

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D16/96

**Penalty tax** – late lodgment of profits tax return – delay in lodgment claimed to be due to difficulties in finalizing accounts – whether penalty tax of 9.17% excessive in the circumstances – Inland Revenue Ordinance sections 82A and 82B.

Panel: Andrew Halkyard (chairman), Charles Hui Chun Ping and Gerald To Hin Tsun.

Date of hearing: 28 May 1996.

Date of decision: 25 June 1996.

The taxpayer was three months late in lodging its 1993/94 profits tax return. The taxpayer claimed that this was due to difficulties in settling disputes with its sub-contractors in Mainland China and that the ensuing delay in finalizing its accounts was unavoidable. The taxpayer had been late in lodging its profits tax return in two previous years of assessment.

Held:

(1) Although it was accepted that the taxpayer had difficulty in finalizing its accounts because of the delay it experienced with its sub-contractors in Mainland China, failure to lodge its profits tax return within the time extended by the Commissioner was not thereby unavoidable. Compliance with the provisions of the Inland Revenue Ordinance is not simply a matter of ‘doing your best’.

(2) In cases involving failure to file profits tax returns on time, the Board of Review has consistently followed the guideline that where there are neither aggravating nor mitigating factors, the penalty should be 10% of the tax undercharged (D53/93, vol 8, 383 considered). Accordingly, in this case a penalty of 9.17% of the amount of tax that would have been undercharged if the late lodgment had not been detected was not excessive in the circumstances.

*Per curiam* In view of the taxpayer’s somewhat poor compliance record, the Commissioner may have been justified in imposing an even higher level of penalty tax.

Professional advisers should be aware of the published tariffs in penalty tax cases and be prepared to justify their submissions in light of established precedents.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

(3) The taxpayer's notice of appeal was not lodged until one month and two days after dispatch by the Commissioner of the penalty tax assessment. As the notice of assessment was served by post, the provisions of sections 82B(1) and 58(3) enabled the Board to have jurisdiction to consider the substantive grounds of appeal.

### **Appeal dismissed.**

Cases referred to:

D53/88, IRBRD, vol 4, 10  
D2/90, IRBRD, vol 5, 77  
D53/93, IRBRD, vol 8, 383  
D11/93, IRBRD, vol 8, 143

Wong Ching Ping for the Commissioner of Inland Revenue.  
H H Lam of Messrs H H Lam & Co for the taxpayer.

### **Decision:**

This is an appeal against the amount of additional or penalty tax imposed by the Commissioner under section 82A(1) of the Inland Revenue Ordinance ('IRO').

### **The facts**

The following facts are not in dispute.

1. The Taxpayer was incorporated in Hong Kong on 23 February 1988. It is principally engaged in trading electrical products.
2. The Taxpayer prepares annual accounts to 31 March. Its auditors and authorised tax representative are Messrs H H Lam & Co, Certified Public Accountants ('the Representative').
3. On 23 March 1994, the Commissioner sent his Block Extension Circular letter for lodgement of the profits tax returns for the year of assessment 1993/94 to all Certified Public Accountants and to all Authorised Tax Representatives.
4. On 6 April 1994, a profits tax return for the year of assessment 1993/94 was issued to the Taxpayer for completion. In accordance with paragraph 7 of the Commissioner's letter of 23 March 1994, the date specified for lodging the Taxpayer's profits tax return for the year of assessment 1993/94 was extended to 15 November 1994.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

5. On 14 February 1995, the Representative submitted to the Inland Revenue Department the Taxpayer's profits tax return for the year of assessment 1993/94 together with its audited accounts for the year ended 31 March 1994.
6. Based on the information contained in the documents set out at fact 5, a notice of assessment was issued by the assessor to the Taxpayer on 3 May 1995 showing net assessable profits of \$1,557,952 with tax payable thereon of \$272,641.
7. The Taxpayer's lodgement history for the previous three years was:

<b>Year of Assessment</b>	<b>Profits Tax Return Issued</b>	<b>Extension Granted to</b>	<b>Profits Tax Return Lodged</b>
1990/91	2-4-1991	15-11-1991	4-12-1991
1991/92	[No details produced to the Board]		
1992/93	1-4-1993	15-11-1993	4-12-1993

