

Case No. D30/13

Penalty tax – repeatedly late in submitting tax return – sections 16(1), 17(1), 51(1), 63G, 68(4), 68(8), 68(9), 80(2), 82(1), 82A and 82B of the Inland Revenue Ordinance – sections 106, 107 and 108 of the Basic Law.

Costs – appeal frivolous and vexatious.

Panel: Kenneth Kwok Hing Wai SC (chairman), Fu Mee Yuk Shirley and Julia Pui-g Lau.

Date of hearing: 4 December 2013.

Date of decision: 21 January 2014.

The Taxpayer was late in the submission of tax returns in 3 out of 4 consecutive years of assessments. The assessment of additional tax by way of penalty for the year of assessment 2010/11 was HK\$63,000, representing 17.55% of the amount of tax of HK\$358,934 which would have been undercharged if the failure had not been detected. The Taxpayer appealed against the 2010/11 penalty tax assessment contending that ‘the amount ... is excessive having regard to all the circumstances’.

Held:

1. The Inland Revenue makes millions of assessments each year. A high degree of compliance by the taxpayers in submitting timely, correct and complete tax returns and information to the Revenue is crucial for the effective operation of HKSAR’s narrowly based and low rate tax system. It is a waste of the Revenue’s limited resources to pamper taxpayers who turn a blind eye to their duty to submit timely, correct and complete tax returns and information. This is also unfair to the honest and compliant taxpayers who take great care to comply and exercise due diligence in complying with their statutory reporting duties. The Taxpayer could not escape liability to pay penalty tax by delegating to others. It is a basic sentencing principle that, as a general rule, higher penalties are meted out to repeat offenders. This was the third contravention in 4 consecutive accounting years. A warning and a penalty of 13.94% proved ineffective. 17.55% is plainly not excessive in the circumstances of this case. We dismiss the appeal and confirm the assessment.
2. The Board considers this appeal to be frivolous and vexatious. We see no reason why other taxpayers should bear the costs of such a waste of public

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resources. Pursuant to sections 82B(3) and 68(9), the Taxpayer should be ordered to pay the sum of \$5,000 as costs of the Board.

Appeal dismissed and costs order in the amount of \$5,000 imposed.

Cases referred to:

Shui On Credit Company Limited v Commissioner of Inland Revenue, (2009) 12 HKCFAR 392

Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7, CA D16/07, (2007-08) IRBRD, vol 22, 454

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

Taxpayer in person.

Tsang Yuk King and Tse Yuen Ling for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant is a barrister in private practice closing his accounts on 31 December each year.
2. A firm of professional accountants has since the year of assessment 2003/04 been the Appellant's tax representatives.
3. Under a block extension scheme, the deadline for the Appellant's tax returns was extended to 3 October 2011 for the 2010/11 year of assessment.
4. The Appellant was late in the submission of tax returns in 3 out of 4 consecutive years of assessments:

<u>Year of assessment</u>	<u>No. of days late</u>	<u>Action taken by Revenue</u>	<u>Percentage of penalty on tax involved</u>
2007/08	77	Warning letter	
2008/09	67	Penalty tax of \$15,800 imposed	13.94%
2009/10	[4 days before extended deadline]		

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<u>Year of assessment</u>	<u>No. of days late</u>	<u>Action taken by Revenue</u>	<u>Percentage of penalty on tax involved</u>
2010/11	59	Penalty tax of \$63,000 imposed	17.55%

5. The Appellant appealed against the 2010/11 penalty tax assessment contending that ‘the amount ... is excessive having regard to all the circumstances’.

The agreed facts

6. The parties agreed the facts stated in the ‘Statement of Facts’ and we find them as facts.

7. The Appellant appealed against the assessment of additional tax by way of penalty assessed upon him on 29 June 2012 under section 82A (‘the Assessment’) of the Inland Revenue Ordinance, Chapter 112 (‘the Ordinance’).

