Case No. D131/95

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

Panel: William Turnbull (chairman), Gerald To Hin Tsun and Dianthus Tong Lau Mui Sum.

Date of hearing: 15 January 1996.
Date of decision: 29 March 1996.

The taxpayer was a company engaging in properties and shares investment. After the deadline for submission of the profits tax return, the taxpayer sent to the Revenue its unaudited management account with the profits tax return showing an assessable profit of $38,712,970. The Revenue rejected the profits tax return as it was not accompanied by an audited account.

The Revenue then issued a notice of estimated assessment to the taxpayer showing $37,110,000. The taxpayer then paid.

Subsequently, the taxpayer sent to the Revenue an audited accounts and profits tax return showing an assessable profit of $38,712,970 which was identical to the amount submitted by the taxpayer previously.

The Commissioner first raised an additional assessment on the taxpayer for the difference between the actual and estimated profits. Then he raised additional tax for late filing of profits tax. The taxpayer appealed against the latter.

Held:

The Board noted that 1) the profit shown in the management accounts was identical to that shown in the audited accounts; 2) the taxpayer's previous auditors had ceased business and the taxpayer had to appoint new auditors. Taking all factors into account, the Board was satisfied that the taxpayer had been treated with undue harshness. Accordingly, the penalty tax imposed was reduced.

Appeal allowed.

Cases referred to:

D53/88, IRBRD, vol 4, 10

D55/93, IRBRD, vol 8, 383
D11/93, IRBRD, vol 8, 143
D64/94, IRBRD, vol 9, 361
D2/90, IRBRD, vol 5, 77
D105/89, IRBRD, vol 6, 384
D24/94, IRBRD, vol 9, 226
D29/93, IRBRD, vol 8, 211
D2/88, IRBRD, vol 3, 125
D61/90, IRBRD, vol 5, 444
D2/92, IRBRD, vol 7, 56

Tai Chou Yeuk Wai for the Commissioner of Inland Revenue.
Taxpayer represented by its accountant.

Decision:

This is an appeal by a private limited company against an assessment to penalty tax raised upon it under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer was incorporated in Hong Kong on 8 August 1962 and commenced business on 2 October 1962. At all material times, the Taxpayer was principally engaged in properties and shares investment.

2. The Taxpayer closed its accounts on 31 December in each year. On 6 April 1994, a profits tax return for the year of assessment 1993/94 was issued to the Taxpayer under section 51(1) of the Inland Revenue Ordinance (the IRO) for completion and submission within one month. However, by operation of the block extension scheme for lodgement of profits tax return, deadline for submission was extended to 31 July 1994.

3. On 5 August 1994, the tax representative, wrote to the Inland Revenue Department (the Revenue) that certain bank confirmations were not yet returned and audited accounts would be forwarded to the Revenue on receipt of the confirmations. At the same time, unaudited management accounts and proposed tax computation together with the profits tax return showing an assessable profit of $38,712,970 were sent to the Revenue.

4. The Revenue, by a letter dated 16 August 1994 rejected the profits tax return as it was not accompanied by audited accounts.

5. A notice of estimated assessment under section 59(3) of the IRO was issued to the Taxpayer on 18 August 1994 for the year of assessment 1993/94 showing assessable profit of $37,110,000 with tax charged thereon of $6,494,250. The

Taxpayer paid the tax demanded on due dates, 18 November 1994 and 18 February 1995.

6. On 8 September 1994, the audited accounts and duplicate profits tax return for the year of assessment 1993/94 showing an assessable profit of $38,712,970 were received by the Revenue.

7. The profits tax return was accepted by the assessor and an additional assessment to profits tax was issued on 17 October 1994 showing additional assessable profit of $1,602,970 with tax chargeable thereon of $280,519. The Taxpayer paid the tax demanded on due dates, 1 December 1994 and 23 February 1995.

