

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D56/94

**Penalty tax** – late filing of tax return – purchase of tax reserve certificate – quantum of penalty.

Panel: William Turnbull (chairman), Cheung Wai Hing and Eugene Ho.

Date of hearing: 9 September 1994.

Date of decision: 28 November 1994

The taxpayer was late in filing its profits tax return. The taxpayer purchased a tax reserve certificate before the expiry of the extended period of time within which to file its profits tax return and informed the Commissioner of the estimated profits. The amount of the tax reserve certificate was sufficient to cover the full liability to profits tax. The quantum of the penalty imposed by the Commissioner under section 82A of the Inland Revenue Ordinance was approximately 5% of the tax involved. The taxpayer appealed to the Board of Review.

Held:

The assessor had disregarded the information which the taxpayer had provided to him about the estimated profits of the taxpayer. The assessor issued an estimated assessment which was substantially below this sum. Where a taxpayer had been advised to deposit with the government the full amount of the estimated tax and has informed the Commissioner of the amount only a small penalty is merited. The Board noted that the taxpayer had been late in filing previous profits tax return and decided that a penalty of approximately 2.5% of the tax involved was appropriate.

**Appeal partly allowed.**

Cases referred to:

Dodge Knitting Co Ltd, Dodge Trading Ltd v CIR 2 HKTC 597

D42/88, IRBRD, vol 3, 395

D58/87, IRBRD, vol 3, 11

Nadrep Ltd v Willmet & Co [1978] 1 All ER 746

British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric

Railways Co of London Ltd [1911-13] All ER 63

D2/92, IRBRD, vol 7, 56

B J Brown for the Commissioner of Inland Revenue.

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V Robert Lew of Messrs James Lew & Co for the taxpayer.

### **Decision:**

This is an appeal by a private limited company against an assessment to additional tax under section 82A of the Inland Revenue Ordinance (the IRO). The facts are as follows:

1. The Taxpayer was incorporated in March 1977 and commenced business in April 1977. The Taxpayer closed its accounts annually on 31 March.
2. On 1 April 1993 a profits tax return for the year of assessment 1992/93 was issued to the Taxpayer requiring its completion and return within one month. An extension to 15 November 1993 was allowed under the 'Block Extension' programme.
3. By a letter dated 10 November 1993, the representative for the Taxpayer sent the sum of \$1,600,000 to the Commissioner to purchase a Tax Reserve Certificate for payment of profits tax. The tax representative informed the Commissioner that it was estimated that the actual amount of tax payable would be approximately that amount and that it was hoped that the Commissioner would allow the profits tax return to be filed by 31 December 1993.
4. By letter dated 18 November 1993 the request for a further extension of time was rejected.
5. On 26 November 1993 the assessor not having received the said return from the Taxpayer raised an estimated profits tax assessment in the sum of \$4,740,000 with profits tax payable thereon of \$829,500.
6. The profits tax return for the year of assessment 1992/93, showing an assessable profit of \$8,999,545 with tax payable thereon of \$1,574,920 was submitted to the Revenue on 13 January 1994.
7. The tax return was accepted and an additional assessment was issued on 14 February 1994 with an additional assessable profit of \$4,259,545. The additional profits tax on this amount was \$745,420 making the total profits tax for the year of assessment 1992/93 of \$1,574,920.
8. The Taxpayer had failed to submit its profits tax returns within the time stipulated on previous occasions. The following is a list of the occasions when the Taxpayer was late in filing its tax returns:

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Year of Assessment	Date of issue	Extension Allowed to	Date of Submission	Returned Profit \$
1987/88	6 April 1988	31 October 1988	20 November 1989	-
1989/90	2 April 1990	14 November 1990	12 February 1991	4,529,877
1990/91	2 April 1991	15 November 1991	24 December 1991	3,218,439
1991/92	1 April 1992	15 November 1992	3 December 1992	4,489,347

9. In respect of the year of assessment 1987/88 a warning letter dated 25 July 1990 was sent to the Taxpayer informing the Taxpayer that it had committed an offence under section 80(2)(D) of the IRO. The warning letter informed the Taxpayer that no action would be taken on that occasion but pointing out that any future offence would not be treated so leniently.
10. On 31 March 1994, the Commissioner of Inland Revenue gave notice to the Taxpayer that he proposed to assess additional tax by way of penalty for the year of assessment 1992/93 in respect of the failure by the Taxpayer to comply with the requirements of the IRO.
11. By letter dated 11 April 1994 the representative for the Taxpayer made representations to the Commissioner of Inland Revenue.
12. On 10 May 1994 the Commissioner of Inland Revenue having taken the representations into account issued a notice of assessment to additional tax under section 82A of the IRO for the year of assessment 1992/93 in an amount of \$75,000.
13. On 9 June 1994 the representative for the Taxpayer gave notice of appeal to the Board of Review against this assessment to additional tax.

The representative for the Taxpayer duly appeared before the Board. He explained to the Board that the Taxpayer had sent its accounts to the auditor by the end of September 1993 but due to the increase in the volume of the business of the Taxpayer the audit had not been completed until the end of December 1993. He pointed out that on 10 November 1993 the Taxpayer had purchased a Tax Reserve Certificate in the amount of \$1,600,000 which fully covered the tax liable of \$1,574,920.

