

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D105/95

Penalty tax – late filing of profits tax return – more tax had been paid – quantum of penalty – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Albert Ho Chun Yan and Charles Hui Chun Ping.

Date of hearing: 17 October 1995.

Date of decision: 12 February 1996.

The taxpayer carried on garment manufacturing and knitting business. It did not file its profits tax return on time. The assessor raised on the taxpayer an estimated assessment and the profits tax thereon was \$1,314,000 which was duly paid by the taxpayer.

8 months later, the taxpayer lodged its profits tax return which showed that the actual assessable profits was lower than that was estimated by the assessor, and the profits tax thereon should only be \$954,321. As a result, it had paid \$359,679 in excess.

Later the Commissioner imposed a penalty tax of \$200,000 upon the taxpayer for late filing of its tax return. The taxpayer appealed and argued, inter alia, that the penalty was excessive.

Held:

It is clear that the Inland Revenue Ordinance imposes obligations upon taxpayers to report their taxable profit correctly and timely. However, the fact that the taxpayer had paid more tax than it would otherwise have had to pay is a strong mitigating factor in the present case. Had the taxpayer not been for the overpayment the penalty would have been much greater.

For the purposes of section 82A, the tax undercharged is \$954,321 rather than \$1,314,000. Thus, the Commissioner is correct to impose a penalty of \$200,000 which is equivalent to approximately 21% of the tax undercharged.

Appeal dismissed.

Cases referred to:

D53/93, IRBRD, vol 8, 383

D2/92, IRBRD, vol 7, 56

D61/90, IRBRD, vol 5, 444

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D11/93, IRBRD, vol 8, 143

D6/94, IRBRD, vol 9, 88

D68/94, IRBRD, vol 9, 379

D42/93, IRBRD, vol 8, 318

Leung Man Keung for the Commissioner of Inland Revenue.

Wu Sai Wing of S W Wu & Co for the taxpayer.

Decision:

This is an appeal by a Taxpayer carrying on business against a penalty tax assessment assessed in respect of the late filing of a tax return. The facts are as follows:

1. The Taxpayer commenced business in Hong Kong in 1976 and since then has been engaged in garment manufacturing and knitting. The Taxpayer closes its accounts on 31 March in each year.
2. On 1 April 1993, the Commissioner issued a profits tax return for the year of assessment 1992/93 under section 51(1) of the Inland Revenue Ordinance (the IRO), requiring the Taxpayer to complete and return it within one month which was subsequently extended to 15 November 1993.
3. On 26 November 1993, the assessor not having received the 1992/93 profits tax return raised on the Taxpayer an estimated assessment for that year in the sum of \$4,760,000 with profits tax thereon of \$714,000. The Taxpayer did not object to this estimated assessment and paid the tax as demanded.
4. On 2 February 1994 the assessor raised an estimated additional assessment for the year of assessment 1992/93 in the sum of \$4,000,000 with profits tax thereon of \$600,000. The Taxpayer did not object to this estimated additional assessment and paid the tax as demanded.
5. On 18 October 1994, the Taxpayer lodged the profits tax return for the year of assessment 1992/93 showing assessable profits of \$6,362,141. If this profits tax return had been filed on time, it is probable that the assessor would have assessed the Taxpayer in the amount of returned profits, that is, \$6,362,141 being \$2,397,859 less than the two estimated assessments which had been accepted by the Taxpayer. The amount of profits tax on this difference would be \$359,679.
6. The Taxpayer has a record of failing to submit profits tax returns within the time stipulated:

Year of

Date of issue

Date of

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Assessment	of return	Extension allowed	submission
1989/90	2-4-90	15-11-90	4-1-91
1990/91	2-4-91	15-11-91	29-4-92
1991/92	1-4-92	15-11-92	21-6-93

7. In respect of the years of assessment 1990/91 and 1991/92, the amounts of tax undercharged in consequence of the late submission of returns were \$436,589 and \$679,051 respectively. As a result, the Taxpayer had been assessed to additional tax by way of penalty under section 82A of the IRO in the sums of \$20,000 for the year of assessment 1990/91 and \$100,000 for the year of assessment 1991/92.
8. On 16 January 1995, the Commissioner gave notice to the Taxpayer under section 82A of the IRO that he proposed to assess it to additional tax by way of penalty for the year of assessment 1992/93 in respect of its late filing of profits tax return. The notice stated that the amount of tax which had been undercharged was \$1,314,000.
9. On 14 February 1995, the Taxpayer submitted its representations to the Commissioner.
10. On 24 March 1995, the Commissioner, having considered and taken into account the representations, assessed the Taxpayer to additional tax by way of penalty of \$200,000 for the year of assessment 1992/93.
11. On 21 April 1995, the tax representative lodged on behalf of the Taxpayer an appeal to the Board of Review against the assessment for additional tax issued under section 82A of the IRO.

