**Case No. D9/05**

**Penalty tax** – incorrect tax return – relying on employer's returns not a reasonable excuse – whether 'or' in paragraph 48 of D118/02 should be 'and' – 'resort to investigation' category – whether additional tax is excessive – section 82A of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Edward Cheung Wing Yui and Adrian Wong Koon Man.

Date of hearing: 18 March 2005.
Date of decision: 27 April 2005.

The appellant was employed by a medical supplies company as a sales representative. In the appellant's tax returns he declared income which was the same as that reported by his former employer to the IRD. In the course of IRD's investigation into the tax affairs of the appellant's former employer, the latter submitted revised employer's returns showing travel allowance as income of the appellant. The assessor raised on the appellant an additional assessment to which the appellant did not object.

The appellant contended that the former employer gave him wrong information and message.

The Board considered whether 'or' in paragraph 48 of D118/02, IRBRD, vol 18, 90, should be '**and**'.

**Held:**

1. The appellant knew that he had received travel allowance. Under the Ordinance, he had the duty to report the correct amount of income. The Board of Review has repeatedly held that relying on the employer's returns is not a reasonable excuse. If and to the extent that (upon which we make no finding of fact) the former employer had given the appellant incorrect advice, this is a matter for the appellant to take up with his former employer elsewhere.

2. The use of the word 'or' between (a) and (b) and between (b) and (c) in paragraph 48 in D118/02 suggests that (a), (b) and (c) are disjunctive and that penalty at 100% is appropriate for any of the cases in (a) **or** (b) **or** (c). In our respective

view, the word 'or' between (a) and (b) and between (b) and (c) should be '**and**'. Cases which stated that 100% was the norm was disapproved by the Board in D118/02 (see paragraphs 49 and 50). It seems to us that if (c) alone were to warrant a 100% penalty, this would come quite close to 100% being the norm which the Board categorically rejected.

3. Mr Leung Kin-wa submitted that it took a complete year for the IRD to investigate and reach agreement with the appellant on the amounts of travelling expenses deduction. In the Board's view, this is an unhelpful exaggeration in an attempt to fit this case into the 'resort to investigation' category for 100% penalty. Such investigation as there was in this case was the run-of-the-mill investigation in every case where there had been some understatement of income and was a far cry from the 'assets betterment' cases which call for a 100% penalty.

4. The Board is inclined to accept interest as a relevant factor, to compensate the Revenue for the loss arising from the delay in tax payment and not to allow a appellant to benefit from the delay in tax payment. However, the delay in tax payment factor does not outweigh the mitigating factors. Moreover, in view of the fall in interest rates since the 7% rate was adopted by IRD in their penalty policy, IRD must not assume that the rate would necessarily be approved by the Board. There should be evidence on the interest rates, (deposit and loan rates) during the relevant period to enable the Board to form a view on the reasonableness of the 7% rate. Taking into consideration all the relevant circumstances in this case, the Board is of the view that the Assessments are excessive and should be reduced by half to approximately 16.35%.

**Appeal allowed.**

Cases referred to:

D118/02, IRBRD, vol 18, 90
D53/88, IRBRD, vol 4, 10
D96/03, IRBRD, vol 18, 905

Taxpayer in person.
Leung Kin Wa, Mak Kwok Wing and Chen Hei for the Commissioner of Inland Revenue.

**Decision:**

1. This is an appeal against the following assessments ('the Assessments') all dated 13 October 2004 by the Deputy Commissioner of Inland Revenue, assessing the appellant to additional tax under section 82A of the Inland Revenue Ordinance, Chapter 112, in the following sums:

| Year of assessment | Additional tax | Charge no |
|---|---|---|
| 1996/97 | $700 | 9-2628890-97-A |
| 1997/98 | $800 | 9-4100019-98-3 |
| 1998/99 | $500 | 9-2301237-99-4 |
| 1999/2000 | $600 | 9-2238411-00-7 |
| 2000/01 | $400 | 9-2259286-01-5 |
| Total | $3,000 | |

***Additional tax for making incorrect tax returns***

2. The relevant section is 82A(1)(a) for making incorrect tax returns for the five years of assessment 1996/97 to 2000/01 by understating income.

***The relevant facts***

3. During the five years of assessment, the appellant was employed by a medical supplies company as a sales representative. His job was to promote sales to clinics and hospitals in Hong Kong, Kowloon and the New Territories.