8. On 1 May 1995, the Commissioner of Inland Revenue gave notice to the Taxpayer under section 82A(4) of the IRO of his intention to assess additional tax by way of penalty in respect of its late filing of profits tax return for the year of assessment 1993/94.

9. By a letter dated 18 May 1995, the Taxpayer made representations to the Commissioner in pursuance of section 82A(4)(a)(ii).

10. On 1 June 1995, the Commissioner of Inland Revenue issued a notice of assessment for additional tax under section 82A for the year of assessment 1993/94 in the amount of $30,000.

11. By a letter dated 22 June 1995, the Taxpayer gave notice of appeal to the Board of Review against the assessment to additional tax by way of penalty.

At the hearing of the appeal the Taxpayer was represented by its accountant. She informed the Board that for the past 30 years her company had filed its profits tax return through its auditors. She said that this was the first time for them to receive notice of assessment for additional tax by way of penalty and that it was her belief that they had filed all previous profits tax returns on time in the past.

She said that the previous auditors had ceased business on 31 December 1993 and that the present auditor had been appointed on 11 May 1994. She said that there had been no loss to the Revenue and that all tax had been paid as demanded. She said that the Taxpayer had not sought to evade tax and had invited the Revenue to issue an estimated assessment based on the unaudited management accounts and the tax computation. This had been provided to the Revenue so that they could assess tax in the usual way. The profit which had been reported in the management accounts was identical to that which was shown in the audited accounts and which had been accepted by the assessor. She said that there had been no deliberate delay in filing the audited accounts. The reason was because the auditors required confirmation of balances with the bank.

The representative for the Commissioner took a much different point of view. We quote from her submission:

> 'For the year of assessment 1993/94, taxpayers who closed accounts on 31 December 1993 were granted an extension to 31 July 1994 under the "Block Extension Scheme". Under the cover of a letter dated 5 August 1994 but received by the Revenue on 6 August 1994, that is, already beyond the compliance date under the Block Extension Scheme, the Taxpayer's representative lodged the unaudited management accounts, a tax computation and profits tax return for the year of assessment 1993/94 to the Revenue. By a letter dated 16 August 1994 the Revenue rejected the profits tax return as it was not accompanied by audited accounts. An estimated assessment under section 59(3) of the Inland Revenue Ordinance was issued on 18 August 1994 with estimated profit of $37,110,000 in the absence of a properly completed tax return. It was until 8 September 1994 that the Taxpayer filed the profits tax return with audited accounts showing an assessable profit of $38,712,970. It was thus a matter of fact that the Taxpayer had committed an offence for failure to file tax return within the extended prescribed time, which would be 31 July 1994 for the Taxpayer.'

The representative for the Commissioner omitted to mention that the management accounts and tax computation which were rejected by the assessor showed assessable profits of the exact amount which was contained in the profits tax return which was accepted with the audited accounts. She also failed to give any satisfactory explanation as to why the estimated assessment was for a lesser sum than that which the Taxpayer had volunteered in the tax return which it first filed. When asked about this by the Board the answer was to the effect that the compute prepared the assessment.

Having pointed out to the Board that the quantum of the penalty should be assessed as a percentage of the total amount of tax ultimately assessed without reference to the estimated assessment (with which this Board naturally agrees), the representative said that the additional tax of $30,000 which had been assessed was only 0.44% of the tax undercharged 'not even up to half percent of the tax undercharged'. She submitted that the additional tax of $30,000 was 'already on the extremely lenient side'.

She challenged the statement that the Taxpayer had for 30 years filed tax returns on time and drew the attention of the Board to the following three incidents where the Taxpayer had been late in filing its profits tax return:

Year of Assessment	Date of issue of Profit Tax Return	Expiry date for Submission	Extended Due Date under Block Extension Scheme	Date of Profits Tax Return lodged	Amount of Assessable Profit Involved $

1987/88	6-4-1988	5-5-1988	31-7-1988	9-8-1988	13,909,043
1988/89	3-4-1989	2-5-1989	31-7-1989	15-8-1989	16,784,309
1989/90	2-4-1990	1-5-1990	31-7-1990	2-8-1990	18,993,871

The representative for the Commissioner said that the repeated delay for four years in submission of returns caused the Inland Revenue Department to incur unnecessary time, cost and effort. She even questioned the honesty and integrity of the Taxpayer which she said were 'dubious'.