The representative submitted that the tax had been prepaid and accordingly there was no basis for the Commissioner to impose additional tax.

The representative for the Taxpayer referred us to:

Dodge Knitting Co Ltd, Dodge Trading Ltd v CIR 2 HKTC 597

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D42/88, IRBRD, vol 3, 395

D58/87, IRBRD, vol 3, 11

Nadrep Ltd v Willmetts & Co [1978] 1 All ER 746

British Westinghouse Electric and Manufacturing Co Ltd v Underground

Electric Railways Co of London Ltd [1911-13] All ER 63, and

D2/92, IRBRD, vol 7, 56

The representative for the Commissioner referred the Board to a number of Board of Review decisions in which penalties had been imposed for the late filing of returns and said that in the present case the Commissioner had only imposed a penalty of approximately 5% of the tax involved. With regard to the purchase of a Tax Reserve Certificate the representative for the Commissioner pointed out that interest was payable on Tax Reserve Certificates and that a Taxpayer could redeem a Tax Reserve Certificate at anytime but subject to the forfeiture of interest thereon. He submitted that the purchase of a Tax Reserve Certificate was not the same as payment of tax.

The representative for the Commissioner also drew to our attention the past performance of the Taxpayer and the many occasions on which the Taxpayer had been late in filing its return. He also pointed out that a warning letter had previously been issued.

This is a unique and difficult case. The tax representative who appeared before us had appeared in previous cases and had taken to heart statements made by previous Boards of Review which were that taxpayers should work in harmony with the Commissioner. If a taxpayer for some reason or other is not able to file its tax return within the time stipulated then the Taxpayer should take the Commissioner fully into its confidence and should inform the Commissioner as accurately as possible of the profits which have been made and then submit audited accounts as soon as possible.

In the case before us the Taxpayer went one stage further. The Taxpayer actually volunteered payment of the tax as well as informing the Commissioner of what was the estimated amount of the tax which would be assessed.

The assessor ignored what the Taxpayer had told him. By letter dated 10 November 1993 the Taxpayer had informed the assessor that the amount of tax estimated by the Taxpayer was \$1,600,000. In the event this sum proved to be very accurate. This was notified to the assessor before the expiry of the extension granted. There was no way at that time that the Taxpayer could make payment of the tax involved. Unless and until a tax assessment is issued there is no method other than the purchase of a Tax Reserve Certificate by which Taxpayer can demonstrate to the Commissioner of its conviction to pay tax. Although it is true and correct that the purchase of a Tax Reserve Certificate does not constitute the payment of tax, at the same time it must be noted that there is no other way of paying tax.

The Taxpayer applied for an extension of time up to the end of December. We were informed by the representative for the Commissioner that the due date for making application for a further extension of time was 14 days before 15 November 1993 and that

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as no reason for the request for the extension was given a notice of refusal was issued to the representative on 18 November 1993. We note that on 26 November 1993 the assessor chose to ignore the information provided to him by the representative for the Taxpayer and issued an estimated profits tax assessment with tax payable thereon of only \$829,500. No explanation was given to the Board as to why the assessor would ignore the information which he had received from the representative for the Taxpayer.

On the other hand it must be noted that the Taxpayer had a long record of filing its tax returns late. A warning letter had already been issued which had the effect of expediting the filing of subsequent returns but nevertheless the same were late. Boards of Review have repeatedly pointed out in previous cases that taxpayers have an obligation to keep their accounts and have the same audited so as to comply with their obligations under the IRO. If they fail to do so then they must expect to receive penalties of substantial sums.

What we have to do in this case is to try to balance the good and bad points of the conduct of the Taxpayer and reach a fair decision in all of the circumstances.

The representative for the Taxpayer submitted that the Taxpayer had paid its tax in advance by virtue of the purchase of a Tax Reserve Certificate and that accordingly the Commissioner had no power to impose a penalty. In the course of the hearing the representative for the Taxpayer accepted that this submission was wrong in law. The Dodge Knitting case is the clearest authority on this point. In that case Liu J stated that the consequence of failing to file a tax return was the same as filing a nil return. The purchase of a Tax Reserve Certificate in the present case is a very strong mitigating circumstance but that is all. It does not cancel the power of the Commissioner to impose a penalty for late filing of a return.

It seems to us that where a tax representative has advised his client to deposit with the Government the full amount which he estimates will be payable by way of profits tax and the client accepts that advice any penalty subsequently imposed should be very modest. It must be in the interest of the Commissioner and Hong Kong generally to encourage people to make payment where they are in default. In the present case we would have no hesitation in reducing the penalty to zero if it were not for the previous record of the Taxpayer and the previous warning letter. Indeed we have no doubt that the Commissioner likewise would not have imposed a penalty in such circumstances. However the fact is that the Taxpayer has repeatedly been late in the past and has received one formal warning. In such circumstances the conduct of the Taxpayer merits a penalty. However we feel that an appropriate penalty in the present unique case would be an amount of \$39,000 which is approximately 2.5% of the tax which would have been undercharged.

We hope that this decision will indicate to taxpayers that there are substantial benefit for them if they do work closely with the Commissioner and inform the Commissioner of the anticipated profits and at the same time deposit with the Government the amount of tax which they expect will be assessed.

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Accordingly we order that the amount of additional tax imposed by the Commissioner, namely, \$75,000 be reduced to \$39,000.