4. In the appellant's tax returns for the five years of assessment, the appellant declared the following income which was the same as the income reported by his former employer to the Inland Revenue Department ('IRD'):

| | |
|---|---|
| 1996/97 | $219,690 |
| 1997/98 | $222,352 |
| 1998/99 | $226,005 |
| 1999/2000 | $237,093 |
| 2000/01 | $252,338 |

5. In the course of IRD's investigation into the tax affairs of the appellant's former employer, the former employer submitted revised employer's returns showing the following travel allowance as income of the appellant:

| | |
|---|---|
| 1996/97 | $13,602 |
| 1997/98 | $15,024 |
| 1998/99 | $18,600 |
| 1999/2000 | $18,720 |

2000/01 $18,720

6. On 21 February 2003, the assessor issued an additional assessment for the year of assessment 1996/97 showing net chargeable income of $13,602.

7. By letter dated 1 March 2003, the appellant informed IRD that he had omitted to report travel allowance in his 1995/96 to 1999/2000 (a slightly different five year period, but nothing turns on this difference) tax returns; enclosed a copy of the former employer's revised returns for those five years of assessment; and requested IRD to inform him of the amount of tax that he should pay.

8. On 18 March 2004, the appellant reached agreement with IRD on the amount of deductions on account of travelling expenses incurred by him.

9. On 31 March 2004 and 30 April 2004, the assessor issued additional assessments for the five years of assessment based on the agreed computation.

10. The appellant did not object to any of the additional assessments referred to in paragraph 9 above and these assessments have become final and conclusive under section 70 of the Ordinance as regards the amount of the assessable income.

11. The following table shows the extent of the understatement of income:

| **Year of assessment** | **A: Reported income** | **B: Income omitted** | **C: Income after investigation (A+B)** | **B/C** |
|---|---|---|---|---|
| | **$** | **$** | **$** | **%** |
| 1996/97 | 219,690 | 13,602 | 233,292 | 5.83 |
| 1997/98 | 222,352 | 15,024 | 237,376 | 6.33 |
| 1998/99 | 226,005 | 18,600 | 244,605 | 7.60 |
| 1999/2000 | 237,093 | 18,720 | 255,813 | 7.32 |
| 2000/01 | 252,338 | 18,720 | 271,058 | 6.91 |
| | 1,157,478 | 84,666 | 1,242,144 | 6.82 |

12. The following table shows the additional tax imposed by the Deputy Commissioner as a percentage of the amount of tax undercharged:

| Year of assessment | A: Tax undercharged | B: Additional tax | B/A |
|---|---|---|---|
| | $ | $ | % |
| 1996/97 | 1,620 | 700 | 43.21 |
| 1997/98 | 1,714 | 800 | 46.67 |
| 1998/99 | 1,343 | 500 | 37.23 |
| 1999/2000 | 2,248 | 600 | 26.69 |
| 2000/01 | 2,248 | 400 | 17.79 |
| | 9,173 | 3,000 | 32.70 |

***Whether reasonable excuse***

13. The appellant contended that the former employer gave him wrong information and message

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14. The appellant knew that he had received travel allowance. Under the Ordinance, he had the duty to report the correct amount of income. The Board of Review has repeatedly held that relying on the employer' s returns is not a reasonable excuse. If and to the extent that (upon which we make no finding of fact) the former employer had given the appellant incorrect advice, this is a matter for the appellant to take up with his former employer elsewhere.

15. In our decision, the appellant had no reasonable excuse for making incorrect returns.

***D118/02 – whether 'or' in paragraph 48 should be 'and'***

16. Paragraph 48 in D118/02, IRBRD, vol 18, 90, reads as follows (emphasis added):

> *' 48. One of the earliest statement in relation to assessment at 100% of the tax involved is to be found in D53/88, IRBRD, vol 4, 10. The Board there pointed out that penalty at 100% of the amount of tax undercharged is appropriate to those cases:*
>
> *(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO* ***or***
>
> *(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax* ***or***
>
> *(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.'*

17. The use of the word 'or' between (a) and (b) and between (b) and (c) suggests that (a), (b) and (c) are disjunctive and that penalty at 100% is appropriate for any of the cases in (a) **or** (b) **or** (c).