8. The Assessment was imposed for the failure by the Appellant to furnish his Tax Return – Individuals (‘Tax Return’) for the year of assessment 2010/11 within time allowed pursuant to a notice given to him under section 51(1) of the Ordinance. The additional tax of HK\$63,000 so imposed is 17.55% of the amount of tax of HK\$358,934 which would have been undercharged if the failure had not been detected.

9. Particulars of the Appellant’s delay in filing the Tax Return and the additional tax by way of penalty is as follows:

Year of assessment	2010/11
Date of issue of the Tax Return	3 May 2011
Extended due date for filing the Tax Return	3 October 2011
Date of receipt of the Tax Return	1 December 2011
Period of delay in filing the Tax Return	59 days
Tax undercharged	\$358,934
Additional tax by way of penalty	\$63,000
Percentage of additional tax on tax undercharged	17.55%

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10. The Appellant commenced his profession as a barrister-at-law in Hong Kong under a sole-proprietorship business in the name of [name omitted here] in 1993.
11. The Appellant appointed Company A as his authorized representative ('Tax Representative') since the year of assessment 2003/04.
12. On 31 March 2011, the Respondent issued a circular letter to the Tax Representative explaining the lodgment arrangement for the tax returns for year of assessment 2010/11 ('Block Extension Scheme'). For represented cases involving sole proprietorship business accounts, the date of submission of the tax returns was extended to 3 October 2011.
13. On 3 May 2011, the Assistant Commissioner issued a notice for filing Tax Return for the year of assessment 2010/11 to the Appellant and required him to complete and return it to the Inland Revenue Department within three months from the date of issue.
14. By reason of the Block Extension Scheme for lodgment of tax return for year of assessment 2010/11, the due date for the Appellant to file the Tax Return for 2010/11 was extended to 3 October 2011.
15. On 11 November 2011, the Assessor, not having received the duly completed Tax Return from the Appellant, raised an estimated Profits Tax assessment ('Estimated Assessment') under section 59(3) of the Ordinance for the year of assessment 2010/11 with estimated assessable profits in the total amount of HK\$1,388,000 and tax payable of HK\$208,200.
16. By a notice dated 1 December 2011, the Appellant through his Tax Representative lodged an objection against the Estimated Assessment and submitted the relevant Tax Return at the same time which showed assessable profits before charitable donations of HK\$2,462,389. In Part 6 of the Tax Return, the Appellant indicated that he wished to elect for Personal Assessment.
17. On 6 March 2012, the Assessor revised the Estimated Assessment under section 64(3) of the Ordinance with assessable profits adjusted to HK\$2,433,264. On the same date, the Assessor issued a Notice of assessment under Personal Assessment ('Personal Assessment') to the Appellant, which showed the profits and the tax payable of HK\$358,934.
18. No prosecution under section 80(2) or section 82(1) of the Ordinance has been instituted in respect of the same facts.
19. On 30 March 2012, the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') issued a notice of intent to assess additional tax given under section 82A(4)

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of the Ordinance ('the Notice') to the Appellant in respect of the Appellant's failure to furnish the Tax Return for the year of assessment 2010/11 within the prescribed time allowed. If the Department had not detected the failure, tax amounting to \$358,934 would have been undercharged. The Notice stated that a penalty by way of additional tax up to three times the amount of tax that would have been undercharged might be imposed. The Appellant was invited to submit written representations to the Deputy Commissioner.

20. By a letter dated 7 May 2012, the Appellant made representations to the Deputy Commissioner in response to the Notice.

21. On 29 June 2012, the Deputy Commissioner, having considered the representations, assessed the Appellant to additional tax by way of penalty under section 82A of the Ordinance in the amount of HK\$63,000.

22. By a letter dated 30 July 2012, the Appellant filed a notice of appeal to the Clerk to the Board of Review against the assessment to additional tax by way of penalty.

