Case No. D96/03

Penalty tax – salary income omitted from return – whether additional tax is excessive – Penalty Loading Statement – sections 51, 68(4), 80(2), 82A & 82B(2) of the Inland Revenue Ordinance ('IRO') – Notice of Appeal – whether out of time – section 71(1) of the Interpretation and General Clauses Ordinance.

Panel: Anna Chow Suk Han (chairman), James Julius Bertram and Charles D Booth.

Date of hearing: 25 November 2003.
Date of decision: 6 February 2004.

The taxpayer held a high and responsible position in the employer company. Her employer filed four revised Employer's Returns of Remuneration and Pensions (Form IR56B) in respect of the taxpayer for the years of assessment 1994/95 to 1998/99. In February 2000, the assessor commenced tax investigation on the background of the four revised IR56B. The income understated by the taxpayer in her Tax Return – Individuals came to a total sum of $4,626,406 which amounted to 61% of the taxpayer's correct income. The Commissioner of Inland Revenue ('the Commissioner') was of the opinion that the taxpayer had no reasonable excuse for making incorrect tax returns for the years of assessment 1994/95 to 1998/99. Having considered and taken into account the taxpayer's representations, the Commissioner issued Notices of Assessment and Demand for Additional Tax under Section 82A for the years of assessment 1994/95 to 1998/99 to the taxpayer on 12 June 2003. The average penalty worked out to be 25.7% of the tax undercharged. By a letter dated 14 July 2003, the taxpayer gave notice of appeal to the Board against the additional tax assessments.

The taxpayer confessed that the mis-calculations in her tax returns were caused by errors made by her employer in the employer's returns and by her negligence in verifying those figures in them. She realised that ignorance or time constraint was no excuse for her failure to look after her tax returns but urged upon the Board that she had no intention to avoid the payment of tax and she had been a regular and prompt taxpayer. She had been out of jobs for two years and her salary had dropped.

At the hearing the Revenue produced to the Board the Revenue's Penalty Loading Statement and explained that when the Revenue classified a penalty case, it would look at three elements, the taxpayer's co-operation, the taxpayer's culpability and the penalty scale otherwise known as the commercial restitution, that is, the interest element. In the present case, the Revenue took into account the taxpayer's co-operation and classified this case under 'Full Voluntary

Disclosure' in the table under Part D. Further, since this case involved five years of understatement, the Revenue classified the culpability as under 'Group a' of the same table. Under this table, the normal penalty loading for cases classified under 'Full Voluntary Disclosure' and 'Group a' is 15% of the tax undercharged and including the interest element, the maximum penalty loading is 60%. The prevailing commercial restitution is at 7% compound interest per annum.

Held:

1. By applying the decision in D98/99 and by virtue of section 71(1)(a) of the Interpretation and General Clauses Ordinance (Cap 1), the computation of the one month period should start on 14 June 2003 and the appeal period should expire on 13 July 2003, which, however, was a Sunday. Thus by virtue of section 71(1)(b) of Cap 1, the appeal period was extended to the following day, that is, 14 July 2003, and the notice of appeal was not filed out of time.

2. None of the matters raised by the taxpayer such as the employer's mistake, the taxpayer's negligence, lack of intent to evade tax, financial difficulty, heavy business commitments and past good record amounts to a reasonable excuse for the taxpayer's understatement of her income.

3. 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. 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.

Appeal dismissed.

Cases referred to:

D57/95, IRBRD, vol 11, 19
D113/99, IRBRD, vol 14, 650
D71/91, IRBRD, vol 7, 1
D101/02, IRBRD, vol 18, 6
D98/98, IRBRD, vol 13, 482
D179/98, IRBRD, vol 14, 78
D22/02, IRBRD, vol 17, 515
D118/02, IRBRD, vol 18, 90
D34/88, IRBRD, vol 3, 336
D53/88, IRBRD, vol 4, 10

Chan Chor Ming for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. The Taxpayer appeals against the imposition of penalty by way of additional tax assessed upon her under section 82A of the Inland Revenue Ordinance ('IRO') for making incorrect 'Tax Returns – Individuals' for the years of assessment 1994/95 to 1998/99.

Statement of facts

2. The Taxpayer was employed by the Employer on 1 July 1994 as a general manager (merchandising) to oversee the whole merchandising department. She was dismissed on 14 January 1999.