18. In our respective view, the word 'or' between (a) and (b) and between (b) and (c) should be '**and**'.

19. In D53/88, IRBRD, vol 4, 10, what the Board there said at page 13 was that:

> '*In other cases, the Board of Review had said that the starting point for assessing penalties where a taxpayer has failed in his or its obligations under the Inland Revenue Ordinance is 100% of the amount of the tax undercharged. That penalty is appropriate to those cases where there has been no criminal intent and the Taxpayer has totally failed in his or its obligations under the Inland Revenue Ordinance, and where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax.*
>
> *Furthermore, in cases where the Board has ruled that a 100% penalty is appropriate, the failure by the Taxpayer to fulfil his or its obligations under the Inland Revenue Ordinance has persisted for a number of years, usually the full statutory limitation period of six years.'*

Clearly, what the Board in D53/88 was saying was that 100% is appropriate where (a) **and** (b) **and** (c) are all satisfied.

20. Cases which stated that 100% was the norm was disapproved by the Board in D118/02 (see paragraphs 49 and 50). It seems to us that if (c) alone were to warrant a 100% penalty, this would come quite close to 100% being the norm which the Board categorically rejected.

***D96/03***

21. In D96/03, IRBRD, vol 18, 905, the appellant was a general manager (merchandising). In her tax returns for five years of assessment 1994/95 to 1998/99, she understated her income by failing to report consultancy fee or other payments totalling $4,626,406 or 61% of her correct income. Her case was classified as one of full voluntary disclosure. She was assessed to 25.7% of tax undercharged as additional tax.

22. In paragraphs 50 and 51, the Board cited D118/02 and went on to state that:

> *'50. Further, as found in D53/88, IRBRD, vol 4, 10 and quoted by the Board in D118/02, the Board there pointed out that penalty at 100% of the amount of tax undercharged was appropriate to those cases:*
>
> *(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligation under the IRO, or*
>
> *(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statement or has otherwise had difficulty in assessing the tax, or*
>
> *(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.*
>
> *51. We are in agreement with the aforesaid approaches adopted by the Board. The present case involves the filing of incorrect tax returns for five consecutive years and the income understated comes to a total sum of $4,626,406. Applying the same principles, we consider that a penalty at 100% of the tax undercharged as the starting point in this case is not inappropriate. On account of the Taxpayer's co-operation and the fact that this case is a case of multiple omissions, the classification and the penalty range within which it was put by the Revenue are not out of place.'*

23. In D96/03, the Board there upheld the penalty tax assessments on the footing that 100% was the starting point for incorrect tax returns for five consecutive years.

24. In D96/03, the Board's attention was not drawn to the question whether the word 'or' in paragraph 48 in D118/02 should be 'and'.

***Whether excessive in the circumstances of this case***

25. Mr Leung Kin-wa submitted that it took a complete year for the IRD to investigate and reach agreement with the appellant on the amounts of travelling expenses deduction. In our view, this is an unhelpful exaggeration in an attempt to fit this case into the 'resort to investigation' category for 100% penalty. Such investigation as there was in this case was the run-of-the-mill investigation in every case where there had been some understatement of income and was a far cry from the 'assets betterment' cases which call for a 100% penalty.

26. We asked Mr Leung Kin-wa to draw our attention to aggravating factors in this case compared with D96/03. He said that in this case, the time for the correct amount of tax to be paid was longer. He sought to justify the additional tax in this case by reference to the 7% interest or commercial restitution approach adopted by IRD.

27. In D96/03, the taxpayer, as a manager, ought to have known better. In our case, the appellant was a sales representative. In D96/03, the taxpayer understated 61% of her correct income. In our case, the appellant understated 6.82% of his correct income. Both factors point to a lower penalty in this case.

28. We are inclined to accept interest as a relevant factor, to compensate the Revenue for the loss arising from the delay in tax payment and not to allow a taxpayer to benefit from the delay in tax payment. However, the delay in tax payment factor does not outweigh the mitigating factors. Moreover, in view of the fall in interest rates since the 7% rate was adopted by IRD in their penalty policy, IRD must not assume that the rate would necessarily be approved by the Board. There should be evidence on the interest rates, (deposit and loan rates) during the relevant period to enable the Board to form a view on the reasonableness of the 7% rate. We do not have any evidence on interest rates in this case.

29. Taking into consideration all the relevant circumstances in this case, we are of the view that the Assessments are excessive and should be reduced by half to approximately 16.35%.

***Disposition***

30. We allow the appeal and reduce the Assessments as follows:

| **Year of assessment** | **Additional tax in the Assessments** | **Additional tax as reduced by the Board to** |
|---|---|---|
| | **$** | **$** |
| 1996/97 | 700 | 350 |
| 1997/98 | 800 | 400 |
| 1998/99 | 500 | 250 |
| 1999/2000 | 600 | 300 |
| 2000/01 | 400 | 200 |
| | 3,000 | 1,500 |