Case No. D56/96

Penalty tax – whether 3.1% penalty excessive – mitigating circumstances – whether 5% surcharge under section 71(5) minimum penalty under section 82A(1).

Panel: Kenneth Kwok Hing Wai SC (chairman), Barry J Buttifant and Karl Kwok Chi Leung.

Date of hearing: 8 July 1996.
Date of decision: 24 October 1996.

The taxpayer was 35 days late in submitting its profits tax return. The Board found as a fact that the delay was completely the fault of the former professional accountant. The taxpayer had an unblemished, albeit relatively short, track record; was remorseful and had engaged new professional accountants. There was no actual loss of revenue.

Held:

That the penalty of 3.1% ($150,000) of the amount of tax involved was excessive in the very special circumstances of this case; that the 5% surcharge under section 71(5) is not and should not be the minimum penalty under section 82A(1); and that the penalty was reduced to 0.41% ($20,000).

Appeal allowed.

Cases referred to:

D105/89, IRBRD, vol 6, 384
D1/95, IRBRD, vol 10, 71
D31/94, IRBRD, vol 9, 196
D24/94, IRBRD, vol 9, 226
D64/94, IRBRD, vol 9, 361
D2/90, IRBRD, vol 5, 77

Ngai Ngai Nui Leung for the Commissioner of Inland Revenue.
Taxpayer represented by its Chief Executive Officer.

Decision:

1. This is an appeal against the assessment dated 22 January 1996 by the Commissioner of Inland Revenue, assessing the Taxpayer to additional tax under section 82A of the Inland Revenue Ordinance, chapter 112 ('the IRO'), in the sum of $150,000.

2. The year of assessment is 1994/95 ('the relevant year of assessment'). The relevant provision is section 82A(1)(d) in respect of the requirements of the notice given to the Taxpayer under section 51(1) of the IRO to furnish profits tax return. The amount of tax involved is $4,832,311.

The facts

3. From the agreed Statement of Facts, the documents placed before us and the oral evidence adduced at the hearing, we make the following findings of fact.

3.1 The Taxpayer was incorporated in Hong Kong on 2 February 1990 and since then has carried on businesses as manufacturers, assemblers, wholesalers, exporters, importers and agents.

3.2 The Taxpayer closes its accounts annually on 31 December in each year.

3.3 Prior to the relevant year of assessment, the Taxpayer had never been late in the submission of profits tax returns.

3.4 The accounts of the Taxpayer for the relevant year of assessment were audited by an international firm of accountants and were finalised in or around February 1995. In or around February or March 1995, the Taxpayers submitted all necessary documents to a one-man firm of local certified public accountants ('the former CPA') to compute the tax position and to prepare the profits tax and employer's returns.

3.5 On 3 April 1995, a profits tax return for the relevant year of assessment ('the Return') was issued to the Taxpayer under section 51(1) of the IRO, requiring the Taxpayer to complete and return the same within 1 month from that date.

3.6 As the Taxpayer was an existing client of the former CPA, automatic extension for submission of the Return was granted to 31 July 1995.

3.7 By letter dated 8 May 1995, the Financial Controller of the Taxpayer wrote to the former CPA urging them to submit the Return promptly to IRD:

> 'As we have already sent you all the materials for preparing the profits tax return and employer returns on our behalf for many weeks, it already comes very close to our deadline to submit that to the Inland Revenue Department. At the same time, our staff have also received their salaries returns for a certain period of time and we should send them a copy as soon as possible.'

'As a result, if it is possible, we would prefer you to send us ALL the above documents on or before 11 May 1995 (this Thursday) ...'

3.8 Senior management in the Taxpayer was then made aware of the fact that the sole proprietor of the former CPA had not been keeping good health and was not attending his office regularly. The Taxpayer began the process of taking some work away from the former CPA.

3.9 Sometime in early June 1995, the Chief Executive Officer of the Taxpayer ('the CEO') telephoned and, in the absence of the sole proprietor of the former CPA, spoke to someone in the former CPA's office identified as 'Mr X' who was said to be looking after the Taxpayer's account. This person told the CEO that the matter was in hand and claimed that the accounts had been submitted to the Inland Revenue Department ('IRD'). When the CEO pointed out that the CEO had not signed the necessary forms, this person changed his version, told the CEO that an extension had been sought, and that such request for extension would automatically be granted, and assured the CEO that the sole proprietor was 'on top of' things.