3. For the years of assessment 1994/95 to 1998/99, the Employer filed Employer's Returns of Remuneration and Pensions ('Form IR56B') in respect of the Taxpayer showing the following income:

Year of assessment	**Date of signature**	**Basis period (year ended)**	**Income**	**Rent paid to landlord by employee/rent refunded to employee**
			$	$
1994/95	3-5-1995	31-3-1995	370,000	0
1995/96	30-4-1996	31-3-1996	297,521	270,000
1996/97	28-5-1997	31-3-1997	297,019	295,000
1997/98	8-5-1998	31-3-1998	804,000	0
1998/99	17-6-1999	31-3-1999	1,330,250	0

4. On 20 June 1995, the Employer filed revised Form IR56B in respect of the Taxpayer for the year of assessment 1994/95 showing the following revised income:

Year of assessment	**Date of signature**	**Basis period (year ended)**	**Income**	**Rent paid to landlord by employee/rent**

				refunded to employee
			$	$
1994/95	20-6-1995	31-3-1995	190,000	180,000

5. The Taxpayer declared the following particulars of income in the Tax Returns – Individuals for the years of assessment 1994/95 to 1998/99:

Year of assessment	Date of signature	Basis period (year ended)	Income	Quarter provided
			$	$
1994/95	1-6-1995	31-3-1995	190,000	180,000
1995/96	12-6-1996	31-3-1996	397,521	170,000
1996/97	27-6-1997	31-3-1997	297,019	295,000
1997/98	10-6-1998	31-3-1998	804,000	0
1998/99	3-6-1999	31-3-1999	1,166,667	0

6. On the basis of the income returned, the assessor raised on the Taxpayer the following salaries tax assessments:

Year of assessment	Date of issue	Income	Quarter value	Assessable income
		$	$	$
1994/95	17-11-1995	190,000	19,000	209,000
1995/96	7-10-1996	397,521	39,752	437,273
1996/97	15-12-1997	297,019	29,701	326,720
1997/98	29-9-1998	804,000	0	804,000
1998/99	17-9-1999	1,166,667	0	1,166,667

7. Under cover of a letter dated 1 May 1998, the Employer filed revised Form IR56B in respect of the Taxpayer for the year of assessment 1996/97 showing the following revised income:

Year of assessment	Date of signature	Basis period (year ended)	Income	Rent paid to landlord by employee/rent refunded to employee
			$	$
1996/97	1-5-1998	31-3-1997	592,019	0

8. On 8 December 1998, the Employer filed revised Form IR56B in respect of some employees including the Taxpayer for the years of assessment 1994/95 to 1997/98. Particulars of the revised income of the Taxpayer are as follows:

Year of assessment	**Date of signature**	**Basis period (year ended)**	**Income**	**Rent paid to landlord by employee/rent refunded to employee**
			$	$
1994/95	8-12-1998	31-3-1995	819,282	198,000
1995/96	8-12-1998	31-3-1996	1,458,520	141,226
1996/97	30-11-1998	31-3-1997	1,801,980	0
1997/98	30-11-1998	31-3-1998	2,000,000	0

9. By a letter dated 11 December 1998, the Taxpayer informed that the Employer 'inadvertently made an error in filing my salaries tax return for the years of assessment 1994/95 to 1997/98'. She stated that she had asked the Employer to file the revised Form IR56B referred to in paragraph 8 above.

10. In accordance with the revised Form IR56B, the assessor issued additional salaries tax assessments for the years of assessment 1994/95 and 1995/96 on 12 February 1999 and additional salaries tax assessments for the years of assessment 1996/97 and 1997/98 on 15 February 1999.

11. By a letter dated 22 February 1999, the Tax Representative lodged objections against the additional assessments for 1994/95 to 1996/97 on behalf of the Taxpayer on the ground that 'the amount of quarters assessed for the years mentioned are excessive'.

12. By letters both dated 12 March 1999, the assessor requested the Tax Representative and the Employer to provide copy of the Taxpayer's employment contract, tenancy agreement, etc. The assessor also asked the Employer to state the basis of determining the housing allowance of the Taxpayer.

13. Under cover of a letter 25 March 1999, the Employer submitted a copy each of the Taxpayer's employment contract and lease agreement. The employment contract showed that the Taxpayer was entitled to an annual salary of $1,400,000 starting from 1 July 1994. The Employer also submitted some handwritten notes endorsed by its Personnel Manager, Ms A, showing that Ms A had asked the Taxpayer to confirm her own income for the year of assessment 1996/97 before sending out the Taxpayer's tax return.

