Case No. D112/99

Penalty Tax – failure to submit a profits tax return within the stipulated period – unintentional delay – penalty in the rate of 10% of the tax undercharged under section 82A of the Inland Revenue Ordinance (the ' IRO').

Panel: Anna Chow Suk Han (chairman), Lester Kwok Chi Hang and Kenneth Graeme Morrison.

Date of hearing: 10 December 1999.
Date of decision: 27 January 2000.

The taxpayer is a company incorporated in Hong Kong on 22 July 1988 and commenced business on 8 August 1988. The taxpayer used to close its accounts annually on 31 March. The taxpayer failed to return the profits tax return (' the Return') for the year of assessment 1997/98 within the extended deadline on or before 14 November 1998. By notice dated 8 December 1998 (' the Estimated Assessment'), the assessor raised an estimated assessment on the taxpayer under section 5(3) of the IRO with estimated assessable profits of $450,000 and tax payable of $62,225. The Revenue did not receive any objection to the Estimated Assessment from the taxpayer. The Return, which showed assessable profits of $1,312,359, was received by the Revenue on 29 December 1998. This was late by 45 days. On 25 January 1999, the assessor raised an additional assessment on the taxpayer. On 11 March 1999, a revised notice of assessment which took into account the refund/discharge of 10% of the final tax for the year of assessment of 1997/98 under section 87 of the IRO was issued to the taxpayer. On 21 April 1999, the Commissioner gave notice (' the Notice') to the taxpayer under section 82A(4) of the IRO to advise that she proposed to assess the taxpayer to additional tax in respect of the failure to comply with the requirements of the notice given under section 51(1) of the IRO and that the taxpayer had the right to submit written representations with regard to the proposed assessment of additional tax. In response to the Notice, the taxpayer submitted written representations on 4 May 1999. On 11 June 1999, the Commissioner, having considered and taken into account the representations, issued a notice of assessment and demand for additional tax under section 82A for the year of assessment 1997/98 (' the Assessment') in the amount of $16,000. The additional tax represents 8.69% of the tax undercharged. By a letter dated 7 July 1999, the taxpayer lodged an appeal against the Assessment. In a gist, the taxpayer' s case was that the unique merger exercise with its resulting problems, which impeded the finalisation of the company' s accounts, constituted a reasonable excuse and/or that the penalty should be waived accordingly. The taxpayer had a past record of late submission of its profits tax returns in two previous years of assessment. The periods of delay were of 6 days and 7 days respectively. However, penalty actions were not taken against the taxpayer in view of the slight delays.

Held:

1. Having carefully considered the taxpayer's grounds of appeal, its representative's evidence, submission and the material produced, the Board did not find that the taxpayer had a reasonable excuse for the delay in filing its profits tax return.

2. The Board accepted that there was a merger exercise as a result of which the taxpayer had difficulties in finalizing its account but it did not accept that it constituted a reasonable excuse for the delay.

3. Every taxpayer has an obligation to observe the law and to meet the time limits set thereunder. Otherwise, our tax system will be prejudiced.

4. The taxpayer should file its profits tax return by the extended date on 14 November 1998. It had about 8 months to prepare its accounts after its year end on 31 March. Had the merger exercise been complicated and time consuming, the taxpayer should have acted prudently by informing the Revenue and seeking an extension of time, which they had not done so in the present case.

5. As to the taxpayer's claim that the delay was unintentional, no taxpayer should have such an intention. Thus, the absence of it, was neither a defence nor a mitigating factor.

6. Neither can the taxpayer's misconception that there would be a reminder from the Revenue on the outstanding profits tax return, be a ground of appeal against liability nor be it a mitigating factor.

7. The Board was unable to accept the taxpayer's method of computation of penalty as such method was not so provided in the IRO.

8. As in various past decision, the Board adopted the penalty starting point for late filing of return at 10% of the tax undercharged or tax that would have been undercharged if the taxpayer was a first offender, the delay was unintentional and the Revenue had suffered no loss. The Revenue's assessment of additional tax represented 8.69% of the tax undercharged. In all of the circumstances, the Board found the penalty imposed not to be excessive.

