Case No. D134/00

Penalty tax – late filing of returns – whether an application for extension of time is an excuse – whether payment of tax under the First Estimated Assessment a mitigating factor – whether quantum of penalty excessive – unintentional – sections 68(9) and 82A of the Inland Revenue Ordinance (' IRO') – frivolous appeal – order to pay cost.

Panel: Kenneth Kwok Hing Wai SC (chairman), Philip Kan Siu Lun and Adrian Wong Koon Man.

Date of hearing: 29 January 2001.
Date of decision: 6 March 2001.

The taxpayer is a company incorporated in Hong Kong. On 1 April 1999, a profits tax return for the year of assessment 1998/99 was issued to the taxpayer requiring the taxpayer to complete and return it to the Inland Revenue Department (' IRD') within one month from the date of issue. The taxpayer' s auditor asked for extension but was rejected. On 10 June 1999, the assessor, not having received the duly completed return from the taxpayer, raised an estimated profits tax assessment for the year of assessment 1998/99. Some five months later, the assessor, still not having received the duly completed return from the taxpayer, raised an estimated additional profits tax assessment for the year of assessment 1998/99.

The return was received and was late by eight months and nine days from the due date of 1 May 1999. The Commissioner assessed additional tax in respect of the taxpayer' s failure to furnish the tax return within time allowed. The taxpayer appealed against the additional tax.

Held:

1. The taxpayer has failed to comply with the requirement to submit the return within the one month period allowed. Subject to the question of reasonable excuse, the taxpayer is liable for additional tax.

2. Making an application for extension of time two days before its due date is not an excuse. What makes it all the more inexcusable is that no ground was alleged in the application. It was the duty of the appellant to regulate its own affairs in such a way so as to comply with the requirements of the IRO. On basis of the facts, the Board found that the taxpayer showed a lack of any or any proper concern in complying

with its duty to file tax returns on time. Its failure to submit the return within the time allowed is in the Board' s decision inexcusable.

3. The Board sees no reason why the phrase ' in consequence of' in section 82A(1)(ii) should not have the same meaning as the same phrase in section 82A(1)(i). The Board is concerned with ' the amount of tax which ... has been undercharged in consequence of the failure ...' , not ' the amount of tax which has been undercharged in consequence of the detection of the failure ...' (CIR v Kwok Siu-tong [1978] HKLR 26 considered).

4. Further, the alternative provision is ' the amount of tax ... which would have been undercharged if such failure had not been detected' . Had such failure not been detected, the amount of tax, which would have been undercharged, is $319,703. The maximum amount of additional tax is $319,703. The assessment in the sum of $32,000 is 10.01% of the amount of tax, which would have been undercharged if the failure had not been detected.

5. What is aggravating in this case is that the accounts closed on 30 April each year meant that the taxpayer had twelve months to submit its audited accounts by 1 May in the following year. Payment of tax under the First Estimated Assessment is not a mitigating factor. If the taxpayer had the intention to delaying to the tax liability, the additional tax would and should have been much higher than 10.01%. The maximum amount for which the taxpayer is liable is three times the amount of tax undercharged or which would have been undercharged. The Board considered that the assessment at 10.01% is not excessive (D24/94, IRBRD, vol 9, 226 and D56/96, IRBRD, vol 12, 1 distinguished).

6. The discretion of the Board under section 68(9) to order an unsuccessful taxpayer to pay costs is not expressed to be restricted to appeals which are obviously unsustainable. The Board is of the opinion that this appeal is frivolous and vexatious and an abuse of the process. The taxpayer has wasted the time and resources of the Board and those of IRD and put forward obviously unsustainable arguments.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

CIR v Kwok Siu-tong [1978] HKLR 26
D24/94, IRBRD, vol 9, 226
D56/95, IRBRD, vol 12, 1

Leung Chung Kan for the Commissioner of Inland Revenue.

Mak Kam Hung of Harvest Financial Consultancy Limited for the taxpayer.

Decision:

1. This is an appeal against the assessment (' the Assessment') dated 29 March 2000, charge number 1-1095900-99-2, by the Commissioner of Inland Revenue, assessing the Taxpayer to additional tax under section 82A of the IRO, in the sum of $32,000 in respect of the year of assessment 1998/99.

2. The relevant provision is section 82A(1)(d) of the IRO for failing to comply with the requirements of the notice given to the Taxpayer under section 51(1) to furnish the profits tax return for the year of assessment within the time allowed.

