Case No. D149/01

Penalty tax – late filing of returns – sections 51(1) and 82A of the Inland Revenue Ordinance ('IRO') – whether persistent failure to submit return on time should be regarded as a specie of tax evasion – whether cavalier attitude of the appellant in delaying to submit accounts aggravated the default.

Panel: Ronny Wong Fook Hum SC (chairman), Ronald Tong Wui Tung and Wong Chi Ming.

Date of hearing: 16 October 2001.
Date of decision: 6 February 2002.

The appellant was a company, which adopted 30 June as the 'year end' for its accounts. On 1 April 1999, the Revenue sent to the appellant a return for the year of assessment 1998/99 and the appellant failed to comply with the time limit to submit this return one month from its dispatch. The appellant submitted a return which was received by the Revenue on 10 July 1999. It was late by two months and nine days.

The appellant lodged its return for the year of assessment 1999/2000 on 4 July 2000. It was late by two months and one day. The auditor's report for this return was signed on 28 May 2000. The Commissioner assessed additional tax by virtue of its failure to comply with section 51(1) of the IRO in relation to the filing of returns. The appellant appealed against such assessment.

Held:

1. There is no doubt that the appellant failed to comply with the requirements of a notice given to him under section 51(1) of the IRO. The appellant is therefore liable to be assessed additional tax under section 82A of an amount not exceeding treble the amount of tax which 'would have been undercharged if the failure to comply with a notice under section 51(1) had not been detected'. The amount of tax which would have been undercharged would have been the full amount of tax which was eventually assessed (D40/94, IRBRD, vol 9, 269 followed).

2. The Board considered that the relevant wordings of section 82A were unambiguous, there was no justification to refer to the speech of the Financial Secretary in order to ascertain the true meaning of that section. The Board further saw no reason why

persistent failure to submit return on time should not be regarded as a specie of tax evasion.

3. The Board considered the cavalier attitude of the appellant in delaying to submit accounts which were ready by 28 May 2000 till 4 July 2000 aggravated the default. Having considered the track record of the appellant up to the year of assessment 1998/99, the level of penalty for that year should be 4.99% of the tax which would have been undercharged had its default not been detected and the Board saw no justification to disturb the existing assessment for the year of assessment 1999/2000 (D53/95, unreported followed).

Appeal dismissed.

Cases referred to:

D40/94, IRBRD, vol 9, 269
D53/95 (unreported)
D11/93, IRBRD, vol 8, 143
D24/94 (unreported)
D56/94 (unreported)
D1/95, IRBRD, vol 10, 71
D56/96, IRBRD, vol 12, 1
D59/96, IRBRD, vol 12, 8
D25/97, IRBRD, vol 12, 204
D100/97, IRBRD, vol 12, 544

Chan Sin Yue for the Commissioner of Inland Revenue.
Taxpayer represented by its tax representative.

Decision:

Background

1. The Appellant is a company incorporated on 3 August 1993. It commenced a 'karaoke' business on 9 April 1994. It adopted 30 June as the 'year end' for its accounts.

2. On 1 April 1999, the Revenue sent to the Appellant a return for the year of assessment 1998/99. The Appellant was required to submit this return within one month of its despatch. The Appellant failed to comply with this time limit.

3. By notice of estimated assessment dated 10 June 1999, the Appellant was assessed on the basis of estimated profits at $5,900,000 with tax thereon at $1,030,845.

4. By notice dated 6 July 1999, the Appellant's then representative ('the Representative') lodged objection against the estimated assessment for the year of assessment 1998/99 on the ground that the same was excessive. In support of this objection, the Appellant submitted a return which showed assessable profits of $3,844,871. This objection was not received by the Revenue until 10 July 1999. It was late by two months and nine days.

5. On 3 April 2000, the Revenue issued to the Appellant a return for the year of assessment 1999/2000. This return should have been completed and submitted to the Revenue within one month from the date of issue.

6. The Appellant lodged its return for the year of assessment 1999/2000 on 4 July 2000. It was late by two months and one day. The auditor's report which accompanied this return was signed on 28 May 2000.

7. On the basis of the return so submitted, the Revenue raised an assessment for the year of assessment 1999/2000 in the sum of $394,428.

8. After exchanging correspondence with the Appellant and the Representative, on 16 February 2001, the Revenue revised the assessment for the year of assessment 1998/99 to the figures as shown in the return submitted on 10 July 1999.

9. By notice under section 82A(4) of the IRO dated 13 March 2001, the Commissioner informed the Appellant of her intention to assess additional tax by virtue of its failure to comply with section 51(1) of the IRO in relation to the filing of returns.