23. The Appellant had previously failed to submit his Tax Return for the years of assessment 2007/08 and 2008/09 within the time stipulated and details are as follows:

Year of Assessment	2007/08	2008/09
Date of issuing of Tax Return	2 May 2008	4 May 2009
Extended due date for filing of Tax Return	2 October 2008	5 October 2009
Date of receipt of Tax Return	18 December 2008	11 December 2009
Length of delay in filing Tax Return (Days)	77	67
Assessable Profits (HK\$)	951,175	1,050,426
Tax that would have been undercharged (HK\$)	83,699	113,352

24. In relation to the Appellant's late filing of Tax Return for the year of assessment 2007/08, the Respondent issued a warning letter to the Appellant on 27 April 2009 informing him that no action would be taken against the Appellant. However, any future offence of similar nature would not be treated so leniently.

25. (a) In relation to the Appellant's late filing of Tax Return for the year of assessment 2008/09, the Deputy Commissioner issued a notice under

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section 82A(4) of the Ordinance to the Appellant on 21 April 2010. By a letter dated 3 June 2010, the Appellant through his Tax Representative submitted written representations to the Deputy Commissioner.

- (b) Having considered the representations, the Deputy Commissioner issued a Notice of assessment and demand for additional tax under section 82A of the Ordinance on 15 July 2010 to the Appellant. The amount of additional tax by way of penalty under section 82A of the Ordinance was \$15,800.

26. The Appellant filed the Tax Return for the year of assessment 2009/10 on 30 September 2010, 4 days before the extended due date for filing.

Ground of Appeal

27. The Appellant's 'Statement of grounds of appeal' reads as follows:

'The amount of additional tax of \$63,000 assessed by the Deputy Commissioner of Inland Revenue is excessive having regard to all the circumstances.'

The relevant statutory provisions

28. Section 16(1) of the Ordinance provides that:

'In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period ...'

29. Section 17(1) provides that:

'For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of— (a) domestic or private expenses, including— (i) the cost of travelling between the person's residence and place of business ...'

30. Section 51(1) provides that:

'An assessor may give notice in writing to any person requiring him within a reasonable time stated in such notice to furnish any return which may be specified by the Board of Inland Revenue for ... property tax, salaries tax and profits tax ...'

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31. Section 63G, a provision added in 1975, provides that:

‘ Every person who is chargeable to profits tax under Part 4 in respect of the year of assessment commencing on 1 April 1975 or any succeeding year of assessment shall be liable to pay provisional profits tax in respect of that year of assessment in accordance with this Part.’

32. Section 68(4), (8)(a) and (9) provide that:

‘ (4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

‘ (8)(a) After hearing the appeal, the Board shall confirm, reduce, increase or annul the assessment appealed against or may remit the case to the Commissioner with the opinion of the Board thereon.’

‘ (9) Where under subsection (8), the Board does not reduce or annul such assessment, the Board may order the appellant to pay as costs of the Board a sum not exceeding the amount specified in Part 1 of Schedule 5, which shall be added to the tax charged and recovered therewith.’

The amount specified in Part 1 of Schedule 5 is \$5,000.

33. Section 82A(1) provides that:

‘ Any person who without reasonable excuse ... (d) fails to comply with the requirements of a notice given to him under section 51(1) ... 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 ... has been undercharged in consequence of the failure to comply with a notice under section 51(1) ... or which would have been undercharged if such failure had not been detected.’

34. Section 82B(2) and section 82B(3) provide that:

82B(2) *‘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.'*

82B(3) *'Sections 66(2) and (3), 68, 68A, 69 and 70 shall, so far as they are applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax.'*

The Board's function in a tax appeal

35. Whether to assess a taxpayer to additional tax and, if the answer is in the affirmative, the amount of additional tax to be assessed, are matters for the Commissioner. It is entirely up to the Commissioner to decide whether to impose a severe or lenient penalty. If the taxpayer accepts the penalty and pays up, that is the end of the matter and the Board does not come in at all.

36. Section 82B confers on a taxpayer the right to appeal to the Board. Once the taxpayer invokes the statutory right of appeal, he is subject to the appeal scheme provided by the Ordinance, including the provisions referred to above and below.