The admitted facts

3. Based on the facts stated in the statement of facts and admitted by the Taxpayer, we make the following findings of fact.

4. The Taxpayer is a company incorporated in Hong Kong on 21 August 1987, commenced business on 15 September 1987, and was engaged in the provision of agency services and trading in machinery.

5. The Taxpayer closes its accounts annually on 30 April.

6. The Taxpayer was late by five months and twenty-nine days in the submission of its profits tax return for the year of assessment 1996/97, returning profits of $5,420,568.

7. The Taxpayer was late by two months and ten days in the submission of its profits tax return for the year of assessment 1997/98, returning profits of $1,808,173.

8. A circular letter captioned ' Block Extension Scheme for lodgment of 1998/99 tax returns' had been issued to tax representatives on 31 March 1999. In paragraph 8, it was specified that no extension would be allowed to taxpayers with accounting date falling between 1 April 1998 and 30 November 1998.

9. On 1 April 1999, a profits tax return for the year of assessment 1998/99 (' the Return') was issued to the Taxpayer under section 51(1) of the IRO requiring the Taxpayer to complete and return it to the IRD within one month from the date of issue.

10. On 29 April 1999, IRD received a letter dated 29 April 1999 from Company A, the Taxpayer' s auditors, requesting for an extension to 31 May 1999 for filing the Return.

11. As the Taxpayer closes its accounts annually on 30 April, the request for extension was rejected on 14 May 1999.

12. On 10 June 1999, the assessor, not having received the duly completed Return from the Taxpayer, raised an estimated profits tax assessment (' the First Estimated Assessment') for the year of assessment 1998/99 in the sum of $1,990,000 with tax payable thereon of $318,400.

13. No objection to the First Estimated Assessment was lodged by the Taxpayer.

14. Some five months later, on 9 December 1999, the assessor, still not having received the duly completed Return from the Taxpayer, raised an estimated additional profits tax assessment (' the Second Estimated Assessment') for the year of assessment 1998/99 in the sum of $1,000,000 with tax payable thereon of $160,000.

15. By notice dated 23 December 1999, Company A lodged an objection against the Second Estimated Assessment on the ground that it was excessive.

16. As the Return was not lodged at the same time, IRD could not accept the notice dated 23 December 1999 as a valid notice of objection under section 64 of the IRO and rejected the objection on 6 January 2000.

17. By notice dated 8 January 2000, received by IRD on 10 January 2000, the Taxpayer' s representative, Harvest Financial Consultancy Limited, lodged an objection against the Second Estimated Assessment on the ground that it was excessive.

18. The Return was received on 10 January 2000 and showed assessable profits of $1,998,146. It was late by eight months and nine days from the due date of 1 May 1999.

19. On 18 January 2000, the assessor revised the Second Estimated Assessment under section 64(3) of the IRO with revised additional assessable profits of $8,146 and revised tax payable thereon of $1,303.

20. By a letter dated 24 February 2000, the Commissioner gave the Taxpayer notice under section 82A(4) of the IRO of her intention to assess additional tax in respect of the Taxpayer's failure to comply with the requirements of the notice given to him under section 51(1) of the IRO to furnish the tax return within the time allowed.

21. By a letter dated 14 March 2000, the Taxpayer submitted written representations to the Commissioner.

22. On 29 March 2000 the Commissioner issued the Assessment.

23. By a letter dated 20 April 2000, Harvest Financial Consultancy Limited gave notice of appeal against the Assessment.

The appeal hearing

24. At the hearing of the appeal, the Taxpayer was represented by three persons from Harvest Financial Consultancy Limited, that is, Mr MAK Kam-hung, Mr GO Wai-hon and Miss LAI Miu-sheung. No person from the Taxpayer attended the hearing. Mr MAK Kam-hung, who had conduct of the appeal for the Taxpayer, did not call any witness.