Appeal dismissed.

Cases referred to:

D70/89, IRBRD, vol 5, 69
D48/89, IRBRD, vol 5, 512
D10/98, IRBRD, vol 13, 108
D11/93, IRBRD, vol 8, 143

Lee Yun Hung for the Commissioner of Inland Revenue.
Taxpayer represented by its financial controller.

Decision:

The appeal

1. The Taxpayer has appealed against the additional tax assessment raised on it under section 82A of the Inland Revenue Ordinance (the IRO) for failure to comply with the requirements of a notice under section 51(1) of the IRO for the year of assessment 1997/98 by failing to submit a profits tax return within the stipulated period.

The background facts

2. The Taxpayer is a company incorporated in Hong Kong on 22 July 1988 and commenced business on 8 August 1988. It carries on a business of providing landscape architectural services.

3. The Taxpayer closes its accounts annually on 31 March.

4. On 1 April 1998, a profits tax return for the year of assessment 1997/98 (' the Return') was issued to the Taxpayer under section 51(1) of the IRO. The Return should be completed and returned to the Inland Revenue Department (' the Revenue') within one month from the date of issue. However, under the Revenue' s block extension scheme for lodgment of returns, an extension of time for submitting the Return was granted up to and including 14 November 1998.

5. The Taxpayer failed to observe the extended deadline. By notice dated 8 December 1998 (' the Estimated Assessment'), the assessor raised an estimated assessment on the Taxpayer under section 5(3) of the IRO with estimated assessable profits of $450,000 (before setting off loss brought forward of $72,878) and tax payable of $62,225. The Revenue did not receive any objection to the Estimated Assessment from the Taxpayer.

6. The Return was received by the Revenue on 29 December 1998. This was late by 45 days. The Return showed assessable profits of $1,312,359.

7. On 25 January 1999, the assessor raised the following additional assessment on the Taxpayer:

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Profits per return	1,312,359
Less: Profits previously assessed	450,000
Additional assessable profits	862,359
Additional tax payable	142,289

8. On 11 March 1999, a revised notice of assessment which took into account the refund/discharge of 10% of the final tax for the year of assessment 1997/98 under section 87 of the IRO was issued to the Taxpayer.

9. On 21 April 1999, the Commissioner gave notice (' the Notice') to the Taxpayer under section 82A(4) of the IRO to advise that she proposed to assess the Taxpayer to additional tax in respect of the failure to comply with the requirements of the notice given under section 51(1) of the IRO and that the Taxpayer had the right to submit written representations with regard to the proposed assessment of additional tax.

10. In response to the Notice, the Taxpayer submitted written representations on 4 May 1999.

11. On 11 June 1999 the Commissioner, having considered and taken into account the representations, issued a notice of assessment and demand for additional tax under section 82A for the year of assessment 1997/98 (' the Assessment') in the amount of $16,000. The additional tax represents 8.69% of the tax undercharged.

12. By a letter dated 7 July 1999, the Taxpayer lodged an appeal to the Board of Review against the Assessment.

13. The Taxpayer has a past record of late submission of its profits tax returns in the years of assessment 1994/95 and 1995/96. The periods of delay were of 6 days and 7 days respectively. However, penalty actions were not taken against the Taxpayer in view of the slight delays.

The Taxpayer' s case

14. The Taxpayer' s grounds of appeal are contained in its letter to the Board of 7 July 1999, which are summarized by the Respondent (the Revenue) in its submission as follows:

(i) The lateness in submitting the profits tax return ' was not being intentional' .

(ii) The Taxpayer failed to receive any letter from the Revenue which again reminded taxpayers of their situation.

(iii) The Taxpayer was not disclaiming its offence of late filing, but felt that its unique merger exercise should be given a more compromising deadline for submission.

(iv) Given that the submission of the profits tax return is about 1 month late, interest on non-payment is approximately $2,800 per month, using an overdraft rate of 10% [$336,220 x 10% x 1/2 = $2,800].

