

**Case No. D35/13**

**Penalty tax** – late filing of tax return – whether penalty tax imposed was excessive – sections 51(1), 82A(1) and 82B of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Miu Liong Nelson and Marianna Tsang Wai Chun.

Date of hearing: 3 January 2014.

Date of decision: 27 January 2014.

The Appellant was a sole proprietor in the business of the import and export of diamonds. For the year of assessment 2010/11, he submitted his tax return 1 month and 12 days late. The Commissioner did not take any penal action, but warned the Appellant that any future transgression would not be treated so leniently. For the year of assessment 2011/12, the Appellant was 28 days late in filing his tax return. The Commissioner raised penalty tax of \$10,000 by way of additional tax, under section 82A of the IRO. No prosecution under section 80(2) or 82(1) of the IRO was instituted against the Appellant. The Appellant appealed against the additional tax raised, arguing that there was miscommunication between the Appellant and the Tax Representative whilst preparing the accounts. Also, the Appellant argued that he was travelling out of Hong Kong.

**Held:**

1. Section 82B of the IRO confers on a taxpayer the right to appeal to the Board against additional tax raised by the Commissioner as penalty tax for late submission of tax return. Once this right is invoked, the Board must consider the matter afresh, to consider whether the assessment appealed against must be confirmed, reduced, increased or annulled (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 applied).
2. A high degree of compliance by taxpayers in submitting timely, correct and complete tax returns and information to the Revenue was crucial for the effective operation of the HKSAR's tax system. Therefore, it was right that penalty tax shall be imposed for late submission of tax return, in order to punish the delinquent taxpayers and to deter those and other taxpayers.

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3. The Board took a serious view of omission or understatement of income. Carelessness or recklessness was not a licence to omit reporting of income. A second or further contravention was an aggravating factor that, as a general rule, a heavier penalty should be imposed for subsequent contraventions (D16/07, (2007-08) IRBRD, vol 22, 454 considered).
4. The Appellant had more than 6 months to compute his assessable income and more than 5 months to submit the tax return. He also had the assistance of professional accountants as his tax representative. The Appellant could not escape liability to pay penalty tax by delegating to others. In any event, no evidence was filed by the Appellant to substantiate the argument of miscommunication between the Appellant and the Tax Representative.
5. The penalty tax was 14.2% of the tax which would have been undercharged if the Appellant's failure to submit his tax return within the extended deadline had not been detected. It was plainly not excessive in the circumstances of the case.
6. The present case was a bad case of abuse of process, because the Appellant only sent a representative to attend the hearing before the Board, who was late, had no knowledge of the Appellant's prior late submission of tax return, and simply regurgitated the appeal grounds without adducing any supporting evidence.

**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  
D19/07 (2007-08) IRBRD, vol 22, 454

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

Shah Dhruvesh Kiran for the Appellant.

Leung Wing Chau and Chung Mei Yan for the Commissioner of Inland Revenue.

**Decision:**

**Introduction**

1. The Appellant closes his account on 31 March each year.

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2. He was late by 1 month 12 days in submitting his tax return for the year of assessment 2010/11. The Respondent did not take any penal action against him but sent him a letter warning him that any future transgression would not be treated so leniently.

3. Despite the warning, the Appellant was again late in submitting his tax return for the ensuing year of assessment. This time the delay was 28 days.

4. He was assessed to penalty tax in the sum of \$10,000 which was equivalent to 14.2% of the tax which would have been undercharged if his failure to submit his tax return within the extended deadline had not been detected.

5. He appealed stating that (written exactly as it stands in the original):

‘ ... kindly Request you to avoid this time and we shall do our best to be on time in future’.

**The agreed facts**

6. The parties agreed the facts stated in the ‘Statement of Facts’ and we find them as facts, see paragraphs 7 to 25 below.

7. The Appellant has appealed against the assessment of additional tax imposed under section 82A of the Inland Revenue Ordinance, Chapter 112, (‘the Ordinance’) for the year of assessment 2011/12 issued on 26 June 2013 (‘the Assessment’).