In the course of her submission the representative for the Commissioner referred us to the following Board of Review Decisions:

D53/88, IRBRD, vol 4, 13

D55/93, IRBRD, vol 8, 383

D11/93, IRBRD, vol 8, 143

D64/94, IRBRD, vol 9, 361

D2/90, IRBRD, vol 5, 77

D105/89, IRBRD, vol 6, 384

D24/94, IRBRD, vol 9, 226

D29/93, IRBRD, vol 8, 211

D2/88, IRBRD, vol 3, 125

D61/90, IRBRD, vol 5, 444

With due respect to the representative for the Commissioner we do not find this case to be anything like as serious as she would like us to believe. We have before us the Board of Review decisions which we have carefully considered before reaching our decision. One, D64/94 was a case where a Taxpayer filed management accounts and was penalised with a penalty of $50,000 which amounted to 6.5% of the tax undercharged. The Board considered that this was not unreasonable or excessive. The other case is D24/94 where management accounts were submitted and the Board reduced a penalty of $80,000 being equal to approximately 3.2% of the tax involved to a nominal penalty of $5,000 on the ground that the quantum was excessive.

It is our opinion that the Taxpayer in this case has been treated with undue harshness and that the penalty should be substantially reduced. We noted that in case D24/94 'the first estimated assessment was issued after the management account had been filed but this assessment, according to the Revenue's representative, was the product of a computer system' (page 248). We also do not consider this case to be one of a series of failures on the part of the Taxpayer to file returns within time. The representative for the Commissioner placed great emphasis on the past record of the Taxpayer but we note that all three occasions were some years ago and that on one occasion the Taxpayer was only two days late, on one occasion only nine days late and that the longest delay was only fifteen days. Surely there is some grace period which is applied before deciding that an offence has been committed. On the other hand the representative failed to take any heed of the fact that the Taxpayer had lost its previous auditors who had ceased business and had managed to appoint new auditors and have their accounts audited with comparative efficiency. It is not necessarily easy for a company to find new auditors and brief them with regard to the affairs of the company so as to be able to file tax returns within a few days of the expiry of the deadline.

In reaching our decision we have carefully weighed the two principles outlined in the two cases to which we have referred.

The first of the two cases was D29/93. This appeal was quite a complicated appeal with the Taxpayer seeking and being given approval to introduce novel grounds of appeal which in the event were unsuccessful. The Taxpayer argued that the Commissioner was not entitled to require Taxpayers to produce audited accounts, that the penalty was excessive because the return was only four days outside the extended penalty free allowance period, and that there had been no undercharge because a first return had been filed which was in excess of the amount of the second return.

In four out of the five preceding years the Taxpayer had been late in filing its tax returns. In respect of the year in question a tax return with management accounts was filed on the same day as an estimated assessment was issued. The extended deadline for filing tax return was 15 November 1991 and the return and estimated assessment were respectively filed and issued on 29 November 1991. On 20 January 1992 a second estimated additional assessment was issued and eventually on 19 February 1992 audited accounts were submitted with an objection against the second estimated assessment.

It can be seen from this outline of the facts that D29/93 was significantly different to the case now before us.

In D29/93 the Board found in favour of the Commissioner on all grounds. The Board was satisfied that requiring the submission of audited accounts was within the powers of the Commissioner. The Commissioner was within his power to impose a penalty. The Board confirmed the penalty imposed by the Commissioner but the decision is silent as to the grounds on which the Board considered that the penalty was not excessive.