15. Mr A, the financial controller of the Taxpayer appeared on behalf of the Taxpayer. Mr A proposed to produce some documents in support of the Taxpayer' s case. Mr Lee of the Respondent expressed his concern that the Respondent had not been given an opportunity to examine these documents. A short adjournment was granted to the parties in order that they might come to an agreement on the production of these documents.

16. After the adjournment, Mr Lee explained to the Board that the documents which the Taxpayer proposed to produce were certain correspondence exchanged between the Taxpayer and some third parties, indicating valuation of certain assets as a result of a merger, an agreement for sale and purchase of shares of the Taxpayer with the completion date on 3 March 1998 and two sets of accounts, one prepared on 3 March 1998 for the purpose of the sale and purchase and the other for submission to the Revenue. Mr Lee expressed his view that these documents were perhaps to substantiate the Taxpayer' s claim that there were problems encountered by the Taxpayer after the sale and purchase of the shares. In this connection, Mr Lee informed the Board that the Respondent accepted the Taxpayer' s case that there was a merger exercise, possibly as a result of which there were problems encountered by the Taxpayer in the preparation of the company' s accounts. Mr A confirmed that the purpose of production of these documents was to render his explanation of the Taxpayer' s case clearer and more effective by way of reference to these documents. That being the case, it was agreed that the documents needed not be produced until the Taxpayer saw the necessity to make reference to them as the hearing progressed.

17. Mr A chose to give evidence under oath. Mr A gave evidence to the effect that an agreement for sale and purchase of the Taxpayer' s shares was entered into on 3 March 1998, under which the sale price was to be determined according to the net assets value of the Taxpayer. Thus, longer time was required to verify the existence of the tangible and intangible assets of the company and their value and to seek confirmation from the debtors on the debt balances. Finalization of the accounts was delayed by reason of the seller and the purchaser having difficulties

in reaching an agreement on the value of the assets since the same affected the share price of the transaction. Further, as the major shareholder, Mr B, was residing outside Hong Kong, longer time was required to take instructions from him.

18. It transpired during the investigation and at the hearing that there was a misconception on the part of Mr A that the amount of $184,062 was the penalty initially imposed by the Revenue for the late filing of the Taxpayer's profits tax return but the same was reduced to $16,000 as a result of the Taxpayer's representation to the Revenue. Mr A contended that the principle should be such that if it had been accepted that there was 'a genuine reason' for the delay, no penalty should be imposed at all. After the explanation to Mr A that the amount of $184,062 was not a penalty but it was the amount of tax which had been undercharged, Mr A still felt that the penalty of $16,000 should not be imposed, because of the reason given. Mr A believed that the merger exercise was a unique one which would not be repeated by the Taxpayer and it deserved a special treatment. Mr A asserted that this was not a case whereby the delay was caused by the mismanagement or a lack of attention of the matter by the directors of the company. Since the Respondent did not intend to challenge the Taxpayer's claim of having difficulties in finalizing the company's accounts which were caused by the merger exercise, the Taxpayer did not produce the documents to prove its case.

The Respondent's (the Revenue's) case

19. It was submitted by the Respondent that it was not the Revenue's case that the late filing was a deliberate act or that the late filing was done with a view to postpone payment of tax. But the Taxpayer had the obligation to file its returns on time.

20. There was no obligation on the Revenue to issue reminders to taxpayers and as a practice, the Revenue did not send out reminders. The Board's attention was drawn to the following comment in Board of Review Decision, D70/89, IRBRD, vol 5, 69:

> *'The Taxpayer is a company carrying on a sophisticated business. It had the benefit of professional advice. If the professional advisers of the Taxpayer did not warn the Taxpayer of the likely consequences of failure to file tax returns on time, this is a matter for the Taxpayer to take up with its advisers and cannot affect the quantum of the penalties. Furthermore there is no obligation on the Inland Revenue Department to issue warnings in individual cases. The Inland Revenue Department draws attention to penalties when issuing tax return forms and also by means of television and newspaper advertisements. It is the duty of the Taxpayer to comply with the provisions of the Inland Revenue Ordinance. To protect the public revenue, the legislature has made provision for very heavy penalties to be imposed on those who fail in their obligations under the Inland Revenue Department.'*

