

# INLAND REVENUE BOARD OF REVIEW DECISIONS

## Case No. D74/89

Penalty tax – quantum of penalty – section 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Michael Choy Wah Ying and Gerald C Dobby.

Date of hearing: 7 November 1989.

Date of decision: 24 November 1989.

The taxpayer was a company carrying on business in Hong Kong which was late in filing its tax return. It was submitted that the tax return had been filed on 4 January in the following year and that the Revenue Department had the opportunity of assessing all of the tax due without any delay in the payment date.

Held:

A penalty of \$150,000 was excessive and should be reduced to \$15,000.

Appeal allowed in part.

Chan Kim Mou for the Commissioner of Inland Revenue.

Chow Tak Ming of Byrne & Co for the taxpayer.

Decision:

### 1. THE SUBJECT MATTER OF THE APPEAL

The Taxpayer appealed against the imposition of an assessment to additional tax in the sum of \$150,000 pursuant to section 82A of the Ordinance.

### 2. THE FACTS

The following facts were not in dispute:

- 2.1 The Taxpayer was incorporated in Hong Kong pursuant to the provisions of the Companies Ordinance in 1983.

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- 2.2 The profits tax return of the Taxpayer for the year of assessment 1985/86 was issued on 1 April 1986 but the completed return was not received by the Revenue until 19 January 1987.
- 2.3 The profits tax return of the Taxpayer for the year of assessment 1986/87 was issued on 1 April 1987 but the completed return was not received by the Revenue until 4 January 1988.
- 2.4 The profits tax return of the Taxpayer for the year of assessment 1987/88 ('the return'), was issued on 6 April 1988 but the completed return was not received by the Revenue until 4 January 1989.
- 2.5 Although form 'BIR 51', the number allocated to a profits tax return, requires the taxpayer to complete and file the return within one month from its date of issue, under what is referred to as the 'block extension arrangement' the Revenue permit corporation to file their profits tax returns on or before the next following 31 October, namely on automatic six months extension to the period specified in form 'BIR 51'.
- 2.6 By letter dated 31 October 1988, the auditors of the Taxpayer, who at all material times were its tax representatives, applied for an extension until 30 November 1988 within which to file the return. No reason(s) to support the request was notified to the Revenue.
- 2.7 By printed notice dated 5 November 1988, the Taxpayer's request for an extension was refused.
- 2.8 On 29 December 1988 the Revenue issued a notice of assessment and demand for profits tax for the year of assessment 1987/88 based on estimated profits of \$1,000,000. This document disclosed profits tax of \$180,000 together with provisional tax for the year of assessment 1988/89 of \$170,000 and required the tax of \$227,189 to be paid as to \$184,689 on or before 28 February 1989 and as to \$42,500 on or before 8 May 1989.
- 2.9 On 4 January 1989 the Revenue received a letter dated 28 December 1988 from the auditors enclosing the Taxpayer's audited accounts for the year ended 31 March 1988 ('the audited accounts'), the completed return and a proposed tax computation for the year of assessment 1987/88.
- 2.10 The directors' report, the report of the auditors to shareholders and the balance sheet in the audited accounts are all dated 8 July 1988, the signature of the directors to the balance sheet being recorded as having been approved at a meeting of the directors held on 8 July 1988.
- 2.11 On 1 March 1989 the Revenue issued a notice of additional assessment and notice of additional demand for tax based on the profits disclosed by the return

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and which notice required the additional tax to be paid on or before 12 April 1989.

- 2.12 By letter dated 8 May 1989, the Commissioner gave notice to the Taxpayer that he was of the opinion that the Taxpayer had, without reasonable excuse, failed to comply with the requirements of the notice given under section 51(1) for the year of assessment 1987/88. The Commissioner further stated that the tax which had been undercharged in consequence of the failure to comply with the said notice, or which would have been undercharged if such failure had not been detected, amounted to \$480,047. The notice pointed out that under section 82A of the Ordinance the Taxpayer's liability was that to be assessed to additional tax in an amount not exceeding three times the identified amount. The notice informed the Taxpayer of its right to submit written representations not later than 5 June 1989.
- 2.13 By letter dated 18 May 1989, the auditors submitted representations.
- 2.14 On 12 June 1989 the Commissioner issued a notice of assessment and demand for additional tax pursuant to section 82A in the sum of \$150,000 and required that sum to be paid on or before 12 July 1989.
- 2.15 On 15 June 1989, notice of appeal was given by the auditors on behalf of the Taxpayer, the grounds of appeal being as follows:
- 2.15.1 The delay is by no means intentional or with a view to defer tax payment.
- 2.15.2 The Taxpayer closes its books as of March 1988. The usual tax deadline for submitting the profits tax return for 1987/88 under the block extension arrangement is 31 October 1988. The Taxpayer tried its best to meet the tax filing due date and finally was able to file the tax return on 28 December 1988 (that is, only two months after the due date for filing has elapsed).
- 2.15.3 The Taxpayer filed the return on 28 December 1988 while the Commissioner's estimated assessment was issued on 29 December 1988 and reached the Taxpayer's hands not until 4 January 1989. Clearly, the two mails have crossed each other. Also, it is apparent that the Taxpayer submitted the return voluntarily without any pressure from the Inland Revenue Department. No warning of the possible penalty assessment has in fact been given to the Taxpayer by the Inland Revenue Department.
- 2.15.4 The Taxpayer has always been co-operative in complying with the requirements of Inland Revenue Ordinance. The Taxpayer always pays the tax on time and queries raised by the Inland Revenue Department have been answered almost immediately.