8. Particulars of the Appellant’s delay in filing the Tax Return – Individuals for the year of assessment 2011/12 (‘the Return’) are summarised as follows:

Year of assessment	2011/12
Date of issue of the Return	2 May 2012
Extended Due Date for filing the Return	3 October 2012
Date of the Return	19 October 2012
Date of receipt of the Return	31 October 2012
Delay in filing the Return	28 days
Tax undercharged	\$70,450
Additional tax by way of penalty imposed	\$10,000
Percentage of additional tax on tax undercharged	14.2%

9. At all material times, the Appellant is the sole proprietor of [name omitted here] (‘the Business’). The Business was registered under the Business Registration Ordinance on 2 March 2005 with its nature of business as import and export of diamonds. The Appellant closes the accounts of the Business annually on 31 March.

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10. At all material times, the Appellant has appointed Company A as his representative to handle his tax affairs.

11. On 2 May 2012, the Inland Revenue Department ('the Department') issued a notice for filing the Return to the Appellant. The Appellant was required to complete and submit the Return within three months from 2 May 2012.

12. By reason of a Block Extension Scheme for Lodgement of 2011/12 Tax Returns which was applicable to the Appellant who had a representative for his sole-proprietorship business, the due date for filing the Return was extended to 3 October 2012 ('the Extended Due Date').

13. On 31 October 2012, the Department received the Return together with tax computation and financial statements for the year ended 31 March 2012 of the Business. The Return was dated 19 October 2012. The financial statements and the tax computation were also of the same date.

14. On 28 November 2012, the Assessor issued a notice of Profits Tax Assessment for the year of assessment 2011/12 to the Appellant with assessable profits of \$831,592, as per his declaration in the Return. No profits tax was demanded as the Appellant had elected personal assessment.

15. On 4 December 2012, the Assessor issued to the Appellant a notice of personal assessment demanding tax for the year of assessment 2011/12 as follows:

	\$
Income from Business (sole proprietorship)	831,592
<u>Less:</u>	
Married person's allowance	216,000
Child allowance	<u>60,000</u>
Net chargeable income	<u>555,592</u>
Tax payable thereon (after tax reduction of \$12,000)	<u>70,450</u>

16. The Appellant did not object to the profits tax assessment or the personal assessment.

17. No prosecution under section 80(2) or section 82(1) of the Ordinance has been instituted against the Appellant in respect of the same facts.

18. On 4 Mar 2013, the Deputy Commissioner of Inland Revenue issued to the Appellant a notice of intention to assess additional tax under section 82A(4) of the Ordinance in respect of his failure to file the Return by the Extended Due Date ('the Notice'). If the Department had not detected the failure, tax amounting to \$70,450 would have been undercharged. The Notice stated that additional tax by way of penalty up to three times the

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amount of tax that would have been undercharged might be imposed if he did not have a reasonable excuse for such failure. The Deputy Commissioner invited the Appellant to submit written representations.

19. On 25 March 2013, the Department received a letter dated 21 March 2013 from the Appellant in response to the Notice ('First Representation Letter').

20. On 17 April 2013, the Department received from the Appellant another letter dated 16 April 2013 together with photocopies of three pages of his passport ('Second Representation Letter').

21. On 26 June 2013, the Deputy Commissioner, after considering the Appellant's representations, issued to the Appellant a notice of assessment to additional tax by way of penalty under section 82A of the Ordinance for the year of assessment 2011/12 in the amount of \$10,000.

22. By a letter dated 26 July 2013, the Appellant gave notice of appeal to the Clerk to the Board of Review against the assessment to additional tax.

23. According to the movement records of the Immigration Department, during the period of 155 days from the issue date of the Return (2 May 2012) up to the Extended Due Date (3 October 2012), the Appellant was in Hong Kong on 125 days during the following periods:

	<u>No. of days</u>
2 May 2012 to 1 June 2012	31
3 June 2012 to 31 July 2012	59
28 August 2012 to 29 September 2012	33
2 October 2012 to 3 October 2012	<u>2</u>
Total	<u>125</u>

In addition, he was in Hong Kong throughout the period from 3 October 2012 (the Extended Due Date) to 31 October 2012 (date of receipt of the Return).

