INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D125/98

Profits Tax – delay in submitting profits tax return – compound penalty – mitigating and aggravating factors – whether additional tax excessive – section 82A of the Inland Revenue Ordinance.

Panel: Audrey Eu Yuet Mee SC (chairman), Hans Rainer Adalbert Ehrhardt and Michael Neale Somerville.

Date of hearing: 16 November 1998.
Date of decision: 30 November 1998.

The taxpayer, a solicitors' firm, opened a branch office and also admitted a new partner at around the same time.

After more than a week past the date of submission for the taxpayer's tax return for the year of assessment 1996/97 (which has already been extended under the block extension scheme), the taxpayer's tax representative requested for a further extension on the ground that the tax representative's firm had experienced an unexpected shortfall of staff manpower resources. The request was refused by the Commissioner.

The Commissioner informed the taxpayer that on account of their failure to submit their profits tax return in compliance with the Inland Revenue Ordinance (the IRO), he was willing to compound the offence under section 80(5) of the IRO for a penalty of $1,200 provided the taxpayer accepted the penalty and submitted the profits tax return within 14 days. Almost two months later, the tax representative requested for waiver of the compound penalty. The request for waiver was rejected by the Commissioner. The profits tax return was submitted 2 months and 7 days after the due date.

The tax representative made written representations regarding the proposed assessment of additional tax. Additional tax pursuant to section 82A of the IRO was assessed in the sum of $170,000 which was 14.4% of the amount of tax undercharged.

The taxpayer had also failed to submit their profits tax return for the previous year of assessment 1995/96 within the time stipulated and was assessed to additional tax in the sum of $40,000. The tax undercharged was $412,929.

The taxpayer appealed pursuant to section 82B of the IRO on the ground that the amount of additional tax for the year of assessment 1996/97 is excessive having regard to the circumstances.

Held:

(1) The onus is on the taxpayer to persuade the Board that the additional tax imposed is excessive.

(2) The Board accepted that the year of assessment 1996/97 was a period of financial boom such that high staff turnover and difficulty in recruitment were mitigating factors to be taken into account. There was some material of the boom in the taxpayer's business illustrating their operational problems. The Board was however unable to attach much significance to this ground due to the paucity of material in support but found it to be a mitigating factor.

(3) Unlike the case of D59/96 where the audited accounts were received prior to the due dates for payment of taxes, there was actual loss in this case, namely, a loss of interest on the part of the Revenue. This however is not a significant factor (D63/96 followed).

(4) The Board accepted that the offence the year of assessment for 1995/96 should not be an aggravating factor.

(5) The Board noted that the taxpayer was given some discount for the offence for the year of assessment 1996/97 according to internal guidelines adopted by the Revenue in assessing additional tax which shows that the Commissioner had taken into account the mitigation factors.

(6) The Revenue's internal guidelines cannot be a fetter or binding on the Board's exercise of discretion on appeal but the Board was unable to see any error in principle in the approach. The amount of additional tax imposed was not excessive nor was it outside the scale imposed in some of the cases relied upon.

Appeal dismissed.

Cases referred to:

D74/96, IRBRD, vol 11, 693
D59/96, IRBRD, vol 12, 8
D63/96, IRBRD, vol 11, 641

Leung Man Keung for the Commissioner of Inland Revenue.
Ip Pui Sum of Messrs Ip Pui Sum & Co for the taxpayer.

Decision:

The appeal

1. This is an appeal by the Taxpayer, pursuant to section 82B of the Inland Revenue Ordinance (the IRO), against the assessment to additional tax in the sum of $170,000 for the year of assessment 1996/97 on the ground that the amount of additional tax is excessive having regard to the circumstances.

The facts

2. The facts are not in dispute and are set out in an agreed document reproduced as follows:

(1) The Taxpayer is a solicitors' firm. It commenced business in Hong Kong on 28 February 1994 with two partners. The firm's business premises is situated at District X.

(2) In February 1996 the Taxpayer commenced a branch office at District Y. On 22 February 1996, a new partner was admitted into the business.

(3) The Taxpayer closes its accounts on 31 March in each year.

(4) On 1 April 1997, the Commissioner issued a profits tax return for the year of assessment 1996/97 under section 51(1) of the IRO requiring the Taxpayer to complete and return it within one month. The due date for submission was extended to 15 November 1997 under the block extension scheme.

(5) By letter dated 24 November 1997 Messors Ip Pui Sum & Co, CPA (the tax representative) informed that the tax representative's firm had experienced an unexpected shortfall of staff manpower resources and requested for a further extension to 15 January 1998 for submitting the Taxpayer's profits tax return for the year of assessment 1996/97. The request was declined by letter dated 8 December 1997.