37. Hong Kong's appellate courts have held that the Board must:

- (1) consider the matter from the beginning, anew; and
- (2) perform its 'ultimate function' to 'confirm, reduce, increase or annul the assessment' appealed against.

(a) In Shui On Credit Company Limited v Commissioner of Inland Revenue, (2009) 12 HKCFAR 392, Lord Walker NPJ said in the Court of Final Appeal judgment at paragraphs 29 and 30 that the Board's function is to consider the matter *de novo* (meaning starting from the beginning; anew) and the appeal is an appeal against an assessment:

' 29. As the Board correctly observed, by reference to the decisions in Mok Tsze Fung v. CIR [1962] HKLR 258 and (after the amendment of s.64 of the IRO) CIR v. The Hong Kong Bottlers Ltd [1970] HKLR 581, the Commissioner's function, once objections had been made by the taxpayer, was to make a general review of the correctness of the assessment. In Mok Tsze Fung v Commissioner of Inland Revenue, Mills-Owens J said at pp 274-275:

“His duty is to review and revise the assessment and this, in my view, requires him to perform an original and administrative, not an appellate and judicial, function of considering what the proper assessment should be. He acts de novo, putting himself in the place of the assessor, and forms, as it were, a second opinion in substitution for the opinion of the assessor.”

30. *Similarly the Board’s function, on hearing an appeal under s.68, is to consider the matter de novo: CIR v. Board of Review ex parte Herald International Limited [1964] HKLR 224, 237. The taxpayer’s appeal is from a determination (s.64(4)) but it is against an assessment (s.68(3) and (4)) ...’*

(b) In Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7, CA, Fuad VP said at page 23 that the Board must perform its ‘ultimate function’ to ‘confirm, reduce, increase or annul the assessment’ appealed against.

38. On an appeal to the Board:

- (1) The Board, not the representative, is the fact finding body. The onus is on the Appellant through the representative to adduce intelligible evidence on how the late filing came about [section 68(4)].
- (2) The Board, not the Commissioner, is the decision maker. If there is any discretion in any matter, such discretion is to be exercised by the Board.

Submitting true, correct and complete tax returns on time

39. Articles 106 and 108 of the Basic Law provide that the Hong Kong Special Administrative Region shall have independent finances and practise an independent taxation system.

40. Articles 107 and 108 of the Basic Law provide that the HKSAR shall:

- (a) follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product; and
- (b) taking the low tax policy¹ previously pursued in Hong Kong as reference, enact laws on its own concerning types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation.

¹ Tax rates range from 10% to 17.5%, see Schedules 1 and 8 to the Ordinance.

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41. Direct taxation on earnings and profits is an important source of income for HKSAR.
42. While the tax rates are low and the fiscal system is narrowly based, the demands on general revenue are ever increasing.
43. Delay in submitting returns may delay the timely collection of revenue.
44. Omission or understatement of receipts in tax returns causes loss in revenue if the returns are accepted by the Revenue as correct.
45. Failure to notify chargeability, if undetected by the Revenue, causes loss in revenue.
46. The Revenue makes millions of assessments each year. A high degree of compliance by the taxpayers in submitting timely, correct and complete tax returns and information to the Revenue is crucial for the effective operation of HKSAR's tax system.
47. The Revenue can check the accuracy of returns, conduct field audits and prosecute suspected offenders. It can also deploy resources and manpower to copy information it received to the taxpayers.
48. It is a waste of the Revenue's limited resources to:
- (a) conduct checks, investigations and audits which are avoidable had there been a high degree of compliance by taxpayers of their statutory reporting duties; and
 - (b) pamper taxpayers who turn a blind eye to their duty to submit timely, correct and complete tax returns and information.
49. This is also unfair to the honest and compliant taxpayers who take great care to comply and exercise due diligence in complying with their statutory reporting duties. There is no reason for the honest and compliant taxpayers exercising due diligence in the discharge of their statutory reporting duties to foot the bill. Those in breach, not those who comply, should pay.
50. The Appellant could not escape liability to pay penalty tax by delegating to others. A limited company must act through a natural person and it is not open to the Appellant to say 'it is somebody else's fault, not mine'.
51. Penalty tax serves two purposes – to punish the delinquent taxpayers and to deter those and other taxpayers.