25. The business addresses of Harvest Financial Consultancy Limited and Company A are the same.

26. In its letter giving notice of appeal, Harvest Financial Consultancy Limited enclosed a letter dated 20 April 2000 by the Taxpayer to the Clerk to the Board of Review as ' a statement of the grounds of appeal from the aforesaid assessments (sic)' . The following is what Harvest Financial Consultancy Limited called the ' statement of the grounds of appeal' :

> ' With reference to your IRC 1921 dated 29 March 2000, we would like to express our disagreement with your accusation of tax under-charged for $319,703 for the year of assessment 1998/99.
>
> We have tried to apply for an extension of filing the audited accounts for the year of assessment 1998/99 on 29 April 1999. Unfortunately, your letter dated 14 May 1999 confirmed your refusal to grant us the extension. Just as what we anticipated, we would not file the accounts to you before your estimated assessment. Subsequently, on 10 June 1999, we received an estimated assessment which demanded a payment of $347,493 based on an estimated profits of $1,990,000. Based on our estimation, your estimated assessment would be around the same as our actual assessable profits, therefore, we paid the said sum on 1 November 1999. On 9 December 1999, we received an additional assessment on $1,000,000 which levied an additional tax of $155,502 on us. We managed to file the audited accounts on 8 January 2000 to you with assessable profits of $1,998,146 which have only a very very slightly (sic) difference with your first estimated assessment. A final assessment was issued on 18 January 2000. The final tax of $2,606 which was a charge on the additional profits figure ($8,146) was duly paid.

By the way, in the past years when we have submitted (sic) the accounts on time, the assessment was also issued in June the spirit of section 82A is to prevent the taxpayer to defer their tax liabilities. We understand that it is the common practice that the Inland Revenue Department will issue an estimated assessment if we cannot submit the account on time. Therefore under this case, we do not see any loss of your department.

We do not deny it was our responsibility for the delay in filing the accounts. Our failure to file the accounts was due to the fact that our accountant who has been working with us since our incorporation, resigned. The new accountant has tried her very best to accomplish the tedious job of finalising the accounts but in vain as our accounts involve many overseas matters. Therefore, an application for extension of the filing the accounts was made. In addition to (sic), as the auditors have some queries need to be cleared and all the directors are always on trip and not in Hong Kong, and our business are majorly involved (sic) overseas matters, the auditors therefore also need time to wait for the confirmations back as we do not want to have a qualified report. Unlike other company besides taxation purposes (sic), our report is an important information for our business counterparts which is an image of our financial standings. In our point of view to manage and promote our business is the major focus. After received (sic) the demand notes, we have duly paid all tax payments. We never have an intention of delaying filing of the account.

We should be grateful if you could kindly take into consideration the facts mentioned above and waive the charge against us accordingly as your tax undercharged figure is complete (sic) incorrect.

Thank you for your anticipation.(sic)'

Our decision

27. Under section 82B(2) of the IRO, there are only three possible grounds of appeal. They are that:

(a) the Taxpayer is not liable to additional tax;

(b) the amount of additional tax assessed on the Taxpayer exceeds the amount for which the Taxpayer is liable under section 82A; and

(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.

28. The onus of proving that the Assessment is excessive or incorrect is on the Taxpayer, according to sections 68(4) and 82B(3).

Whether Taxpayer liable to additional tax

29. 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.'*

30. The Taxpayer has failed to comply with the requirement to submit the Return within the one month period allowed. Subject to the question of reasonable excuse, the Taxpayer is liable for additional tax.

31. Making an application for extension of time two days before its due date is not an excuse. What makes it all the more inexcusable is that no ground was alleged in the application; that the application was to the Taxpayer' s knowledge rejected on 14 May 1999; and that in any event the Taxpayer failed to submit the Return within the extension sought. The Taxpayer sought an extension until 31 May 1999 but the Return was not submitted until 10 January 2000 when it had to submit the Return to validate the objection against the Second Estimated Assessment.

32. There is no evidence to support any of the factual matters alleged in the fourth paragraph of the ' statement of the grounds of appeal' . Further and in any event, none of the alleged matters is a reasonable excuse. **It has been said by the Board of Review time and again that it was the duty of the appellant to regulate its own affairs in such a way so as to comply with the requirements of the IRO**. The Taxpayer closed its account on 30 April 1998 and had twelve months by the due date of 1 May 1999 to finalise its audited accounts for the year ended 30 April 1998. We asked Mr MAK Kam-hung why it was that the Taxpayer could not have done it within twelve months, in contrast with listed companies which were required to publish their financial results within five months (reduced to four months as from July 2000) from the end of their financial years. Mr MAK Kam-hung claimed that the Taxpayer' s accountant left in April 1997 and the Taxpayer was a small company. Neither is tenable. There was a 24-month period between April 1997 and 1 May 1999. The profits returned by the Taxpayer was $5,420,568 for the year of assessment 1996/97, $1,808,173 for the year of assessment 1997/98 and $1,998,146 for the year of assessment 1998/99. Moreover, Company A gave a qualified audit opinion arising from limitation of audit scope.