(6) On 28 November 1997, the Commissioner issued a letter to the Taxpayer to inform that the Taxpayer had failed to comply with the requirements under section 51(1) of the IRO in respect of profits tax return for the year of assessment 1996/97 and the Commissioner was willing to exercise his power under section 80(5) of the same IRO and compound the offence for a penalty of $1,200 provided that the Taxpayer accepted the penalty and submitted the profits tax return within 14 days from the date of issue of the letter.

(7) By letter dated 22 January 1998 the tax representative requested the Commissioner to waive the compound penalty. The letter and the profits

tax return together with the statement of accounts for the year of assessment 1996/97 were received on 22 January 1998. The period of delay in the submission of the return was 2 months and 7 days.

(8) On 4 February 1998 the assessor raised on the Taxpayer a profits tax assessment for the year of assessment 1996/97 in the amount of $7,866,906. The profits tax charged on the shares of assessable profits of partners not having elected for personal assessment was $790,624.

(9) On 10 February 1998, the assessor issued a letter to the tax representative informing that the request for waiver of compound offer was not agreed.

(10) On 29 April 1998 having known that the new partner would not have tax advantage under personal assessment, the Commissioner issued a demand note for the year of assessment 1996/97 to the Taxpayer for the new partner's share of assessable profits. The revised profits tax demand was $1,180,035 which is also the tax undercharged in question.

(11) The Taxpayer has also failed to submit the profits tax return for the year of assessment 1995/96 within the time stipulated:

Date of Issue of return	**Extension Allowed**	**Date of Submission**
1 April 1996	15 November 1996	27 June 1997

As a result of such failure, the Taxpayer had been assessed to additional tax by way of penalty for the year of assessment 1995/96 in the sum of $40,000 under section 82A of the IRO. Tax undercharged for the year was $412,929.

(12) On 8 May 1998, the Commissioner gave notice under section 82A(4) to the Taxpayer informing his intention to assess additional tax under section 82A of the IRO by way of penalty for the year of assessment 1996/97 in respect of the failure by the Taxpayer to comply with the requirements of a notice given to the Taxpayer under section 51(1) of the IRO. The notice stated that the amount of tax undercharged was $1,180,035.

(13) By letter dated 19 May 1998, the tax representative made representations to the Commissioner with regard to the proposed assessment of additional tax.

(14) On 12 June 1998 the Commissioner, having considered and taken into account of the representations, issued a notice of assessment for

additional tax under section 82A of the IRO for the year of assessment 1996/97 in the amount of $170,000. The tax charged was paid.

(15) By letter dated 7 July 1998 the tax representative appealed to the Board of Review in respect of the additional tax for ht year of assessment 1996/97.

The issue

3. In the statement of the grounds of appeal, the Taxpayer argued that it had reasonable excuses for the delay in submitting the return. This would have been a defence rendering the Taxpayer not liable for additional tax. However, the matters raised in the statement of ground, such as rapid business growth, shortage of staff or accounting issues in relation to disbursement, do not amount to reasonable excuses. The Taxpayer is under a statutory duty to file its tax return on time and to arrange its affairs accordingly. At the hearing, Mr Ip for the Taxpayer confirmed that these are relied upon as mitigating factors rather than reasonable excuses for the delay. The Taxpayer is not denying its liability for additional tax. It is saying that the amount is excessive.

4. The delay in this case was 2 months and 7 days. The additional tax imposed was 14.4% of the amount of tax undercharged.

The Taxpayer's case

5. At the hearing, Mr Ip for the Taxpayer urged upon us the following mitigating factors:

(1) The certified public accountants, Messrs Ip Pui Sum & Co tried to increase its staff and there was an improvement when compared to the delay in the previous year.

(2) Although the Taxpayer came across rapid growth, it had tried its best to cope and there was an improvement when compared to the delay in the previous year.

(3) There was no intention to delay the payment of tax, the delay was due to operational problems.

(4) The tax return which was eventually filed was accepted by the Revenue. There was no need for the Revenue to raise further queries. This is further proof that the Taxpayer did not try to delay.

(5) The Revenue did not suffer any loss other than the interest due to the delay.

6. Mr Ip referred us to D74/96, IRBRD, vol 11, 693 for the proposition that previous non compliance should be dealt with in the relevant year of assessment and should not be left pending as a potential aggravating factor for subsequent non compliance. He also cited D59/96, IRBRD, vol 12, 8 as setting out the principles applicable in these cases.

(1) Section 82A is not and must not be used as a means to generate revenue.

(2) Nor should it be used or abused to oppress, harass or bully taxpayers or their tax representatives.

(3) A clear record is a mitigating factor of some importance.

