Case No. D15/01

Penalty tax – late filling of tax return – reasonable excuse – sections 51(1) and 82A of the Inland Revenue Ordinance (' IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Ronald Tong Wui Tung and Duffy Wong Chun Nam.

Date of hearing: 6 January 2001.
Date of decision: 26 April 2001.

The taxpayer, a company incorporated in Hong Kong in August 1994, subsequently took over a bar and restaurant business. In 1996 the Revenue sent to the taxpayer a return and in reply the taxpayer informed the Revenue that it had not commenced business. As a result the taxpayer was asked by the Revenue, inter alia, to note that should they commence to earn chargeable profits, they must inform the Commissioner in writing within four months after the end of the accounting period.

In April 1999, the Revenue sent to the taxpayer a return for the first time. The return was for the year of assessment 1998/99. In August 1999 the Revenue sent to the taxpayer returns for years of assessment 1995/96 to 1997/98.

In September 1999, the tax representative of the taxpayer sought an extension of time till 15 November 1999 for submission of all four returns. The Revenue acceded to its request. There was no submission by the taxpayer on the extended date.

The Revenue contacted the taxpayer several times during the period between December 1999 and January 2000. On 21 January 2000, the taxpayer submitted all four returns to the Revenue. The taxpayer and the Revenue reached agreement on 1 March 2000 as to the correct assessable profits for the years of assessment 1995/96 to 1998/99. On 17 March 2000, the taxpayer was assessed on the basis of the profits so agreed.

On 5 May 2000, the Commissioner informed the taxpayer that she intended to assess additional tax by virtue of the taxpayer' s failure, without reasonable excuse, to comply with the notice given under section 51(1) of the IRO. After considering representations from the taxpayer, the Commissioner imposed additional tax on the taxpayer ranging between 113% and 132%.

The taxpayer contended that from July 1996 to August 1997 it had on three occasions asked the Revenue for the issuance of returns. As a result of the Revenue' s inactivity, it did not press further in 1998.

The Revenue made no admission of the events between July 1996 and August 1997 as alleged by the taxpayer. The Revenue further argued that the events between July 1996 and August 1997 were irrelevant to the liability of the taxpayer. The penalty related to the delay between 5 December 1999 and 21 January 2000.

Held:

1. The Revenue had allowed extension of time. Bearing all factors in mind, the taxpayer did not have reasonable excuse for their non-compliance.

2. The level of sanction depends on the nature of infraction and the circumstances of each case. It is dangerous to treat penalties imposed under section 82A for one type of transgression as if the same is equally applicable for other violations under the same section.

3. Prior to receipt of the return for the year of assessment 1998/99, the taxpayer did not have a track record of habitual non-compliance. Given the history of the dispute, it is not unreasonable for the taxpayer, when faced with such drastic starting point, to entertain a belief that section 82A was being used by the Revenue to make up tax lost between the years of assessment 1996/97 and 1999/2000. The Board was of the view that a surcharge of 5% for all the years would be reasonable in the circumstances of this case.

Per curiam:

Despite the adversarial nature of these appeals, it is the duty of all parties appearing before this Board to draw its attention to all relevant authorities. This duty is heightened when one of the parties is a layman and has no legal training whatsoever.

Appeal allowed in part.

Cases referred to:

D105/96, IRBRD, vol 14, 79
D34/88, IRBRD, vol 3, 336

D56/96, IRBRD, vol 12, 1
D59/96, IRBRD, vol 12, 8
D100/97, IRBRD, vol 12, 544

Lee Chan Pui Kwan for the Commissioner of Inland Revenue.
Taxpayer represented by its director.

Decision:

Background

1. In 1986, Mr A commenced a bar and restaurant business in the name of Restaurant B. Apart from Restaurant B, Mr A also carried on a similar business in the name of Restaurant C.

2. On 2 August 1994, Mr A incorporated two companies in Hong Kong. The first is Company D which subsequently took over the business of Restaurant B. The second is Company E which subsequently took over the business of Restaurant C.

3. We are concerned with the liabilities of Company D and Company E for additional tax imposed by the Commissioner on 8 September 2000. It is common ground between the parties that the two cases are identical. We shall hereinafter refer solely to Company E in outlining the relevant facts.

4. On 9 February 1996, the Revenue sent to Company E a return for the year of assessment 1994/95. By a letter dated 2 April 1996, Company E informed the Revenue that it had not commenced business. As a result the Revenue sent to Company E a copy of Form 1812 on 24 May 1996. By that form, Company E was asked to note that should they commence to earn chargeable profits, they must inform the Commissioner in writing within four months after the end of the accounting period and that they are still required to keep sufficient records of their income and expenditure to enable the assessable profits of the business to be readily ascertained.