3.10 On 18 August 1995, an estimated profits tax assessment was issued for the relevant year of assessment under section 59(3) of the IRO in the amount of $17,050,000. The due dates for payment of the 2 instalments of tax were 20 November 1995 and 12 February 1996.

3.11 On 4 September 1995, the former CPA submitted the Return on behalf of the Taxpayer. The Return shows assessable profits of US$3,792,685 equivalent to HK$29,286,734. The date stated in the Return as the date of the CEO's signature was '25 August 1995', and the Return was submitted under cover of the letter dated 29 August 1995 from the former CPA to IRD.

3.12 The Return was accepted by the IRD as correct and on 22 September 1995, the assessor raised an additional profits tax assessment for the relevant year of assessment under section 60 of the IRO in the amount of $12,236,734 ($29,286,734 - $17,050,000). The due dates for payment of the 2 instalments of tax were 28 November 1995 (8 days after the due date of the 1st instalment under the estimated assessment), and 22 February 1996 (10 days after the due date of the 2nd instalment under the estimated assessment).

3.13 On 4 December 1995, the Commissioner gave notice to the Taxpayer in terms of section 82A(4) of the IRO that he proposed to assess the Taxpayer to additional tax by way of penalty for the relevant year of assessment in respect of the failure to comply with the requirements of the notice given to it under section 51(1) of the IRO.

3.14 On 19 December 1995, the IRD received the written representations dated 19 December 1995 from another firm of Certified Public Accountants ('the new CPA') made by them on behalf of the Taxpayer. Appendices 1 and 2 were not enclosed with the representations, but were submitted subsequently on 4 January 1996.

3.15 By about December 1995, the Taxpayer had instructed the new CPA in the place and stead of the former CPA.

3.16 On 22 January 1996, the Commissioner, having considered and taken into account the Taxpayer's representations, assessed the Taxpayer to additional tax under section 82A of the IRO in the sum of $150,000 for the relevant year of assessment ('the Assessment').

3.17 By letter dated 6 February 1996 from the new CPA, which letter was received by the Board of Review on 14 February 1996, the Taxpayer lodged its appeal against the Assessment on the ground that the Assessment was excessive.

3.18 There is no actual loss of revenue in this case. The due dates for payments of the 2 instalments under the additional assessment were a matter for IRD and they were in or around the same period of the respective due dates under the estimated assessment, 8 and 10 days respectively thereafter.

The hearing

4.1 At the hearing before us, the CEO gave evidence on oath verifying the statement of facts in the written submission of the Taxpayer and was cross-examined by the representatives for the Commissioner. The sole proprietor of the former CPA also gave evidence on oath. The representatives for the Commissioner did not ask this witness any question in cross-examination.

4.2 A number of documents were 'exhibited' in the written submission of the Taxpayer and those documents were tendered in evidence by the Taxpayer.

4.3 A number of documents were appended to the written submission of the Commissioner and those documents were tendered in evidence by the Commissioner. The Commissioner adduced no oral evidence.

4.4 The written submission of the Commissioner drew our attention to sections 51(1) (a) & (b), 59(3), 60, 80(2)(d), 82A(1)(d) & (ii), and 82A(4) of the IRO, and 6 decisions of the Board of Review, namely:

(a) D105/89, IRBRD, vol 6, 384
(b) D1/95, IRBRD, vol 10, 71
(c) D31/94, IRBRD, vol 9, 196
(d) D24/94, IRBRD, vol 9, 226
(e) D64/94, IRBRD, vol 9, 361, and
(f) D2/90, IRBRD, vol 5, 77.

Our decision

5. On the notice of appeal, there is only one issue for our decision, namely whether the amount of additional tax is excessive having regard to the circumstances.