33. The Taxpayer showed a lack of any or any proper concern in complying with its duty to file tax returns on time. Its failure to submit the Return within the time allowed is in our decision inexcusable.

Whether in excess of the amount under section 82A

34. The Return showed assessable profits of $1,998,146. The tax payable was $319,703.

35. The maximum amount of additional tax is ' treble the amount of tax which 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' .

36. In CIR v Kwok Siu-tong, misspelt as ' Kwok Sui-tong' in the case name in the Hong Kong Law Reports, [1978] HKLR 26 at page 34, Mr Commissioner Liu, as he then was, considered the meaning of the phrase ' in consequence of' in respect of an incorrect tax return and held that:

> ' *The phrase "in consequence of" is defined in the Concise Oxford Dictionary as "as a result of". For the term under discussion to become operative, a causal link between two occurrences must be established.'*

37. We see no reason why the phrase ' in consequence of' in section 82A(1)(ii) should not have the same meaning as the same phrase in section 82A(1)(i).

38. In our decision, the First Estimated Assessment has not been shown to have been caused by the failure to submit the Return within the time allowed. We are concerned with ' the amount of tax which ... has been undercharged in consequence of the failure ...' , not ' the amount of tax which has been undercharged in consequence of the **detection of** the failure ...' . **Detection** of the failure to submit the Return set the procedure of issuing estimated assessments in motion. No causal link between the Taxpayer' s failure to submit the Return within the time allowed and the First Estimated Assessment has been shown. The First Estimated Assessment has not been shown to have been issued ' in consequence of' the Taxpayer' s failure to submit the Return within the time allowed and is therefore not relevant in computing the maximum amount of additional tax.

39. **Further, as the Board of Review has said time and again, the alternative provision is ' the amount of tax ... which would have been undercharged if such failure had not been detected' .** Had such failure not been detected, the amount of tax which would have been undercharged is $319,703. The maximum amount of additional tax is treble $319,703.

40. The Assessment in the sum of $32,000 is clearly not in excess of the maximum amount under section 82A.

Whether excessive having regard to the circumstances

41. $32,000 is 10.01% of the amount of tax which would have been undercharged if the failure had not been detected.

42. For reasons given above, the Taxpayer showed a lack of any or any proper concern in complying with its duty to file tax returns on time.

43. This is the third consecutive year of assessment of breach of its duty to submit profits tax returns on time. What is aggravating in this case is that the accounts closed on 30 April each year meant that the Taxpayer had twelve months to submit its audited accounts by 1 May in the following year.

44. The Taxpayer makes no apology for any of its repeated failures to submit profits tax returns on time.

45. Payment of tax under the First Estimated Assessment is not a mitigating factor. Had the Taxpayer shown any or any proper concern in complying with its duty to submit profits tax returns on time, there would have been no need for IRD to issue the two estimated assessments and IRD' s resources would not have been wasted on dealing with the Taxpayer' s two objections.

46. Harvest Financial Consultancy Limited contended in its letter dated 5 October 2000 to the Commissioner that the Taxpayer ' never have the intention to delaying to the tax liability' . If the Taxpayer had such intention, the additional tax would and should have been much higher than 10.01%.

47. Mr MAK Kam-hung of Harvest Financial Consultancy Limited cited D24/94, IRBRD, vol 9, 226 and D56/96, IRBRD, vol 12, 1. The facts in this appeal bear no resemblance to the two cases cited by Mr MAK Kam-hung.

48. The maximum amount for which the Taxpayer is liable is three times the amount of tax undercharged or which would have been undercharged. We have carefully considered all the points raised on behalf of the Taxpayer orally and in writing. In our decision, the Assessment at 10.01% is not excessive and we have very nearly decided to increase it pursuant to sections 68(8)(a) and 82B(3) of the IRO.

Disposition

49. We dismiss the appeal and confirm the Assessment.

Costs order

50. The discretion of the Board under section 68(9) to order an unsuccessful Taxpayer to pay costs is not expressed to be restricted to appeals which are obviously unsustainable. The maximum sum was increased from $100 to $1,000 in 1985 and further increased to $5,000 in 1993. $5,000 represents only a small fraction of the costs of the Board in disposing of an appeal.

51. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process. The Taxpayer, through Harvest Financial Consultancy Limited, has wasted the time and resources of the Board of Review and those of IRD and put forward obviously unsustainable arguments. Pursuant to section 68(9) of the IRO, we order the Taxpayer to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.