At the hearing of the appeal the Taxpayer was represented by its tax representative. He submitted that the reason for the late filing of the tax return was because his clients had difficulties caused by a computer virus which occurred in September 1992. He said that as a result of this it had been necessary to reenter all of the information in the computer in respect of the preceding year which had not been completed until June 1993 and that his client had not been able to complete the accounts in time to file their tax return by 15 November 1993. He said that the penalty should be substantially reduced because as a result of the computer virus his clients had not challenged two estimated assessments which together substantially exceeded the taxable profit of his clients and as a result his clients had paid \$359,679 more tax than they would otherwise have had to pay. The tax representative provided further information to the Board in answer to questions from the Board. We will deal with this later in this decision.

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The representative for the Commissioner submitted that the penalty was not excessive in the circumstances. He pointed out that the Taxpayer had a long history of failing to file its tax returns on time. He said that the Commissioner had taken all of the relevant facts into account when assessing the penalty including the fact that the Taxpayer had paid more tax than it otherwise might have had to do.

The representative for the Commissioner cited to us the following cases:

D53/93, IRBRD, vol 8, 383

D2/92, IRBRD, vol 7, 56

D61/90, IRBRD, vol 5, 444

D11/93, IRBRD, vol 8, 143

D6/94, IRBRD, vol 9, 88

D68/94, IRBRD, vol 9, 379

The submissions by the representative for the Taxpayer in this case carry little weight. With due respect to his clients they were at best cavalier in their treatment of their obligations under the IRO. The Board asked the representative a number of questions with regard to the computer virus which was blamed for the late filing of the tax returns. In answer to a number of questions the tax representative informed the Board that the Taxpayer had only installed the computer system during 1992, presumably before September 1992. It was a 'tailor made' system. The Taxpayer had three PC type computers each of which operated on its own and were not interlinked. Indeed the Taxpayer's representative said that the problem which his clients had was compounded by the fact that only one of the three computers was actually used for keeping the accounts. He said this in the context of it only being possible to use one person at a time to maintain the accounts.

The tax representative also informed the Board that it was necessary to consider 'the real world', and said that his clients only wrote up their accounts once each year after the end of the year. To operate their business they apparently relied on invoices from suppliers which they paid without question. It is not quite clear how they paid their 500 employees without any accounts. The tax representative said that the Taxpayer was regularly late in preparing its accounts.

We consider reference to the computer virus as being irrelevant to the case before us. It was used as an excuse in the preceding year which is a matter not before us and of no concern to us. What we have to consider is the penalty of \$200,000 imposed upon the Taxpayer in respect of the year of assessment 1992/93. If, as we were told, the Taxpayer prepared its accounts once each year after the end of the year then it would be incumbent upon it to have the same speedily and quickly prepared.

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The IRO is quite clear. It imposes obligations upon taxpayers to report their taxable profit correctly and timely. It is incumbent upon all taxpayers to conduct their affairs in such a way as to ensure that they can comply with their obligations under the IRO. Clearly in the present case the Taxpayer has not done so in the year in question and has repeatedly failed so to do in previous years. The Taxpayer has already been penalised in respect of two previous years. If the Taxpayer persists in such conduct then the Taxpayer must accept that penalties in future years will substantially increase exponentially.

However there is one strong mitigating fact in the present case. This is that as a result of the conduct of the Taxpayer it has paid more tax than it would have if it had kept proper accounts and filed its tax return on time. As was said in Board of Review case D42/93, IRBRD, vol 8, 318 the fact that the Taxpayer has paid more tax than it otherwise might have done should be of some benefit to the Taxpayer and should be considered as one factor in the overall picture.

We have carefully taken everything into account and have formed the opinion that the Commissioner has been correct in imposing a penalty of \$200,000 which is equivalent to approximately 21% of the tax undercharged. Had it not been for the overpayment the penalty would no doubt have been much greater. The Taxpayer appears to have learnt little from the two previous penalties imposed for late filing of returns. We hope that as a result of this penalty and the fact that the Taxpayer has in addition paid \$359,679 more tax than might have been the case had it fulfilled its obligations under the Ordinance, it will send a clear message to the Taxpayer that it is unwise to ignore one's obligations under the IRO.

For the sake of clarification we place on record that the sum of \$1,314,000 stated in Fact 8 above is the sum stated in the notice issued by the Commissioner. However the tax undercharged for the purposes of section 82A is of course the lower amount of \$954,321. This is the figure correctly used by the Commissioner to calculate the quantum of the penalty and which has been used by this Board of Review.

For the reasons given we dismiss this appeal and confirm the penalty tax assessment of \$200,000 against which the Taxpayer has appealed.