Case No D24/94 was a case heard by a different Board but with the same chairman and was heard within twelve months of the preceding decision. In this case the Taxpayer applied for an extension of time within the extended period and simultaneously filed a profits tax return with unaudited management accounts. The request for an extension of time was rejected and an estimated assessment was issued on 26 November 1993. On 29 November 1993 an additional assessment was issued which brought to account the difference between the original estimated assessment and the return with management accounts filed by the Taxpayer. On 15 December 1993 the Taxpayer filed a profits tax return with its audited accounts and objected to the additional tax assessment dated 29 November 1993 on the ground that it was excessive because the tax return filed with the audited accounts had shown a smaller assessable profit. The second tax return with the audited accounts was accepted by the assessor and appropriate amendments made to the assessable profit. The Commissioner then imposed a penalty on the Taxpayer of $80,000.

This case is of importance because the Board considered the question of the quantum of the penalty. We adopt the wording used by the Board in that case which was as follows:

> 'It is perfectly clear that the correct interpretation of section 82A is that a taxpayer is at risk of being assessed to penalty if the section 51(1) notice served on him is not fully complied with by the date specified therein, or such other date as may apply by operation of the applicable block extension or any extension afforded on request by the assessor.
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> It is an agreed fact that the last date on which the Taxpayer's return for the year of assessment 1992/93 had to be lodged was 15 November 1993. It is an agreed fact that it was not so filed. Accordingly, and with respect to the Taxpayer's representative, the first of the alternative grounds of appeal is misconceived.
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> The fact that a taxpayer has put the Revenue on notice that a liability to tax existed and has paid the proper amount of tax on or before the date(s) when such tax would have been payable had the return been filed within time is irrelevant to the application of section 82A. If the notice is not complied with it is within the discretion of the Commissioner as to which of the penal provisions of the IRO he should invoke. The Board has no right to question the exercise by the Commissioner of his discretion to invoke section 82A, as opposed to prosecuting or compounding under section 80.
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> A reasonable excuse:
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> The Board is satisfied that its earlier decisions that delay caused by problems encountered with a computer system do not constitute a reasonable excuse, refer D2/92, are correct.
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> The quantum of the penalty:

The only question for consideration in this appeal is whether, in the circumstances, the penalty was excessive.

The Board notes that:

The Revenue accepts that the Taxpayer was not seeking to evade tax.

This is not one of a series of failures on the part of the Taxpayer to file a return within time.

A request for an extension of one month, admittedly at the 11th hour, was rejected even though the management accounts had been filed.

It is an agreed fact that the tax payable by the Taxpayer for the year of assessment 1992/93 was paid within the time it would have been payable had the return been filed within time.

The Board appreciates that the tax computation and its supporting schedules was not lodged until the return was lodged but the only likely practical effect of that is the profit disclosed by the management accounts is likely to exceed the taxable profit, as was the fact in this appeal.

The first estimated assessment was issued after the management accounts had been filed but this assessment, according to the Revenue's representative, was the product of a computer system and it was superseded almost immediately by a revised assessment based on the profit disclosed by the management accounts, refer paragraphs (5) and (6) of the agreed facts.

Taking all of these factors into account the Board is satisfied that the Taxpayer has been treated with undue harshness and that whilst some penalty is merited a penalty of $80,000 is, in the particular circumstances applicable to this appeal, excessive.

Decision

The Board allows the Taxpayer's appeal against the quantum of the penalty imposed by the Commissioner and directs that the notice of assessment and demand for additional tax under section 82A of the IRO dated 28 February 1994 be amended to impose additional tax of $5,000 in lieu of the $80,000 specified therein.'

We, like the Board in case D24/94, feel that the Taxpayer in the case now before us has been treated with undue harshness. Accordingly we order that the penalty tax imposed be reduced from $30,000 to $5,000.

INLAND REVENUE BOARD OF REVIEW DECISIONS