14. The assessor accepted the revised quarters value of $78,106 for the year of assessment 1995/96 and allowed the objection for the year of assessment 1996/97. On 5 May 1999, revised salaries tax assessments for the years of assessment 1995/96 and 1996/97 were issued under Section 64(3) of the IRO.

15. By letters dated 9 June 1999, the assessor sought further information from the Taxpayer and the Employer in relation to the revised Form IR56B referred to in paragraph 8 above.

16. The Employer responded on 16 June 1999 and advised, with supporting schedules, that salaries and bonus were paid to the Taxpayer by autopay and cheques.

17. Having failed to receive the Taxpayer's reply to the letter dated 9 June 1999, the assessor issued a reminder on 22 November 1999.

18. On 8 February 2000, the assessor commenced tax investigation on the background of the four revised IR56Bs by issuing a notice under section 51(4)(a) and 51(4A) of the IRO requiring the Employer to submit records and information in respect of the Taxpayer, including the original employment contract, personnel file, payment records, tenancy agreements and general ledger showing the salary payments to the Taxpayer.

19. The Taxpayer furnished the required information on 21 June 2000. She confirmed that salaries were paid by bank transfer or by cheque. In respect of the reason for late reporting, the Taxpayer stated 'Presumably the company Finance Dept responsibility'.

20. Among the records submitted by the Employer, the assessor noted that the Employer's Chief Financial Officer, Mr B, had reported to the Employer on 24 October 1998 that only a portion of the Taxpayer's remuneration were reported to the Inland Revenue Department ('the Revenue'). Mr B suspected that the ' "creative" "tax efficient" (on the part of the employee) arrangements have not been in compliance with the law' .

21. By a letter dated 22 January 2003, the assessor requested the Taxpayer to explain the failure to report consultancy fee or other payments received from the Employer in her own Tax Returns – Individuals for the years of assessment 1994/95 to 1998/99. The Taxpayer replied on 10 February 2003.

22. The following is a summary of the income understated by the Taxpayer in her Tax Returns – Individuals:

Year of assessment	**Assessable income per return**			**Assessable income per final & conclusive assessment**			**Income understated**
	Income $	Quarters $	Total $	Income $	Quarters $	Total $	$

1994/95	190,000	19,000	209,000	819,282	81,928	901,210	692,210
1995/96	397,521	39,752	437,273	1,458,520	78,106	1,536,626	1,099,353
1996/97	297,019	29,701	326,720	1,801,980	0	1,801,980	1,475,260
1997/98	804,000	0	804,000	2,000,000	0	2,000,000	1,196,000
1998/99	1,166,667	0	1,166,667	1,330,250	0	1,330,250	163,583
Total	2,855,207	88,453	2,943,660	7,410,032	160,034	7,570,066	4,626,406

The income understated amounts to 61% of the Taxpayer's correct income.

23. The Commissioner of Inland Revenue ('the Commissioner') was of the opinion that the Taxpayer had without reasonable excuse made incorrect tax returns for the years of assessment 1994/95 to 1998/99. On 26 February 2003, the Commissioner gave a Notice of Intent to assess Additional Tax under Section 82A of the Ordinance and invited the Taxpayer to make representations.

24. Having considered and taken into account the Taxpayer's representations, the Commissioner issued Notices of Assessment and Demand for Additional Tax under Section 82A for the years of assessment 1994/95 to 1998/99 to the Taxpayer on 12 June 2003. The Taxpayer was advised that if she wishes to appeal against the assessments, she must give notice in writing to the Clerk to the Board of Review within one month after the issue of the notices of assessment. The following is a summary of the amounts of additional tax assessed on the Taxpayer:

Year of assessment	**Tax undercharged**	**Section 82A additional tax**	**Additional tax as percentage of tax undercharged**
	$	$	$
1994/95	115,581	44,858	38.8%
1995/96	175,439	53,681	30.6%
1996/97	230,753	52,930	22.9%
1997/98	150,800	23,818	15.8%
1998/99	27,809	4,713	16.9%
	700,382	180,000	25.7%

25. By a letter dated 14 July 2003, the Taxpayer gave notice of appeal to the Board of Review against the above additional tax assessments.

The Taxpayer's case

26. She was engaged by the Employer in 1994. She had been heavily committed to her business undertakings and travelling schedules and not until December 1998, she had the opportunity to look into her tax affairs. She confessed that the mis-calculations in her tax returns were caused by the errors made by the Employer in the Employer's returns and by her negligence in verifying those figures in them.