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52. The Board takes a serious view of omission or understatement of income, see D16/07, (2007-08) IRBRD, vol 22, 454 at paragraphs 125 to 128, where the Board cited a number of Board decisions and extracted the following principles from those cases:

- (a) Receipt and accrual of income and the total amount in the 12-month period in a year of assessment are factual matters within the personal knowledge of the taxpayer. Such knowledge does not depend on the taxpayer having been supplied with employer's return(s) or remembering about employer's return(s).
- (b) In cases where the taxpayer was paid by autopay or deposits into the taxpayer's bank account, the taxpayer could easily have ascertained and checked the correct total amount of income by reference to the banking records.
- (c) Carelessness or recklessness is not a licence to understate or omit one's income.
- (d) While an intention to evade tax is undoubtedly an aggravating factor, lack of intention to evade tax is not a mitigating factor for the simple reason that no taxpayer should have the intention to evade tax.
- (e) There is no duty on the part of the Revenue to warn a taxpayer before invoking section 82A.
- (f) Payment of tax is not a relevant factor. It is the duty of every taxpayer to pay the correct amount of tax. If he/she does not pay tax, on time or at all, he/she will be subject to enforcement action.
- (g) The fact that the Revenue was vigilant enough to detect the understatement is not a mitigating factor. The fact that the Revenue suffered no financial loss is not a mitigating factor. It is an aggravating factor if the Revenue has suffered financial loss.
- (h) Financial difficulty or inability to pay the penalty must be proved by cogent evidence.
- (i) In cases of an incorrect return, it is wholly unrealistic for a taxpayer to ask for zero penalty. If anything, this is an indication that the taxpayer is still not taking his/her duties seriously.
- (j) There must be a real difference in penalty between those who mitigate their breaches by being co-operative and those who aggravate their breaches by being obstructive.

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- (k) A second or further contravention is an aggravating factor. If a taxpayer does not get the message from the Revenue's or the Board's treatment of the first or earlier contraventions and does not take proper steps to ensure full and complete reporting of income, a heavier penalty should, as a general rule, be imposed for subsequent contraventions.
- (l) A blatant breach should be punished by a stiff penalty.
- (m) In cases where the Board concludes that the additional tax assessment is excessive, the Board will reduce the penalty assessment.
- (n) In appropriate cases where the Board concludes that the additional tax assessment is manifestly inadequate, the Board will increase the additional tax assessment.
- (o) Where the Board concludes that the appeal is frivolous and vexatious or an abuse of the process of appeal, the Board may impose an order on costs.

53. From time to time, taxpayers who have the knowledge and means of complying with the reporting duties if they have intended or taken the trouble so to do. Through carelessness, or not caring whether they comply with their reporting duties, fail to do so. They show no or no genuine remorse. They take no steps to put their houses in order. They blame other people for their own breaches and argue that it is unfair to penalise them. They demand a waiver of penalty². It is difficult to see how such taxpayers could hope to win the sympathy of the Board in such cases.

The Appellant's income statement for year ended 31 December 2010

54. The Appellant's income statement for year ended 31 December 2010 showed:

- (1) fee income of slightly over HK\$4 million; and
- (2) expenses totalling more than HK\$1.7 million, including the following:

<u>Expenses</u>	<u>HK\$</u>
Accounting fee	19,369
Chambers expenses	216,000
Donations	49,270
Entertainment	366,578
Laundry and clothing	11,622
Medical expenses	178,908
Rent	126,000

² The Appellant does not ask for total waiver or reduction.