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2.15.5 In the light of the above, a penalty of \$150,000 is excessive having regard to the circumstances and will be too heavy a burden for the Taxpayer to bear.

### 3. COMPOSITION OF THE BOARD

The Board notified the parties that two of the directors of the Taxpayer were known to one member of the Board and invited the parties to object to him sitting on the appeal. The representatives of the Taxpayer and the Revenue took no objection thereto.

### 4. THE CASE FOR THE TAXPAYER

#### 4.1 The Opening Submission

The opening submission on behalf of the Taxpayer, made by a partner of the auditors, was extremely lengthy and included a considerable number of passages which were an attempt at putting evidence before the Board. The Board does not consider it necessary to record this submission in any detail. Additionally, the Board has ignored those parts of the submission which were in the nature of evidence as they are irrelevant to this decision. The cogent submissions were as follows:

4.1.1 The appeal was not a case of tax evasion but a case in which a tax return was submitted two months late.

4.1.2 The penalty of \$150,000 was excessive for such a minor offence.

4.1.3 Over 90% of the amount of the tax due on the audited taxable profits was paid in February and April 1989, the normal due dates for taxpayers with a March year end.

4.1.4 The profits tax return was with the Revenue on 4 January 1989 and the Revenue had the opportunity to issue the notice of additional assessment earlier than it was actually issued and when it was issued on 1 March 1989 payment was not required until 12 April 1989.

#### 4.2 The Evidence

Two witnesses were called on behalf of the Taxpayer.

4.2.1 The first witness, a partner of the auditors, gave evidence that:

4.2.1.1 The delay in completing the audit was because of the failure of the Taxpayer's customers to return the standard requests for confirmation of their respective balances.

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- 4.2.1.2 A circular from the Hong Kong Society of Accountants issued on 7 June 1988, described as a sub-standard report any report by auditors which referred to their inability to verify debtors amounting to the sum to be specified in the report.
- 4.2.1.3 No attempt was made to submit draft accounts as, at the time, the Revenue would not accept them although the most recent proforma letter now invites draft accounts.
- 4.2.1.4 The date 8 July 1988, which appears in the audited accounts was the day the auditors' audit team completed their work at the Taxpayer's offices. What took place thereafter was the verification of the Taxpayer's financial position as at 31 March 1988 from the audit team's working papers, subject to any material events which had accrued, if any, between the year end date and 8 July 1988.
- 4.2.1.5 For the accounts and reports to be dated the date upon which they were actually signed, certified by a partner to be 15 December 1988, would have constituted a representation that nothing had occurred between 1 April 1988 and 15 December 1988 which would require the auditors to qualify their report.
- 4.2.2 The second witness, the finance director of the Taxpayer, gave evidence which, essentially, was directed to the difficulties under which the Taxpayer's accounting records were being maintained at the material times. He referred to the size of the accounting department, himself and two others, difficulties with the reconciliation of the manual accounts with the computer accounts during the changeover period, which took place in 1988, an inability to recruit accounting personnel and the failure of the Taxpayer's customers to respond promptly to the request for confirmation of their balances.

### 5. SUBMISSION OF THE REVENUE

The Revenue made a concise written representation which was read to the Board. The submission dealt sequentially with the Taxpayer's grounds of appeal as follows:

- 5.1 Ground one: refer paragraph 2.15.1 above.

Attention was drawn to the record of the Taxpayer in the preceding two tax years. Attention was also drawn to the dates of the report of the directors, the report of the auditors and the signing of the balance sheet, refer paragraph 2.10 above. It was also pointed out that the return, refer paragraph 2.4 above, was dated 21 October 1988 but was not received by the Revenue until 4 January 1989. These facts pointed to there being no reasonable excuse for the Taxpayer's failure to comply with the 'BIR 51' notice.

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5.2 Ground two: refer paragraph 2.15.2 above.

There could be no dispute that, and notwithstanding 'block extension arrangement', the return was not filed within that period.

5.3 Ground three: refer paragraph 2.15.3 above.

The Board was referred to the printed 'notice of instructions' issued with each 'BIR 51' form. These notes made it clear that an offence would be committed, and the potential for penalties incurred, if the requirements of the Ordinance were not complied with. The return shows a printed notice under the space at which it is to be signed. It was submitted that this ground was irrelevant and, in fact, was contradictory to the facts of the case, namely the July dates on the audited accounts.