27. She realized that ignorance or time constraint was no excuse for her failure to look after her tax matters.

28. She urged upon us that she had no intention to avoid the payment of tax and she had been a regular and prompt taxpayer. She had been out of jobs for two years and her salary had now dropped to $840,000.00 per annum.

The Revenue' s case

29. The Revenue submitted that none of the matters raised by the Taxpayer for reduction of the additional tax constituted a reasonable excuse.

30. The IRO placed an obligation on salary earners to file returns of their total taxable income, and that obligation cannot be delegated or transferred. Taxpayers could not blame the employers for the employers' incorrect returns. [D57/95, IRBRD, vol 11, 19 at page 23 and D113/99, IRBRD, vol 14, 650)].

31. There were ample decisions of the Board holding that no intention to evade tax was not a reasonable excuse. [D113/99 quoted above].

32. There were again ample decisions of the Board holding that financial difficulty could not be regarded as a reasonable excuse or a valid ground for appeal. [D71/91, IRBRD, vol 7, 1)].

33. Travelling or business commitment did not constitute a reasonable excuse. [D113/99 at page 658].

34. The Taxpayer' s understatement of her income persisted for five consecutive years. Even if it was accepted that the Taxpayer had an unblemished record, it did not constitute a reasonable excuse. [D101/02, IRBRD, vol 18, 6)].

35. The only ground for the Taxpayer to request for a reduction of the additional tax was 'financial difficulty'. Again this was not a reasonable excuse.

36. Adopting 100% as the starting point and imposing penalties at 25.7% of the tax undercharged, the Revenue is of the view that the additional tax in question was by no means excessive.

The relevant statutory provisions

37. Section 82A of the IRO provides that

'(1) Any person who without reasonable excuse –

(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return .....

(b) ... ...

shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which –

(i) has been undercharged in consequence of such incorrect return, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct; .....'

38. Section 82B(2) of the IRO provides that:

'On an appeal against assessment to additional tax, it shall be open to the appellant to argue that –

(a) he is not liable to additional tax;

(b) the amount of additional tax assessed on him exceeds the amount for which he is liable under Section 82A;

(c) the amount of additional tax, although not in excess of that for which he is liable under Section 82A, is excessive having regard to the circumstances.'

39. Section 68(4) of the IRO provides that

'The onus of providing that the assessment appealed against is excessive or incorrect shall be on the appellant.'

Preliminary issue

40. There was a preliminary issue before the Board as to whether the notice of appeal was filed out of time as prescribed by section 82B(1) of the IRO.

41. Section 82B(1) of the IRO provides that

> *'Any person who has been assessed to additional tax under Section 82A may, within 1 month after notice of assessment is given to him, give notice of appeal to the Board ...'*

42. The five notices of assessment now under appeal are all dated 12 June 2003 and the notice of appeal was given by the Taxpayer and received by the Revenue on 14 July 2003.

43. On the basis of the decision in D98/98, IRBRD, vol 13, 482, the Revenue submitted that the appeal was not out of time and it would not argue otherwise. It accepted that by applying the decision in D98/98 and by virtue of section 71(1)(a) of the Interpretation and General Clauses Ordinance (Chapter 1), the computation of the one month period should start on 14 June 2003 and the appeal period should expire on 13 July 2003, which, however, was a Sunday. Thus, by virtue of section 71(1)(b) of Chapter 1, the appeal period was extended to the next day, that is, 14 July 2003, and the notice of appeal was not filed out of time.

44. This Board accepted this position and thus proceeded with the hearing of the substantive issue.

Substantive issue

45. We accept the Revenue's submission that none of the matters raised by the Taxpayer such as the Employer's mistake, the Taxpayer's negligence, lack of intent to evade tax, financial difficulty, heavy business commitments and past good record, amounts to a reasonable excuse for the Taxpayer's understatement of her income. In this regard, we find support from the cases quoted by the Revenue in its written submission. We do not intend to repeat them here.