21. The Respondent was unable to accept the Taxpayer' s claim that ' its unique merger exercise should be given a more compromising deadline for submission' . Mr Lee referred us to the following passage from Board of Review Decision D48/89, IRBRD, vol 5, 512 which was cited with approval on page 112 of Board of Review Decision D10/98, IRBRD, vol 13, 108:

> *' it is wrong to suggest that because of contingencies a company is not able to produce true and fair account ... even if the contingencies were of an immense magnitude, full provision could have still been made and there was no excuse not to file tax returns.'*

22. The Respondent could not accept the Taxpayer' s computation of penalty as it was not in accordance with the relevant provisions in section 82A of the IRO. Mr Lee also quoted the following passage from Board of Review D11/93, IRBRD, vol 18, 143:

> *' The Inland Revenue Ordinance makes it quite clear that penalties are to be assessed on the full amount of the tax involved. The tax involved is defined as being the amount of tax which would have been undercharged if the failure to file the tax return had not been detected (section 82A(1)(ii)). The fact that the assessor did find out that the tax return had not been duly filed and decided to impose an estimated assessment is not material.'*

23. On the quantum of penalty, the Board' s attention was drawn to the following remark in paragraph 10 of Board of Review Decision D10/98:

> *' Various decisions in the past have indicated that the penalty starting point for late filing is 10% of the tax undercharged or tax that would have been undercharged if the taxpayer is a first offender, it is an unintentional mistake and the Revenue has suffered no loss.'*

24. It was submitted that on the facts of the case and in view of the Board decision in paragraph 23 above, $16,000 being 8.69% of the tax involved was not excessive.

The law

25. Section 82A(1)(d) of the IRO provides that *' Any person without reasonable excuse fails to comply with the requirements of a notice given to him under section 51(1) or (2A), shall, ... be liable to be assessed under this Section to additional tax ...'*

26. Section 82B(2) provides that:

> *' 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.'

Our findings

27. It is the Taxpayer' s case that the unique merger exercise with its resulting problems which impeded the finalization of the company' s accounts, constitutes a reasonable excuse and/or that the penalty should be waived having regard to the circumstances of the case.

28. Having carefully considered the Taxpayer' s grounds of appeal, Mr A' s evidence and submission and the material before us, we do not find that the Taxpayer had a reasonable excuse for the delay in filing its profits tax return.

29. We accept that there was a merger exercise as a result of which the Taxpayer had difficulties in finalizing its account but we do not accept that it constitutes a reasonable excuse for the delay. Every taxpayer has an obligation to observe the law and to meet the time limits set thereunder. Otherwise, our tax system will be prejudiced. In the present case, the Taxpayer should file its profits tax return by the extended date 14 November 1998. It had about 8 months to prepare its accounts after its year end on 31 March. Had the merger exercise been complicated and time consuming, the Taxpayer should have acted prudently by informing the Revenue and seeking an extension of time. We were informed that no attempt had been made in this regard.

30. As to the Taxpayer' s claim that the delay was unintentional, no taxpayer should have such an intention. Thus, the absence of it, is neither a defence nor a mitigating factor.

31. Neither can the Taxpayer' s misconception that there would be a reminder from the Revenue on the outstanding profits tax return, be a ground of appeal against liability nor be it a mitigating factor.

32. Furthermore, we are unable to accept the Taxpayer' s method of computation of penalty as such method is not so provided in the IRO.

33. As in various past decisions of this Board, we adopt the penalty starting point for late filing of return at 10% of the tax undercharged or tax that would have been undercharged if the taxpayer is a first offender, the delay is unintentional and the Revenue has suffered no loss. The

Revenue' s assessment of additional tax of $16,000 represents 8.69% of the tax undercharged. In all of the circumstances, we find the penalty imposed not to be excessive and we hereby dismiss the appeal.