5. It is the case of Company E that:

(a) In about July 1996, Mr A, on behalf of Company E, visited the Revenue. He inquired about the non-receipt of any return from the Revenue. He was told that new file number was being arranged for Company E and he was asked to wait at home.

(b) Mr A submitted a letter to the Revenue on 30 April 1997 informing the Revenue that despite his inquiries in 1996, no return had been received by him for the

years of assessment 1995/96 and 1996/97. Mr A asked that the relevant returns be sent to the designated business address of Company E.

(c) Mr F, a member of staff of its then tax representative, visited the Revenue in about August 1997. Mr F was again told that new file number was being processed and the returns would soon be sent to Company E.

6. On 7 April 1999, the Revenue sent to Company E a return for the first time. The return was for the year of assessment 1998/99.

7. In August 1999, the Revenue commenced investigation into the affairs of Company E. On 4 August 1999, the Revenue sent to Company E returns for years of assessment 1995/96 to 1997/98.

8. By a letter dated 8 September 1999, the tax representative of Company E sought an extension of time till 15 November 1999 for submission of all four returns. The Revenue acceded to its request. There was however no submission by Company E on the extended date.

9. A meeting took place between Mr A and the assessor on 25 November 1999. Mr A promised at this meeting that he would submit the accounting records and returns of Company E from commencement of business to year of assessment 1998/99 within the following ten days. No submission was made by Mr A as promised.

10. The Revenue contacted Mr A and the tax representative several times during the period between December 1999 and January 2000 and pressed them for production of the accounting records and submission of the returns.

11. On 21 January 2000, Company E tendered to the Revenue various accounting records and also submitted the following returns:

Year of assessment	**Date when return sent out**	**Extended date for submission**	**Actual date of submission**	**Profits returned $**
1995/96	4-8-1999	5-12-1999	21-1-2000	724,723
1996/97	4-8-1999	5-12-1999	21-1-2000	1,426,488
1997/98	4-8-1999	5-12-1999	21-1-2000	1,905,711
1998/99	7-4-1999	5-12-1999	21-1-2000	2,907,232

12. According to these returns, Company E paid Mr A director fees in amounts as set out hereunder:

Year of assessment	**Amount**
	$
1995/96	4,000,000
1996/97	4,000,000
1997/98	4,000,000
1998/99	3,000,000

Mr A had previously reported these earnings to the Revenue in his returns for the relevant years of assessment.

13. As a result of further investigations by the Revenue, Company E and the Revenue reached agreement on 1 March 2000 as to the correct assessable profits for the years of assessment 1995/96 to 1998/99 as follows:

Year of assessment	**Assessable profits**
	$
1995/96	1,150,556
1996/97	1,436,324
1997/98	1,909,151
1998/99	2,895,374

14. On 17 March 2000, Company E was assessed on the basis of the profits so agreed.

15. By notice under section 82A(4) dated 5 May 2000, the Commissioner informed Company E of her intention to assess additional tax by virtue of Company E's failure, without reasonable excuse, to comply with the notice given under section 51(1) of the IRO for the years of assessment 1995/96 to 1998/99. After considering representations from Company E dated 15 June 2000, the Commissioner imposed additional tax for the sums set out under column 5 hereunder:

1	2	3	4	5	6
Year of assessment	**Profits originally returned**	**Profits subsequently agreed**	**Tax undercharged on the basis of profits subsequently agreed**	**Additional tax**	**Relationship between 4 & 5**
	$	$	$	$	
1995/96	724,723	1,150,556	189,841	251,000	132%
1996/97	1,426,488	1,436,324	236,993	298,000	126%
1997/98	1,905,711	1,909,151	283,508	338,000	119%
1998/99	2,907,232	2,895,374	463,259	525,000	113%

16. Company E appeals against the additional tax so imposed.

The case of Company E via Mr A

17. He was penalised once for failure to submit his return on time. He learned from his bitter experience the drastic consequences arising from late submission of returns.

18. He was therefore anxious to report the profits of Company E. He stressed the three attempts he made between July 1996 and August 1997. He candidly admitted that as a result of the Revenue' s inactivity, he did not press further in the year 1998.