(4) So is the fact that there is no actual loss of revenue

7. Mr Ip submitted that since the Revenue's only loss was the interest on the undercharged tax, additional tax of 5% should be sufficient. He implied that the discrepancy between the additional tax for the two years, namely 9.96% of the tax undercharged for the year of assessment 1995/96 and 14.4% of the tax undercharged for the year of assessment 1996/97, suggested that the Revenue wrongly regarded the earlier offence as an aggravating factor.

8. The Taxpayer did not call any witness.

The Revenue's case

9. The Revenue did not dispute the mitigating factors relied upon. Mr Leung said that these had been taken into account in the assessment of the additional tax. As to the discrepancy between the percentage of the additional tax imposed for the two years, Mr Leung explained that the Revenue's internal guideline was to set a range of up to 10% for the first offence and a range of up to 20% for the second offence in a five years period.

10. Mr Leung referred to the Commissioner's circular letter dated 26 March 1997 to all tax representatives concerning 'Block Extension Scheme for Lodgement of 1996/97 Tax Returns'. This warned the tax representatives that in all cases where a return had not been lodged by the extended due date, estimated assessments would be issued or penalty proceedings commenced. The letter stated that any request for extensions beyond the due dates would only be granted in the most exceptional circumstances and that such request should be made in writing **at least 14 days in advance of the relevant expiration date of the block extensions** *(emphasis in original circular letter).* In the present case, the tax representative, Messrs Ip Pui Sum & Co only requested for extension on 24 November 1997, after the relevant expiration date of the block extension.

Reasons for decision

11. We have carefully considered all the matters urged upon us both in the written materials and in the oral submissions. We bear in mind that the onus is on the Taxpayer to persuade us that the additional tax imposed is excessive.

12. There is very little evidence or material as to how the difficulties of the accountant's firm have contributed to the delay. There is no information as to when the necessary information was provided by the Taxpayer to the accountant firm for the purpose of preparing the tax return. We note that the accountant's firm did not ask for any extension until the expiry of the block extension and even in the letter of 24 November 1997, there was very little detail supplied as to the difficulties of the accountant firm. At any rate, this has been accepted by the Revenue as a mitigating factor and we accept that 1996/97 was a period of financial boom such that high staff turnover and difficulty in recruitment were mitigating factors to be taken into account. However, the paucity of material means that we are unable to attach too much significance to this ground.

13. We have been provided with some material of the boom in the Taxpayer's business. There is a table showing the staff for 1996/97 fluctuated between 10 and 13. A new office in District Y was opened in February 1997 and a new partner was recruited at about the same time. There is a bundle of file numbers of the cases handled by the Taxpayer during the period. According to the accounts, the income more than doubled from $5,500,000 in the year of assessment 1995/96 to $12,700,000 in the year of assessment 1996/97. We accept that this was a mitigating factor illustrating the operational problems that Mr Ip has referred to.

14. It is accepted that the Taxpayer had no intention to delay the payment of tax. If it were otherwise, this would have been an aggravating factor.

15. When the return was eventually filed this was accepted by the Revenue. If not, this would have resulted in further delay.

16. Unlike the case of D59/96, there was some actual loss in this case. The returns were not submitted until January of the following year and there was a loss of interest on the part of the Revenue. In D59/96, the audited accounts were received in September of the same year prior to the due dates for payment of taxes. However, we do not consider this to be a significant factor. In D63/96, IRBRD, vol 11, 641, it was stated that 'whether the Revenue has suffered pecuniary loss is not an important factor to consider. It is important that the law is observed …'.

17. We take into account that the delay in the year of assessment 1996/97 was a significant improvement over the previous year. However there was still a delay. Thus we do not regard such improvement as a mitigating factor in itself. We fully accept that a person should not be punished twice for the same matter. The earlier offence in the year of assessment 1995/96 should not be an aggravating factor. However, the Taxpayer should have received a significant discount in the year of assessment 1995/96 for what was a first offence. This discount factor is no longer available for the offence in the year of assessment 1996/97. Thus a discrepancy in the penalty can be explained by the absence of the discount

in the second offence. We note the internal guidelines adopted by the Revenue. It would appear that the Commissioner has given the Taxpayer some discount from 20% to 14.4% for the second offence. This shows that the Commissioner has taken into account the mitigating factors. Of course such internal guidelines cannot be a fetter or binding on the exercise of our discretion on appeal. But we do not see any error in principle in the approach. It is difficult to discern any clear scale from the cases cited to us. At the end of day, we ask ourselves if the Taxpayer has persuaded us that the additional tax in this case is excessive. Having considered the maximum imposed by the section and all the circumstances of the case, we are not persuaded that the amount of the additional tax $170,000 (14.4% of the tax undercharged) is excessive. Nor is it outside the scale imposed in some of the cases relied upon. We would dismiss the appeal accordingly.