

Case No. D36/13

Penalty tax – delay in filing tax return – sections 51(1), 59(3), 68, 80(2), 82(1), 82A & 82B of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Chan Lai Yee and Shum Sze Man Erik.

Date of hearing: 10 January 2014.

Date of decision: 28 January 2014.

The Appellant appealed against the imposition of penalty by way of additional tax assessed upon it under section 82A of the IRO for the failure to comply with the requirement of a notice under section 51(1) of the IRO to furnish a profits tax return within the prescribed time allowed. The period of delay was 78 days, and the amount of additional tax charged \$9,000, equivalent to 2.98% of the tax that would have been undercharged if the failure had not been detected.

The Appellant sought to explain the delay by reference to personnel movement, that its only two directors were busy, and that it did not have any bad intention to avoid paying the tax relying on the fact that the tax assessed was paid on time.

The Appellant had two previous failures in filing profits tax return in the past 5 years, the periods of delay in which were 111 and 9 days respectively.

Held:

1. There is no evidential support of any of the factual assertions in the Appellant's grounds of appeal. The assertions in the first ground of appeal lack particulars.
2. The duty is on the Appellant to keep and prepare proper accounts of its tax affairs, and employ sufficient and competent persons to help it to discharge its statutory reporting duties and to work with its own chosen auditors.
3. 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.

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4. 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.
5. Moreover, unlike section 82(1), 'wilfully with intent to evade or to assist any other person to evade tax' is not prerequisite of liability under section 82A.
6. The Appellant had 7 ½ months to furnish the Tax Return. It is the duty of the Appellant to comply with due diligence.
7. 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 by way of compound penalty proved ineffective. 2.98% is plainly not excessive in the circumstances of this case.

Appeal dismissed.

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
D16/07, (2007-08) IRBRD, vol 22, 454
Dodge Knitting Co Ltd and Dodge Trading Ltd v CIR 2 HKTC 597

Managing Director of the Appellant Company for the Appellant.
Lau Wai Sum and Wong Kin Hon for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant closes its accounts on 31 March each year. Under a block extension scheme, the extended due date for it to furnish its profits tax return for the 2011/12 year of assessment was extended to 15 November 2012.

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2. The Appellant was late in his submission of tax returns in 3 out of 4 consecutive years of assessments:

<u>Year of assessment</u>	<u>Period of delay</u>	<u>Tax undercharged¹</u> <u>(\$)</u>	<u>Action taken by Revenue</u>	<u>Percentage of penalty on tax involved</u>
2008/09	111 days	47,842	Compound penalty in sum of \$1,200	
2009/10	9 days		No penal action	
2010/11	No delay			
2011/12	78 days	301,594	Additional tax of \$9,000 imposed	2.98%

3. The Appellant appealed against the 2.98 % additional tax assessment asserting that it was ‘an exceptional case which will not happen in the future’.

Finding of facts

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

5. The Appellant has appealed against the imposition of penalty by way of additional tax assessed upon it under section 82A of the Inland Revenue Ordinance (‘the Ordinance’) for the failure to comply with the requirement of a notice under section 51(1) of the Ordinance to furnish a profits tax return for the year of assessment 2011/12 (‘the Return’) within the prescribed time allowed.

6. The Appellant was incorporated as a private company in Hong Kong in October 2007. It closes its accounts annually on 31 March.

7. The Appellant’s principal activity as reported in the Return was provision of environmental consultancy service.

8. On 2 April 2012, the Assistant Commissioner of Inland Revenue issued a notice for filing profits tax return to the Appellant. By virtue of section 51(1) of the Ordinance, the Appellant was required to complete and submit the Return within one month from 2 April 2012.

¹ Or would have been undercharged if the failure to furnish the tax return within the prescribed time limit had not been detected.

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9. Pursuant to a Block Extension Scheme for lodgement of 2011/12 profits tax returns, which applied also to the Appellant, the due date for filing the Return was extended to 15 November 2012 ('the Extended Due Date').

10. The Appellant did not submit the Return by the Extended Due Date. On 6 December 2012, pursuant to section 59(3) of the Ordinance, the Assessor raised on the Appellant an estimated Profits Tax Assessment for the year of assessment 2011/12 as follows:

Estimated assessable profits	<u>\$990,000</u>
Tax payable thereon	<u>\$151,350</u>

The Appellant did not object to the said assessment.

11. On 1 February 2013, the Appellant submitted the Return together with profits tax computation and audited financial statements for the year ended 31 March 2012, reporting assessable profits of \$1,900,572. The Return submitted was the original one issued on 2 April 2012. The Auditor's Report was signed on 24 January 2013. The financial statements were approved by the Appellant's directors on the same day.

12. Based on the tax return filed, on 25 February 2013, the Assessor raised on the Appellant an Additional Profits Tax Assessment for the year of assessment 2011/12 as follows:

	\$
Profits per return	1,900,572
<u>Less : Profits already assessed</u>	<u>(990,000)</u>
Additional assessable profits	<u>910,572</u>
Additional amount of tax payable thereon	<u>150,244</u>

The Appellant did not object to the additional assessment.