19. He admitted that there was delay between 15 November 1999 and 21 January 2000. He explained that as a result of a bypass operation, he could only work intermittently. Furthermore, he had to deal with more than one returns at the same time.

20. He argued that the whole incident arose as a result of defaults on the part of the Revenue. There was no response to his repeated requests for returns.

Case of the Revenue

21. Company E erred in erroneously informing the Revenue on 2 April 1996 that they had not commenced business. This led to non-issuance of any return until April 1999 when the return for the year of assessment 1998/99 was sent to Company E.

22. The Revenue makes no admission of the events between July 1996 and August 1997 as alleged by Mr A. The Revenue has no record of the letter dated 30 April 1997.

23. The events between July 1996 and August 1997 are irrelevant to the liability of Company E. The penalty relates to the delay between 5 December 1999 and 21 January 2000.

24. The auditor of Company E signed their reports for the years of assessment 1995/96 to 1998/99 on 17 January 2000. It is therefore clear that Company E did not engage any accountant till late. In D105/96, IRBRD, vol 14, 79 this Board had previously ruled that health reason is not a reasonable excuse for the delay.

25. Although the Taxpayer did not expressly challenge the quantum of additional tax in its notice of appeal, the Revenue has no objection to this Board considering whether the additional tax is excessive or otherwise.

26. The Commissioner did take into account the events between July 1996 and August 1997. An allowance of 20% was made in favour of Company E in respect of this factor. The Commissioner had also taken into account the co-operation on the part of Company E. Apart from

drawing our attention to a series of decisions by this Board, Mrs Lee of the Revenue could shed no further light on the reasons leading to the imposition of additional tax ranging between 132% for the year of assessment 1995/96 and 113% for the year of assessment 1998/99.

Our findings of fact

27. We find Mr A to be an honest witness. We accept his version of events between July 1996 and August 1997.

28. We further accept Mr A's evidence that he had a heart operation and his work suffered as a result of his hospitalisation.

The relevant provisions in the IRO

29. Section 82A provides that:

> ' *(1) Any person who without reasonable excuse –*
>
> *(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return ...;*
>
> *(b) makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; or*
>
> *(c) gives any incorrect information in relation to any matter or thing affecting his own liability to tax ...; or*
>
> *(d) fails to comply with the requirements of a notice given to him under section 51(1) or (2A); or*
>
> *(e) fails to comply with section 51(2),*
>
> *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 –*
>
> *(i) has been undercharged in consequence of such incorrect return, statement of information, or would have been so undercharged if the return, statement or information had been accepted as correct; or*

(ii) has been undercharged in consequence of the failure to comply with a notice under section 51(1) or (2A) or a failure to comply with section 51(2), or which would have been undercharged if such failure had not been detected.'

30. Section 51(1) provides that:

' *(1) An assessor may give notice in writing to any person requiring him within a reasonable time stated in such notice to furnish any return ...'*

Did Company E have any reasonable excuse for its failure to comply with the notice of the assessor under section 51?

31. This turns on the question whether the time stated in the relevant notice of the assessor is reasonable or not.

32. We are concerned with four returns. In relation to the one for the year of assessment 1998/99, this was issued to Company E on 7 April 1999. The Revenue allowed extension of time up to 5 December 1999. Company E therefore had no less than seven and a half months to complete this return. We are of the view that Company E had been afforded reasonable time to complete this task. There is no justification for the additional delay between 5 December 1999 and 21 January 2000.

33. As far as the returns for the years of assessment 1995/96, 1996/97 and 1997/98 are concerned, these were issued on 4 August 1999. The Revenue allowed extension of time up to 5 December 1999. Company E had about four months to complete the returns for three years. They did not meet the deadline. They needed an additional 1¾month for that task. We have borne in mind the Revenue' s contention that it is the clear duty on the part of every taxpayer to keep clear records of their income and expenditure. We have also taken into account that passage of time might lead to misplacement of the records kept and it would require greater effort to marshal data of years past as opposed to data of recent origin. We have also weighed in the balance the fact that Mr A was confronted not only with Company E but also with Company D. Bearing all these factors in mind, we are of the view that the Revenue had allowed Company E reasonable time to comply with their notice. Upon receipt of the return for the year of assessment 1998/99 in April 1999, Company E would have sought professional assistance and it would be artificial to expect those professionals to handle the accounts of 1998/99 in isolation without regard to previous years.

The receipt of the return for the year of assessment 1998/99 should have warned Company E and their advisers the necessity to put their tackle in order for the early years.

