence of an earlier authority might explain why the taxpayer did not appeal in some cases or why some Board of Review decisions were not reported. Neither representative cited any of the following cases which are not exhaustive and are relevant to our decision:

- (a) The following passages appear in BR23/75, IRBRD, vol 1, 187 at pages 188 to 189:

*‘Under section 82A of the Inland Revenue Ordinance, the Appellant is liable to a penalty of double the amount of tax which has been undercharged. (This section has since been amended to increase the penalty to treble the amount but the amendment has no application to the case under review).*

*As far as we know there is no hard and fast rule by which the Commissioner determines the penalty to be imposed. It is not uncommon to find cases in which a full penalty has been exacted. Clearly, if a taxpayer’s wilful omission is flagrant a maximum additional tax may be appropriate as a strong deterrent. The circumstances of each particular case must be examined at and if liability is established then any assessment by way of additional tax will not be disturbed unless in the opinion of the Board the additional assessment is excessive.*

*The amount of additional tax originally imposed was \$103,700 which includes compound interest on the tax lost to the Inland Revenue Department. This is less than 75% of the Appellant’s maximum liability. This figure was subsequently reduced by the Commissioner to \$86,000 ...*

*We do not regard the additional tax imposed by the Commissioner to be excessive having regard to the circumstances of the case.’*

- (b) D5/89, IRBRD, vol 4, 177 (130%)
- (c) D4/90, IRBRD, vol 5, 82 (134%)

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- (d) D22/90, IRBRD, vol 5, 167 (increased to 200%)
- (e) D47/90, IRBRD, vol 5, 338 (134%)
- (f) D27/92, IRBRD, vol 7, 279 (141%)
- (g) D53/92, IRBRD, vol 7, 446 (increased to 200%)
- (h) D9/93, IRBRD, vol 8, 137 (128%)
- (i) D57/93, IRBRD, vol 9, 18 (about 133%)
- (j) D9/94, IRBRD, vol 9, 118 (about 130%)
- (k) D37/94, IRBRD, vol 9, 254 (104% and 108% too low)
- (l) D112/95, IRBRD, vol 11, 237 (149%)
- (m) D3/96, IRBRD, vol 11, 320 (115% and 127%)
- (n) D69/00, IRBRD, vol 15, 663 (116%)
- (o) D75/00, IRBRD, vol 15, 686 (124%)

### **The Commissioner's penalty policy**

70. In answer to the chairman's question, Mrs Ip Chui Wue-yun told us that the Commissioner classified this case under 'Group (b)' of 'Incomplete or Belated Disclosures' for all seven years. As she did not defend any of the Assessments with reference to the Commissioner's penalty policy, we express no view on the Commissioner's penalty policy.

### **Previous additional tax assessment for the year of assessment 1995/96**

71. As Mr Benny Y B Yeung made no comment on the two separate penalties imposed for the year of assessment, that is, 1995/96 on 15 May 1997 (in respect of the return's lateness) and on 16 February 2001 (in respect of its incorrectness), we did not consider this point.

### **Whether excessive in the circumstances for the years of assessment 1992/93 to 1996/97**

72. This is a serious case of understatement, both in terms of the dollar amounts of the understated profit (\$19,707,693) and of the percentage of understatement (78.4%). Having

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understated profits at this level over a period of five years, the Taxpayer cannot reasonably expect much sympathy.

73. In the light of the Taxpayer's eight to nine digit turnover and seven to eight digit profits, we have no sympathy with the Taxpayer's apparent ignorance of law or with its apparent lack of accounting knowledge or experience.

74. The Taxpayer overstated its expenses and understated its income.

75. The Taxpayer partially mitigated the damage caused by its breaches of the law by giving the IRD limited co-operation.

76. However, the Taxpayer was in serious default by failing or refusing to produce to the IRD any accounting records, with the exception of the general ledger for the year of assessment 1996/97 and the accounting books for the year of assessment 1997/98; and furthermore during the investigation, the Taxpayer aggravated its breaches by repeatedly alleging that it had filed correct returns.

77. The maximum penalty for which the Taxpayer is liable is 300% of the amount of tax undercharged or which would have been undercharged.

78. We have carefully considered all the points raised by the Taxpayer orally and in writing. In our decision, none of the Assessments for the years of assessment 1992/93 to 1996/97 is excessive.

### **Whether more than ten times the rates in the past four years**

79. Mr Benny Y B Yeung contended that:

‘ A review of the reports from 1997 to 2000 of decisions in recent years appealed to the Board of Review show that the rates of additional tax assess for ... cases of late submission of profits tax returns ranged from **2.47%** to **26.31%** of tax undercharged. ... In respect of the late submission of returns, the rate of additional tax charged is, in some cases, more than ten times the rates which have been charged in the past four years.’

80. Again, as in paragraph 63 above the second part of his contention does not follow from the first. The rate for the year of assessment 1997/98 is 112.8% and the rate for the year of assessment 1998/99 is 106.7%.