10. After considering representations from the Appellant dated 10 April 2001, the Commissioner by notices dated 8 May 2001 imposed additional tax as follows:

Year of assessment	**Tax which would have been undercharged if the Appellant's failure had not been detected**	**Additional tax imposed**	**Relationship between additional tax imposed and the tax that would have been undercharged**
	$	$	%
1998/99	615,179	37,000	6.01
1999/2000	669,214	40,000	5.97

11. This is the Appellant's appeal against such assessment.

The hearing before us

12. The Representative appeared on behalf of the Appellant. We are impressed by the preparation of the Representative and the tenacity that he displayed throughout the hearing.

13. The Representative made the following submissions:

(a) The Representative reminded us of the following fundamental principle in the construction of a tax statute as set out in paragraph 912 of Halsbury's Laws of England 4th edition:

' The language of a statute imposing a tax, duty or charge must receive a strict construction in the sense that there is no room for any intendment, and regard must be had to the clear meaning of the words. If the Crown claims a duty under a statute, it must show that that duty is imposed by clear and unambiguous words, and where the meaning of a statute is in doubt, it must be construed in favour of the subject ...'

(b) The Representative drew our attention to the speech of the then Financial Secretary on 21 May 1969 when he moved the second reading of the Inland Revenue (Amendment) Bill 1969 before the Legislative Council. The Financial Secretary pointed out that the amendments embodied in the Bill 'can be divided into three separate categories. The first of these concerns the strengthening of the Commissioner of Inland Revenue's powers to prevent tax evasion and also power to impose certain new penalties'. The first category of amendments referred to by the Financial Secretary relates to the power of the Revenue to require a taxpayer who is believed to be evading tax to furnish statements of assets and liabilities by specific dates. As far as penalties are concerned, 'the main innovation proposed is the grant of power to the Commissioner to charge "additional tax" ... As this is an alternative to prosecution, a taxpayer may not be prosecuted for an offence in respect of which additional tax has been imposed. Some defaulting taxpayers may prefer this procedure to the more public one of prosecution, which may also bring a higher penalty'. On the basis of this speech of the then Financial Secretary, the Representative argued that additional tax should not be imposed on the Appellant as this is not a tax evasion case.

(c) The Representative argued that by virtue of the estimated assessment, no tax was undercharged. The provisions of section 82A are therefore inapplicable.

(d) The Representative drew our attention to the rapid turnover of accounts staff of the Appellant. He submitted for our consideration a bundle of notices in relation to the dismissals or resignations of the Appellant's accounts staff for the period

between 9 November 1998 and 23 March 1998.

(e) In relation to the year of assessment 1998/99, the Representative explained that his own predicament contributed to the delay. He tendered a certificate issued by a doctor dated 29 December 1999. The doctor opined that the Representative was suffering from 'dysfunctional esophagus syndrom associated with anxious psychology problem'.

(f) As to the level pf penalty, the Representative laid considerable emphasis on a compound offer made by the Revenue on 13 June 2000. He said that the additional tax imposed was far too high given the willingness of the Revenue to accept a compound penalty of $3,000.

14. Ms Chan for the Revenue submitted that the provisions of section 82A are clear and unambiguous. She drew our attention to the decision of this Board in D40/94, IRBRD, vol 9, 269. In that case the taxpayer was late in filing its tax return. An estimated assessment was issued and paid which was in excess of the amount of the profit made by the taxpayer and which was shown in the tax return. The taxpayer paid the estimated assessment and the excess amount was refunded to the taxpayer in due course. The taxpayer submitted that there was no tax in default because it paid excessive provisional profits tax and the public revenue did not suffer in consequence of its failure to submit its return within the time specified. The taxpayer further submitted that there was no tax undercharged and that in fact tax had been overcharged. The Board rejected this argument. The Board pointed out that:

> *'The legislature has chosen to adopt a theoretical situation of what would be the case if the failure to do something had never been found out. Obviously the failure has been found out but this is not material. If the Taxpayer had never filed its tax return then theoretically it would never have paid any tax. That being the case it must follow logically that the amount of tax which would have been undercharged would have been the full amount of tax which was eventually assessed.'*

15. Ms Chan further drew our attention to the earlier default of the Appellant for the year of assessment 1997/98. The Appellant was late in submitting its return for a few days. Ms Chan pointed out that the compound offer was made conditional upon due payment of the penalty and submission of the completed return within 14 days from the date of the offer. The Appellant did not accept the offer and the relevant conditions had not been complied with. The reports of the directors and auditor for the year of assessment 1999/2000 were both dated 28 May 2000. The return of the Appellant was not submitted until 4 July 2000, about a week beyond the deadline envisaged by the compound offer.