6.1 The delay in this case was 35 days.

6.2 The Taxpayer has an unblemished, albeit relatively short, track record.

6.3 Not only did the Taxpayer have no intention to defraud IRD or to delay the charging or assessment or payment of tax, the Taxpayer had every intention of submitting the Return well within time. The Taxpayer wrote and spoke to the former CPA. While the duty to comply with the section 51(1) notice was fairly and squarely on the Taxpayer, and not on their representatives, we had considerable sympathy for the Taxpayer which had placed the matters in professional hands.

6.4 The delay was completely the fault of the former CPA, caused substantially by the ill-health of the sole proprietor.

6.5 There was no actual loss of revenue.

6.6 The Taxpayer has since engaged new professional accountants.

6.7 The Taxpayer was remorseful and said in its representations to IRD that:

> 'The company admits that the delay has caused your department additional administrative inconvenience (for example, by issuing estimated assessments) and apologises for the inconvenience caused. However, it is also important to note that the company has not caused any loss of revenue by your department and the company has been co-operative with your department on tax matters in the past year.'

6.8 The Return was accepted by IRD as correct.

6.9 On principle and before reference to the cases to which our attention has been drawn by representatives for the Commissioner, we are of the opinion that in the very special circumstances of this case, the penalty of 3.1% of the amount of tax involved is excessive and should be substantially reduced.

7. We turn now to the cases cited on behalf of the Commissioner.

7.1 The fact in D105/89 were quite different. The delay was nearly ½ year, with a delay of over 3½ months in the preceding year, and a delay of 3½ months in the year before that. The Board held that 30% was not excessive in the circumstances of that case.

7.2 In D1/95, there was a delay of 5 months and a history of late filing in previous years ranging from 12 days to 96 days. The Board held that 10% was not excessive in the circumstances of that case.

7.3 In D31/94, there was a delay of 1½ months, with a history of late filing in previous years ranging from approximately 2 months to over 7 months. The Board held that 8.74% (the reference in the headnote to 10% appears to be mistaken) was not excessive in the circumstances of that case.

7.4 In D24/94, (on which the Taxpayer also relied), there was a delay of 1 month and the Board reduced the penalty from 3.2% ($80,000) to 0.2% ($5,000). The representatives for the Commissioner sought to distinguish D24/94 on the grounds that there was no request in this case for an extension and there was no submission of management accounts. It is true that there was no request for an extension. It is also true that no management accounts or audited accounts had been submitted. The fault, as we have found, lays with the former CPA. Had the Taxpayer had the wisdom of hindsight, the Taxpayer would not have continued using the services of the former CPA to prepare the Return in the first place and there might have been no non-compliance.

7.5 In D64/94 the Board held at page 368 that 6% was:

> *'not unreasonable given the shortness of the delay. This is particularly so in view of the fact that a surcharge of 5% is routinely imposed on taxpayers who fail to make payment on the due date, even if the delay is one day only, and in cases where the unpaid assessment was made without there having been any default on the taxpayer's part.'*

7.6 D2/90 was a 10% case for 2 consecutive years. The Board reasoned at page 74 that:

> *'For mere delay in payment of tax which is duly assessed after a proper tax return has been promptly submitted, a penalty of 5% is imposed. The failure to file tax returns until some months after the extended period has expired must merit more serious penalties.'*

7.7 We do not understand D64/94 or D2/90 as deciding that having regard to the surcharge of 5% under section 71(5) of the IRO, 5% is or should be the minimum penalty under section 82A(1). If the Legislature had intended that a 5% minimum for section 82A(1), it would have enacted such minimum in express terms, and would not have provided in section 82B(2)(c) that 'it shall be open to the Taxpayer to argue that ... the amount of additional tax ... is excessive having regard to the circumstances'. To read in a 5% minimum is to make nonsense of the discretion of the Board under section 82B(2)(c) to consider the question of excessiveness having regard to the circumstances. Further, there is actual loss of revenue in a section 71(5) case, but there may be no intended and no actual loss of revenue in an additional tax case.

8. For the reasons given above, in our decision, we consider that the penalty of $150,000 (3.1%) is excessive having regard to the circumstances; allow the appeal and reduce the Assessment to $20,000 (0.41%).