46. As to whether the additional tax is excessive under the circumstances of this case, the Revenue contends that the law allows a maximum penalty of 300% of the amount of tax undercharged and in a case of simple omission, a penalty at 10% of the tax undercharged is appropriate. It submits that the present case is not a case of simple omission because the understatement persisted for five consecutive years of assessment and furthermore the internal memorandum of the Employer of 24 October 1998 shows that the Taxpayer had entered into 'creative' and 'tax efficient' arrangements with her Employer. Following the decisions in D179/98, IRBRD, vol 14, 78, D22/02, IRBRD, vol 17, 515, D118/02, IRBRD, vol 18, 90 and D34/88, IRBRD, vol 3, 336, it contends that it is appropriate in this case to adopt 100% of the tax involved as the starting point for imposition of additional tax, with discount for mitigating factors, such as the Taxpayer's co-operation and voluntary disclosure.

47. At the hearing of the appeal, Mr Chan Chor-ming, the representative of the Revenue, produced to this Board the Revenue's Penalty Loading Statement ('the Statement'). We were

referred to Part D on page 3 of the Statement. It was explained to us that when the Revenue classified a penalty case, it would look at three elements, the taxpayer's co-operation, the taxpayer's culpability and the penalty scale otherwise known as the commercial restitution, that is, the interest element. Mr Chan explained that in the present case, the Revenue took into account the Taxpayer's co-operation and thus, classified this case under 'Full Voluntary Disclosure' in the table under Part D. Further, since this case involved five years of understatement, the Revenue classified the culpability as under 'Group a' of the same table. Under this table, the normal penalty loading for cases classified under 'Full Voluntary Disclosure' and 'Group a' is 15% of the tax undercharged and including the interest element, the maximum penalty loading is 60%. We note on page 4 of the Statement that the prevailing commercial restitution is at 7% compound interest per annum.

48. Mr Chan further produced a table showing the detailed calculation of the penalty at 25.7%. The table shows (1) the amount of tax undercharged (2) the penalty loading at 15% of the tax undercharged and (3) the interest on the amount of penalty loading for each of the assessment years in question. On the aforesaid basis, the average penalty works out to be 25.7% of the tax undercharged.

49. We now refer to D118/02, one of the cases produced by the Revenue for the purpose of this appeal. In that case, the Board set out the history of additional tax under section 82A of the IRO and the inter-relationship between section 82A and the other penalty sections in the IRO. On the basis of the background and the analysis of the inter-relationship between the penalty sections of the IRO, the Board in that case took the view that given the fact that 97.5% represented the level of additional fine imposed by the Court for more serious cases of which taxpayers were prosecuted under section 80(2) of the IRO, it would be wrong for the Board to adopt 100% as the starting point for a case with no aggravating or mitigating circumstances. It was also of the view that the circumstances of each particular case must be examined bearing in mind that the maximum penalty was 300%. It expressed the view that the three elements taken into consideration by the Revenue were certainly important factors in determining the level of additional tax but they ought not be all the factors which the Board should take into account in deciding whether the additional tax was excessive or not. Its approach was to consider the overall circumstances of each case and factors that affected the level of penalty including:

(a) the length and nature of the delay,

(b) the amount of tax involved,

(c) the absence of an intention to evade,

(d) whether there is any loss of revenue,

(e) the track record of the taxpayer,

(f) the acceptance of the tax return eventually submitted without further investigation by the assessor,

(g) the lack of education on the part of the taxpayer,

(h) the steps taken to put the taxpayer's house in order,

(i) the provision of management account, and

(j) conduct of the taxpayer before the Board.

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.

52. The Taxpayer was employed by the Employer as a general manager to start a new company and to oversee the whole merchandising department, thus holding a high and responsible position in the company. There were an employment contract of the Taxpayer dated 23 June 1994 showing an annual salary of HK$1,400,000; a memorandum of 17 November 1995 confirming an annual salary of $1,600,000; and a further memorandum of 22 May 1997 showing a revision of salary to $2,000,000 per annum effective the 1 April 1997. There was also an internal memorandum of the Taxpayer's Employer of 24 October 1998, stating that the Taxpayer promised to provide the Employer with documents in support of the portion of her salary which was treated as consultancy fees or housing allowance. At the hearing the Taxpayer also confirmed her understanding that some sort of consultancy agreement should be signed by her to conclude the

matter. On the basis of the aforesaid evidence, the Taxpayer cannot lay blame for the omission on lack of knowledge or reliance upon the Employer' s returns. She was under a duty to make proper returns and to verify doubts or inconsistencies. Ignoring or turning a blind eye to an error or a possible error is not a mitigating factor. Given the length of the delay, the amount involved and the circumstances under which the omission occurred, we consider that the additional tax assessment at 25.7% of the tax undercharged is by no means excessive in the circumstances. We, therefore, dismiss the appeal.