13. 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.

14. On 16 July 2013, the Respondent issued a notice of intention to assess additional tax under section 82A of the Ordinance ('the Notice') to the Appellant in respect of its failure to furnish the Return within the prescribed time allowed. If the Department had not detected the failure, tax amounting to \$301,594 would have been undercharged. The Notice stated that additional tax by way of penalty up to three times the amount of tax that would have been undercharged might be imposed if the Appellant did not have a reasonable excuse for the failure. The Appellant was invited to submit written representations to the Respondent.

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15. By an undated letter received by the Department on 5 August 2013, the Appellant made written representations to the Respondent.

16. On 29 August 2013, the Respondent, having considered and taken into account the written representations, issued to the Appellant a notice of assessment for additional tax by way of penalty under section 82A of the Ordinance in the amount \$9,000 ('the Assessment').

17. By a letter dated 10 September 2013, the Appellant gave notice of appeal to the Clerk to the Board of Review against the Assessment.

18. Particulars of the Appellant's delay in filing the Return and the penalty imposed by way of additional tax are as follows:

Year of assessment	Date of issue of Return	Extended due date	Date of auditor's report	Date of receipt of the Return	Period of delay	Tax undercharged	Amount of additional tax	Percentage of additional tax on tax undercharged
2011/12	02-04-2012	15-11-2012	24-01-2013	01-02-2013	78 days	\$301,594	\$9,000	2.98%

19. The Appellant's previous failures in filing profits tax returns within 5 years are shown as follows:

Year of assessment	Date of issue of tax return	Due date of tax return	Date of auditor's report	Date of receipt of tax return	Period of delay	Tax undercharged
2008/09	04-05-2009	04-08-2009	23-11-2009	23-11-2009	111 days	\$47,842
2009/10	01-04-2010	15-11-2010	17-11-2010	24-11-2010	9 days	\$160,275

20. (a) The Respondent has compounded the Appellant's offence on failure to file the 2008/09 profits tax return within the prescribed time under section 80(5) of the Ordinance. On 16 April 2010, a notice of demand for payment of compound penalty for the year of assessment 2008/09 was issued to the Appellant.

(b) No penal action was taken in respect of the Appellant's failure to file the 2009/10 profits tax return within the prescribed time allowed.

Statement of Grounds of Appeal

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

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- ‘ 1) Due to personnel movement, the previous accountant was left during the audit period, so we need more time to fix the accounting problem (clarify some transitions and prepare accounting documents) in that tough time without her help.
- 2) As the previous accountant were gone, we got a difficulty to work with our auditor effectively to make an audit report for submission.
- 3) We have only 2 directors, they were both having conference in [name of country omitted here] last August and preparing [name of conference omitted here] conference until November, some important decisions could not be made without directors’ approval. This delayed the process.
- 4) The most important is, we don’t have any bad intension to avoid paying the tax as we paid the tax on time when we received the tax assessment at first time.’

The relevant statutory provisions

22. 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.*’

23. 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.

24. 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.’

25. 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

26. Whether to assess a taxpayer to additional tax and, if the answer is ‘yes’, 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.

27. 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.

28. 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.

29. 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

30. 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.

31. 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 policy² 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.

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

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

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

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

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

37. 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.

38. 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.

² Tax rates range from 10% to 17.5%, see Schedules 1 and 8 to the Ordinance.

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39. 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.
40. 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.
41. 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'.
42. Penalty tax serves two purposes – to punish the delinquent taxpayers and to deter those and other taxpayers.
43. 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.

44. 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

45. 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.

46. 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

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

48. 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 ...’

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

50. 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.

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

Consideration of the grounds of appeal

52. There is no evidential support of any of the factual assertions in the grounds of appeal.

53. The assertions in the first ground of appeal lack particulars.

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54. The Appellant closes his accounts on 31 March each year.
55. By the extended deadline of 15 November 2012, it had had:
- (1) more than 7 ½ months to prepare its audited financial statement; and
 - (2) more than 7 ½ months to complete and submit the Tax Return.
56. The duty is on the Appellant to:
- (1) keep and prepare proper accounts of its tax affairs; and
 - (2) employ sufficient and competent persons to help it to discharge its statutory reporting duties and to work with its own chosen auditors.
57. 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.
58. 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.
59. Moreover, unlike section 82(1), ‘wilfully with intent to evade or to assist any other person to evade tax’ is not prerequisite of liability under section 82A.
60. As stated in paragraph 55 above, the Appellant had 7 ½ months to furnish the Tax Return. The statutory reporting duty is known by April and it is the duty of the Appellant to comply with due diligence.
61. 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 by way of compound penalty proved ineffective. 2.98% is plainly not excessive in the circumstances of this case.
- Conclusion and disposition**
62. In the circumstance, the penalty assessment of 2.98% was so lenient that there is simply no room for reduction.
63. We dismiss the appeal and confirm the Assessment.