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<u>Expenses</u>	<u>HK\$</u>
Telecommunications	55,593
Travelling	422,896
Tuition and seminars	95,197

Failure to detect

55. The statutory scheme is that the maximum penalty is treble the tax which has been undercharged *or which would have been undercharged if such failure had not been detected.*

56. In Dodge Knitting Co Ltd and Dodge Trading Ltd v CIR 2 HKTC 597, Liu J held that:

‘ Whilst limb one deals with an actual undercharge, limb two deals with an hypothetical undercharge – a hypothetical situation in a case where the failure was in fact detected – thus enabling the same penalty to be computed on a hypothetical sum of what would have been undercharged if such failure had not been detected.’

Penalty tax as a percentage

57. The Board has repeatedly held that penalty tax should be considered as a percentage of the amount of tax involved.

58. Section 82A does not lay down any amount in dollar terms as a maximum. What it does provide for as the maximum is ‘an amount not exceeding treble the amount of tax ...’

59. The maximum amount varies, depending on the size of the tax involved.

60. This is precisely the reason why there are numerous Board decisions making it clear that the correct approach in penalty tax cases is to look at the penalty tax as a percentage of the amount of tax involved.

61. Where the amounts of tax involved are high, the maximum amount of additional tax will correspondingly be high in dollars.

Consideration of the ground of appeal

62. The sole ground is that the penalty is excessive having regard to all the circumstances.

63. The Appellant closes his accounts on 31 December each year.

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64. By the extended deadline of 3 October 2011, he had had:
- (1) more than 9 months to compute his assessable income; and
 - (2) more than 5 months to complete and submit the Tax Return.
65. He had had the assistance of professional accountants as his tax representative.
66. The accounts of practising barristers are usually prepared on cash basis and are not overly difficult to prepare.
67. A barrister practises as a sole proprietor.
68. Fees are normally paid to the barrister by cheques.
69. Expenses are deductible to the extent they are incurred during the basis period for that year of assessment by such person *in the production of profits* (paragraph 28 above); and no deduction shall be allowed in respect of *domestic or private expenses*, including the cost of travelling between the person's residence and place of business (paragraph 29 above).
70. He had had the benefit of professional services rendered by professional accountants and HK\$19,369 was claimed as accounting fee.
71. Chambers expenses totalling \$216,000 were paid to a limited company.
72. In his letter dated 7 May 2012, he stated at the outset that:
- 'It is with utmost regret that I am again facing an allegation of late filing in circumstances where I had reasonably expected my accountants to reflect on past incidents and take proactive steps to avoid recurrence. As this matter is of considerable concern, I feel it is necessary for me to make this written representation personally (rather than through my accountants) despite my professional commitments.'*
73. This passage, coming from the Appellant himself, shows that:
- (1) He was a repeat offender;
 - (2) He knew he was a repeat offender;
 - (3) Instead of taking any steps to put his house in order and to ensure compliance of his statutory reporting duties, he sought to blame the Tax Representative.

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- (4) There is **no** evidence of any fault on the part of the Tax Representative. Even if the Tax Representative were at fault, that is a matter between the Appellant and the Tax Representative. The statutory reporting duty falls fairly and squarely on the Appellant.
- (5) He was an unrepentant repeat offender.
- (6) The phrase ‘allegation of late filing’ suggests an issue when there is none. He was clearly late.

74. It is a basic sentencing principle that, as a general rule, higher penalties are meted out to repeat offenders. This was the third contravention in 4 consecutive accounting years. A warning and a penalty of 13.94% proved ineffective. 17.55% is plainly not excessive in the circumstances of this case.

75. We should make it abundantly clear that we have only dealt with the lateness of the submission of the Tax Return.

Disposition

76. We dismiss the appeal and confirm the Assessment.

Costs

77. We consider this appeal to be frivolous and vexatious.

78. We see no reason why other taxpayers should bear the costs of such a waste of public resources. Pursuant to sections 82B(3) and 68(9), the Appellant should be ordered to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the additional tax as increased and recovered therewith.

79. The Appellant is **ordered to pay** the sum of **\$5,000 as costs** of the Board, which \$5,000 shall be added to the additional tax.