34. For these reasons, we are of the view that both Company E and Company D do not have reasonable excuse for their non-compliance for all the years of assessment in question.

Quantum for the year of assessment 1998/99

35. There is a wide spectrum of cases included under section 82A.

(a) There are cases involving omission of income (or profits) discovered following investigation into a taxpayer' s affairs by the Revenue;

(b) There are cases involving late submission of profits tax returns by corporations and partnerships; and

(c) There are cases involving omission of salary or property income by individuals.

36. The level of sanction depends on the nature of infraction and the circumstances of each case. It is dangerous to treat penalties imposed under section 82A for one type of transgression as if the same is equally applicable for other violations under the same section.

37. This Board has repeatedly referred to a starting point of one times the amount of tax undercharged. It is important to bear in mind the nature of cases where this starting point is apposite. In D34/88, IRBRD, vol 3, 336 the Board said this:

> ' *As previous Boards have stated in cases of this nature, the starting point for assessing an appropriate penalty would appear to be approximately 100% of the tax undercharged. In effect, this means that, for completely ignoring one' s tax obligations, one can assume that one is likely to have to pay about double the tax which other citizens who handle their tax affairs properly are required to pay. This is not unreasonable when it is borne in mind that the tax rates in Hong Kong are comparatively low and that the system of taxation in Hong Kong relies upon individual taxpayers making full and frank disclosures of all their taxable income on a voluntary basis. If this is taken as the starting point for cases of this type, the question then to be decided is whether on the particular facts of this case there are any extenuating circumstances which would merit a decrease in the amount of the penalties ...'*

We would add in parenthesis that aggravating circumstances such as repeated violations would merit an increase in the amount of the penalties.

38. The 100% starting point has consistently been applied by this Board to the first of the three categories of cases outlined in paragraph 35 above. For cases coming within the second category, the authorities of this Board reflect a different level of penalties:

(a) In D56/96, IRBRD, vol 12, 1, the taxpayer was 35 days late in submitting its profits tax return. The Board found as a fact that the delay was completely the fault of the former professional accountant of the taxpayer. The taxpayer had an unblemished, albeit relatively short, track record; was remorseful and had engaged new professional accountants. There was no actual loss of revenue. The Board held that a penalty of 3.1% ($150,000) of the amount of tax involved was excessive in the very special circumstances of that case. The penalty was reduced to 0.41% ($20,000).

(b) In D59/96, IRBRD, vol 12, 8, the taxpayer was four months and ten days late in submitting its profits tax return. The issue before the Board was whether a 3.55% penalty ($100,000) was excessive having regard to the circumstances. The Board pointed out that section 82A is not and must not be used as a means to generate revenue. The taxpayer there had a clear record and there was no actual loss of revenue. The Board however thought that there were aggravating circumstances - the taxpayer was tardy in its responses and had persisted in its hopeless appeal on liability. The Board reduced the penalty to 1% ($28,187).

(c) In D100/97, IRBRD, vol 12, 544, the taxpayer delayed in submitting its profits tax return for 38 days and was assessed by the Commissioner for additional tax under section 82A in the sum of $18,000 which was 9.83% of the amount of tax involved. The Board by a majority found that the taxpayer had failed to discharge the burden of proving that the assessment was excessive.

39. We regret that the Revenue has not seen fit to draw our attention to this line of authorities. This Board is of the firm view that despite the adversarial nature of these appeals, it is the duty of all parties appearing before this Board to draw its attention to all relevant authorities. This duty is heightened when one of the parties is a layman and has no legal training whatsoever.

40. We were informed that the Commissioner had made a 20% allowance in favour of Company E in respect of the events between July 1996 and August 1997. If that be the case, the Commissioner would have applied a starting point of 133% for the year of assessment 1998/99. Whilst we recognise that there are cases of delayed submission of return involving flagrant disregard by taxpayers of their fiscal obligations as to justify adopting the 100% starting point, the present case is certainly not one of them. The return for the year of assessment 1998/99 was the first return sent to Company E. Prior to receipt of this return, Company E did not have a track record of habitual non-compliance. Given the history of the dispute, it is not unreasonable for Mr A to

entertain a belief when faced with such drastic starting point that section 82A was being used by the Revenue to make up tax lost between the years of assessment 1996 and 1999.

41. We are of the view that a surcharge of 5% of the figures set out in column 4 of the chart in paragraph 15 above for all the years would be reasonable in the circumstances of this case. We order accordingly for both Company E and Company D. We give all parties liberty to apply if there be disagreement in the working out of our orders.