5.4 Ground four: refer paragraph 2.15.4 above.

It was submitted that this was irrelevant. The point in issue is whether the Taxpayer had complied with the Ordinance and the facts demonstrated that it had not. Co-operation and payment of tax on time were not relevant.

5.5 Ground five: refer paragraph 2.15.5 above.

The suggestion that the additional tax was excessive was without merit. The maximum penalty could have been three times \$1,440,141 whereas the penalty was only 10% of that maximum. It was submitted that this was lenient treatment.

### 6. REPLY ON BEHALF OF THE TAXPAYER

The representative submitted that the penalties were not mandatory but could be imposed if there was no reasonable excuse. It was submitted that the intent is to penalize those who seek to evade tax, as opposed to those who are modestly late, as was the Taxpayer. As there was no question of an attempt of evasion the penalty must be regarded as excessive.

### 7. REASONS FOR THE DECISION

7.1 The Board accepts that this is not a case in which a taxpayer set out deliberately to evade or postpone the payment of tax. That category of taxpayer is the person who files no return, does not take objection to an assessment based on estimated profits and does nothing until compelled to do so, invariably after an investigation by the Revenue.

7.2 The evidence on behalf of the Taxpayer was that the auditors could not sign off the accounts until they had received a sufficient number of confirmations of

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balances from the Taxpayer's customers. To have qualified their report, by reference to an inability to confirm those balances, would have been to issue what the Hong Kong Society of Accountants describe as a sub-standard report. However, it would seem to the Board that priorities ought to have been established by the application of some basic common sense. It may well be, although there was no evidence as to this, that the Taxpayer had a relaxed approach to credit control: it sells very expensive items to wealthy people and, perhaps, is reluctant to chase wealthy customers for what it believes its customers may consider to be trivial amounts. Nevertheless, it seems inconceivable that the Taxpayer would be prepared to extend either indefinite or 180 days plus credit. Whilst a signed and returned confirmation of a balance may verify the bookkeeping, the Board cannot be asked to accept, without evidence, that many accounts which were due at 31 March 1988 were not paid prior to, say, 15 October 1988, which, applying common sense, would have entitled the auditors to disregard the need to obtain the requested confirmations as a condition precedent to 'signing off' the accounts. Additionally, and with no disrespect to the Hong Kong Society of Accountants, it seems to the Board that in circumstances in which an auditor has difficulties in producing a report which would not be the type of report described by the Hong Kong Society of Accountants as sub-standard, they ought to prefer the need to maintain the client in compliance with the law as opposed to the need for the accounts to be in compliance with their society's recommendations.

- 7.3 For the purposes of this decision the Board finds it unnecessary to consider the explanation of the Taxpayer's first witness as to the discrepancy between the dates specified in the audited accounts and the evidence as to the date upon which the same signed.
- 7.4 The Board has some sympathy for the Commissioner. The facts known to him at the time he issued the assessment to additional tax under section 82A which did not include the explanations given to the Board, save for the Taxpayer's inability to recruit accounting personnel, indicated that the Taxpayer was in a position to comply with the Ordinance on 8 July 1988 but did not comply until the lodgment of the return, the audited accounts and its tax computation on 4 January 1989. A concerned auditor might, perhaps, have delivered the required documents by hand. With the then known facts before him the Commissioner was entitled to question why the return could not have been filed within the time permitted. It is understandable why the Commissioner took a serious view.
- 7.5 However, and notwithstanding the delay, the fact of the matter is that the Revenue did issue the assessment to additional tax on the day following the day upon which the first payment in respect of the estimated profits was due to be paid, refer paragraph 2.8 above. Factually, that assessment was issued some seven weeks after the necessary information was in the hands of the Revenue. Whilst there was some delay in the recovery of some part of the tax which

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would have been received had the return been filed on or before 31 October 1988, the Revenue chose not to require payment of that part of the tax until 12 April 1989. Whilst the Board accepts that the return would have been one of many tens of thousands being processed by the Revenue, the Board sees no reason why, in fact, the notice of assessment could not have been issued earlier or why the nominated date for payment of the additional tax could not have been way in advance of the date actually nominated. If this is attributable to a computer program then, perhaps, a modified program is called for.

- 7.6 The Board's decision has been arrived at for the following reasons:
- 7.6.1 The Board is satisfied that the delay was not an attempt on the part of the Taxpayer to evade or postpone the payment of tax.
- 7.6.2 The period of time during which some part of the tax was outstanding was some six weeks and the selection of the date by which the outstanding tax was required to be paid was exclusively that of the Revenue.
- 7.7 Whilst the Board would not categorise the explanations put to it as constituting a reasonable excuse, the Board has no alternative but to accept that the explanation dictates the adoption of a lenient approach.

### 8. DECISION

The Board orders the assessment to additional tax pursuant to section 82A to be reduced from \$150,000 to \$15,000.