24. The Appellant had previously failed to submit his Tax Return – Individuals for the year of assessment 2010/11 within the time allowed and details are as follows:

Year of assessment	2010/11
Date of issue of return	3 May 2011
Extended due date for filing return	3 October 2011
Date of receipt of return	15 November 2011
Delay in filing return	1 month and 12 days
Tax undercharged	\$50,166

25. In relation to the Appellant's late filing of the Tax Return – Individuals for the year of assessment 2010/11, no prosecution under section 80(2) or section 82(1) of the Ordinance had been instituted and no additional tax by way of penalty under section 82A of the Ordinance had been imposed. The Respondent issued a letter to the Appellant on 6 March 2012 pointing out his failure and commission of an offence liable to a heavy penalty, and warning that any future offence of this nature would not be treated so leniently.

### **Statement of Grounds of Appeal**

26. The Appellant's statement of grounds of appeal reads as follows (written exactly as it stands in the original):

‘ We would like to appeal to the board of review of file no: [number omitted here]. we apologize for late submit the company's account '[name omitted here] - Y/A 2011/12' on 31/10/2012 at the last moment. It was because of miscommunication between our accountant and us while preparing the account. Secondly, I was on travelling during this period. We hope that you can avoid the penalty of HKD 10,000 this time and we promise for this Y/A 2012/13 I should submit the account earlier. We kindly Request you to avoid this time and we shall do our best to be on time in future.’

27. 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.*’

28. 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.

29. 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 ... (ii) 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.’*

30. 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**

31. 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.

32. 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.

33. 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.

34. 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**

35. 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.

36. 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 policy<sup>1</sup> 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.

37. Direct taxation on earnings and profits is an important source of income for HKSAR.

38. While the tax rates are low and the fiscal system is narrowly based, the demands on general revenue are ever increasing.

39. Delay in submitting returns may delay the timely collection of revenue.

40. Failure to notify chargeability, if undetected by the Revenue, causes loss in revenue.

41. Omission or understatement of receipts in tax returns causes loss in revenue if the returns are accepted by the Revenue as correct.

42. 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.

43. 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.

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

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44. 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.
45. 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.
46. 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'.
47. Penalty tax serves two purposes – to punish the delinquent taxpayers and to deter those and other taxpayers.
48. 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.

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- (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.
- (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.

49. 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 penalty. It is difficult to see how such taxpayers could hope to win the sympathy of the Board in such cases.

### **Failure to detect**

50. 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.*

51. 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**

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

53. 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 ...’

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

55. 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.

56. 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**

57. The Appellant closes his accounts on 31 March each year.

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58. By the extended deadline of 3 October 2012, he had had:
- (1) more than 6 months (from 1 April 2012 to 3 October 2012) to compute his assessable income; and
  - (2) more than 5 months (from 2 May 2012 to 3 October 2012) to complete and submit the Tax Return.
59. He had had the assistance of professional accountants as his tax representative.
60. There is **no** evidence of any miscommunication between the Appellant and the Tax Representative. Even if there was, that is a matter between the Appellant and the Tax Representative. The statutory reporting duty falls fairly and squarely on the Appellant.
61. The Appellant's assertion in his ground of appeal that:
- ‘ I was on travelling during this period ... ’
- is contradicted by the agreed facts (see paragraph 23 above).
62. It is a basic sentencing principle that, as a general rule, higher penalties are meted out to repeat offenders. This was the second contravention in 2 consecutive accounting years. A warning proved ineffective. 14.2% is plainly not excessive in the circumstances of this case.

**Disposition**

63. We dismiss the appeal and confirm the Assessment.

**Costs**

64. The Appellant was absent from the hearing. He sent a representative who:
- (1) was late in attending the hearing and kept the Board, staff in the Clerk's office and representatives from the Revenue waiting for 15 minutes because he was in a meeting;
  - (2) did not know that the Appellant was late in submitting the tax return during the immediately preceding year of assessment; and
  - (3) regurgitated the ground of appeal a number of times without adducing any evidence in support.
65. We consider this appeal to be a bad case of abuse of process.

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66. 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 Assessment and recovered therewith.

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