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81. The following cases [(a) and (b) were cited by Mrs Ip Chui Wue-yun but the remaining cases were not cited by either representative] show that the maximum previously imposed for late returns is much greater than 26.31%:

- (a) D34/88 (75% to 100%)
- (b) D65/00 (increased to 100%)
- (c) D41/89, IRBRD, vol 4, 472 (increased to 100%)
- (d) D48/89, IRBRD, vol 4, 512 (55% and 63%)
- (e) D6/94, IRBRD, vol 9, 88 (40%)
- (f) D68/94, IRBRD, vol 9, 379 (48.16%)
- (g) D89/00, IRBRD, vol 15, 832 (86% and 96%)

### **Whether excessive in the circumstances for the year of assessment 1997/98**

82. The Taxpayer is a repeat offender. Despite the 15 May 1997 additional tax assessment at 8.65% for late 1995/96 return, the Taxpayer was still late in filing the return for the year of assessment 1996/97 (submitted on 27 December 1997 after the extension of the due date to 15 November 1997). The return for the year of assessment 1997/98 was not filed until 7 June 1999, more than six and a half months after the extended due date of 15 November 1998.

83. Mr B testified that upon being informed in about January 1999 of the intended field audit, the First Representative ‘immediately withheld’ submitting the tax return for the year of assessment 1997/98 because they needed to review the tax return thoroughly. As Mrs Ip Chui Wue-yun pointed out in her cross-examination, Mr B’s statement is contradicted by his previous assertion on 8 March 1999 that the Taxpayer had not yet finalised its accounts for the year of assessment 1997/98 [paragraph 17(2)].

84. Even if we had accepted Mr B’s evidence, which we do not, this would not have helped the Taxpayer. The return for the year of assessment 1997/98 should have been furnished by 15 November 1998 and the Taxpayer should have furnished a true and correct return.

85. The Taxpayer made dubious claims in respect of its cost of sales in an attempt to understate its profits and this distinguishes this case from cases where taxpayers filed true and correct returns out of time.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) In the Taxpayer's general ledger, sub-contracting fees of \$60,791,000 were said to have been paid to Company A-Panyu in the year of assessment 1997/98. When Mr Yip Chi-chuen examined the accounting books and records, he found only six invoices aggregating \$14,734,238, the balance of \$46,057,667 not being supported by any invoice or other documentary evidence. The six invoices were all made out by Company A-Panyu to itself.
- (b) Mr Yip Chi-chuen discovered that sub-contracting fees of \$12,537,883 had never been paid to Company A-Panyu.
- (c) Mr Yip Chi-chuen also found two payments of \$2,000,000 claimed to have been paid to Company A-Panyu which had in fact been paid to Company I by means of cheques signed by Mr B. Mr B told the IRD that he had no knowledge of the owners of Company I and that he had no relationship with Company I. However, Mr Yip Chi-chuen obtained a cheque issued by Company I in favour of Mr B and signed by Mr B himself in the sum of \$20,000,000 and deposited into one of Mr B's accounts.
- (d) The Taxpayer's reported cost of sales for the year of assessment 1997/98 was reduced by \$16,537,883 (\$12,537,883 not paid and \$4,000,000 dubious and without any documentary support [paragraphs 36(1) and 37]) and the profit was increased to \$42,738,650. The Respondent's concession that 50% of the profit could be regarded as derived from operations inside Hong Kong explains why the profit after tax audit and investigation was less than the profit before tax audit and investigation by \$3,685,873.

86. We have carefully considered all the points raised by the Taxpayer orally and in writing. In our decision, the Assessment for the year of assessment 1997/98 is not excessive.

### **Whether excessive in the circumstances for the year of assessment 1998/99**

87. The year of assessment 1998/99 is different from the year of assessment 1997/98 in two material respects.

88. The first is that the Taxpayer was again late, not filing the return until 29 February 2000, about three and a half months after the extended due date of 15 November 1999, despite an oral warning on 11 January 2000 (paragraph 27).

89. More significantly, the return was accepted by Mrs Ip Chui Wue-yun as true and correct and she did not rely on the \$39,413 difference which had already been adjusted in the return filed on 29 February 2000 (paragraphs 37 and 38).

## INLAND REVENUE BOARD OF REVIEW DECISIONS

90. We have carefully considered all the points raised by the Taxpayer and by the Respondent orally and in writing. In our decision, the additional tax for the year of assessment 1998/99 at \$2,197,000 (106.7%) is excessive and should be reduced to \$411,650 (20%), compare D63/96, IRBRD, vol 11, 641.

### Disposition

91. Except for the Assessment for the year of assessment 1998/99 which we reduce from \$2,197,000 to \$411,650, we dismiss the appeal and confirm the Assessments.

<b>Year of assessment</b>	<b>Additional tax</b>	<b>Charge number</b>	<b>Decision</b>
	\$		
1992/93	478,000	1-5024542-93-0	Confirm
1993/94	1,032,000	1-5032368-94-4	Confirm
1994/95	1,080,000	1-5055526-95-3	Confirm
1995/96	932,000	1-3150795-96-4	Confirm
1996/97	1,213,000	1-1151625-97-1	Confirm
1997/98	3,543,000	1-2904951-98-7	Confirm
1998/99	2,197,000	1-1111728-99-0	Reduce to \$411,650

92. We thank Mr Benny Y B Yeung and Mrs Ip Chui Wue-yun for their assistance.