Our decision

16. The Representative failed to identify any ambiguity in section 82A of the IRO. There is no doubt that the Appellant failed to comply with the requirements of a notice given to him under section 51(1) of the IRO. The Appellant is therefore liable to be assessed additional tax under section 82A of an amount not exceeding treble the amount of tax which 'would have been undercharged if [the failure to comply with a notice under section 51(1)] had not been detected'. The principle established by this Board in D40/94 is clear. The amount of tax which would have been undercharged would have been the full amount of tax which was eventually assessed. The submissions of the Representative placed no weight on the words 'would have been undercharged if such failure had not been detected'.

17. As the relevant wordings of section 82A are unambiguous, there is no justification to refer to the speech of the Financial Secretary in order to ascertain the true meaning of that section. Even if such reference be legitimate, we entertain serious reservations whether the Financial Secretary had section 82A in mind when he adverted to the question of tax evasion. The Financial Secretary divided the proposed amendments into three categories. He drew a distinction between the first category which gives the Revenue power to require a taxpayer to furnish statements of assets and liabilities and the third category which gives the Revenue power to impose penalties. The reference to tax evasion by the Financial Secretary was in the context of the former but not the latter category. Even if the observations of the Financial Secretary be applicable to the latter category, we see no reason why persistent failure to submit return on time should not be regarded as a specie of tax evasion.

18. We turn now to the level of penalty. This is the area which caused us grave concern. We were initially attracted to the submission of the Representative that any layman would be surprised by the increase of penalty as indicated in the letter to compound the offence to the level of additional tax as eventually assessed. Our disquiet was allayed by consideration of the terms of that offer letter which made it clear that '[The Assistant Commissioner] consider you have thereby committed an offence under Section 80(2)(d) of the Ordinance for which you would be liable on summary conviction to a fine of not exceeding $10,000 and treble the amount of tax which has been undercharged in consequence of such failure or which would have been undercharged had such failure not been detected. The Commissioner would, however, be willing to exercise the power of compounding offences vested in him by Section 80(5) of the Ordinance and agree not to commence proceedings against you under Section 80 in respect of this offence providing you [comply with various conditions specified]'. The seriousness of the situation should have been brought home to any layman who takes reasonable care in perusing this offer. The cavalier attitude of the Appellant in delaying to submit accounts which were ready by 28 May 2000 till 4 July 2000 aggravates the default.

19. In considering the level of penalty, we have borne in mind the decisions of this Board as summarised in the Schedule annexed hereto. We are of the view that we should follow the unreported decision in D53/95. Given its track record up to the year of assessment 1998/99, the

level of penalty for that year should be 4.99% of the tax which would have been undercharged had its default not been detected. As far as the year of assessment 1999/2000 is concerned, we see no justification to disturb the existing assessment.

Schedule

Case number	Date of decision	Period of delay	Previous record	Purchase of tax reserve certificates	Excuses put forward	Special features	Penalty imposed
D11/93	7 June 1993	About 3 months			Managing Director away from Hong Kong on business		20% of the tax involved
D24/94	11 July 1994	1 month	Nil		Business had grown dramatically It had serious computerisation problems		$5,000 instead of $80,000 being 3.2% of the tax involved
D40/94	6 October 1994	1 month and 20 days	Delay in 5 years		Penalty should not have been imposed as estimated assessment issued which was in excess of the profit shown in the return		10% of the tax involved
D56/94	28 November 1994	About 2 months	Delay in 4 years	***	Increase in volume of business Purchase of Tax Reserve Certificate		2.5% of the tax involved
D1/95	7 April 1995	5 months	Delay in 4 years Longest delay 96 days		Business had grown tremendously Accounts team strengthened and new control procedures implemented Auditors replaced		Reduced from 34.1% to 10% of the tax involved
D53/95	4 September 1995	About 1 month	Delay in 1 year		Delay in architects certificate Substantial increase in		4.99% of the tax involved

					business Only one previous delay		
D56/96	24 October 1996	35 days	Unblemished record		Delay completely the fault of former professional accountant		Reduced from 3.1% to 0.41% of the tax involved
D59/96	25 October 1996	4 months and 10 days	Delay in 3 years with maximum delay of 14 days		Difficulties in obtaining in good time all information from overseas associated companies		Reduced from 3.55% to 1%
D25/97	28 May 1997	20 months and 24 days 14 months and 5 days 3 months and 3 days	Delay in 2 yeas		Lack of suitable accounting staff Relocation to a bigger plant Frequency of the directors' travel Installation and implementation of computerised accounting system		17.4% of the tax involved 16.12% of the tax involved 10% of the tax involved
D100/97	26 January 1998	38 days	Clear record		Directors not having time to finalise company accounts	Decision of a majority in the Board	9.83% of the tax involved