8. On 25 August 1995, the Commissioner gave a notice to the Taxpayer under section 82A(4) that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the year of assessment 1993/94 for failure to comply with the terms of a notice given to it under section 51(1) of the IRO.
9. On 1 September 1995, the Taxpayer submitted to the Commissioner representations in response to the notice issued on 25 August 1995. The Taxpayer alleged that finalization of the audited accounts was delayed because:
  - (a) The [Taxpayer's] main business activities are in Mainland China, and the conclusion of each transaction takes lengthy procedures to be finalized, particularly disputes arising sometimes on the quality of the product. In this connection, [the Taxpayer] was in no position to urge the Chinese Authorities to take up immediate action, but only to wait until their confirmative replies ultimately arrived. In this respect, [the Taxpayer] could not expedite in passing information to the accounts department for record purpose.
  - (b) During the year under review, the turnover had been increased by four times of the amount in the previous year, plus the corresponding increase in purchases. Moreover, sub-contracting charges were also incurred. The overload of the accounting work, in addition to the undue delay in ascertaining each transaction, could have caused delay in submission of the accounts to the Inland Revenue Department.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The directors spent most of their time in China, and as a result, accounting records and information could only be accessed till their return to Hong Kong. It was quite often that on many instances urgent matters might have withheld the directors stationing longer in China, the effect of which had upset their time schedule to return to Hong Kong. At the same time, one director was applying for emigration to overseas, and thus the management was charged with additional load of work which was by no means a simple task if the turnover soared by four times.
  - (d) [The Taxpayer] had never intended to fail in comply with the notice under section 51(1), but the circumstances were quite exceptional for the year of assessment 1993/94, which was out of the management's control as business in China had numerous unexplainable grievances.'
10. On 29 September 1995, the Commissioner, having considered and taken into account the Taxpayer's representations and history in lodging its profits tax returns, issued an assessment for additional tax in respect of the year of assessment 1993/94 in the sum of \$25,000. This amount is 9.17% of the tax which would have been undercharged if the Taxpayer's failure to lodge its profits tax return within time had not been detected.
11. On 31 October 1995, the Taxpayer appealed to this Board against the assessment of additional tax on the grounds that the penalty imposed was excessive.

### **Preliminary matter for our decision**

As can be seen from facts 10 and 11, the notice of appeal was not lodged with the Board of Review until one month and two days after despatch by the Commissioner of the additional or penalty tax assessment. The Commissioner's representative, Mr Wong Ching-ping, indicated to us that the Commissioner accepted the Board had jurisdiction to hear the appeal, even though he acknowledged that the Board had no discretion to extend the time limit for appeal under section 82B. After ascertaining that the notice of assessment was served by post and having considered the provisions of sections 82B(1) and 58(3), we agreed with Mr Wong and proceeded to hear the substantive grounds of this appeal.

### **The contentions for the Taxpayer**

The Taxpayer was represented at the hearing by the Representative. No additional evidence was adduced before the Board. The Representative did, however, expand upon the representations and grounds of appeal referred to at facts 9 and 11. To assist the Board, Mr Wong indicated that the Commissioner did not challenge the veracity of the explanations offered by the Representative.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

The Representative advanced the following arguments that the additional or penalty tax was, in terms of section 82B(2), excessive in the circumstances:

- (1) The Taxpayer's main business activity is in China. Specifically, it engages sub-contractors in China to manufacture its products. Disputes arise with the sub-contractors concerning matters such as quality control. These disputes must be settled before the invoices from the sub-contractors are finalized. In light of these disputes, the receipt of final invoices from the sub-contractors was delayed. In turn, the preparation of the Taxpayer's accounts was delayed. The Representative argued that the Taxpayer's fate is in the hands of its sub-contractors; as a practical matter it cannot complain about the delays; and therefore the ensuing delay in finalizing the Taxpayer's accounts was simply unavoidable.

In other words, the Representative argued that the whole accounting process is not in the overall control of the Taxpayer because of its difficulties in finalizing invoices from the sub-contractors in China. If all this activity took place in Hong Kong, then the Taxpayer would not complain about the additional tax assessment. But this is not, the Representative argued, the case before us.

- (2) The Representative then reiterated the matters raised at fact 9(b) to (d).
- (3) The Taxpayer realizes the seriousness of complying with its obligations under the IRO, including timely submission of its profits tax returns. The Representative then noted that the Taxpayer's profits tax return for the year of assessment 1994/95 was filed before the due date.

### **Contentions of the Commissioner**

As indicated above, for the purposes of expediting the appeal, Mr Wong was prepared to accept the factual basis of the explanations offered by the Representative for the delay in lodging the Taxpayer's profits tax return. He was not, however, prepared to accept that it followed the delay was unavoidable.

Mr Wong referred to various decisions of the Board of Review, including D53/88, IRBRD, vol 4, 10 (where the Board agreed that a company must make arrangements for proper conduct of its taxation affairs and it was not to the point that the company was unable to cope with a dramatic increase in its business) and D2/90, IRBRD, vol 5, 77 (for the proposition that a penalty amounting to 9.17% of the tax undercharged (fact 10 refers) was already lenient for a case where a taxpayer delayed lodging a return in contravention of section 51(1)).

### **Reasons for our decision**

## INLAND REVENUE BOARD OF REVIEW DECISIONS

In cases involving failure to file profits tax returns on time, the Board of Review has consistently followed the guideline that where there are neither aggravating factors nor mitigating ones, the penalty should be 10% of the tax undercharged (see D53/93, IRBRD, vol 8, 383).

We accept that the Taxpayer had no intention to avoid delaying the proper payment of tax. We also accept that the Taxpayer suffered difficulty in finalizing its accounts because of delays it experienced with its sub-contractors in China. In this regard, the regimen of the Representative's argument was that additional tax should not be assessed because the Taxpayer had tried its best to lodge its profits tax return in time and its failure to do so was 'unavoidable'. We do not agree. Compliance with the provisions of the IRO is not optional; it is not a matter of simply 'doing your best'. Accordingly, notwithstanding Mr Wong's generous concession in accepting the Representative's contentions as proved, it would take much more to convince us that the penalty tax in this case was excessive in the circumstances. Indeed, it seems that a penalty of 9.17% is at the lower end of the range for cases of this nature (contrast D11/93, IRBRD, vol 8, 143 where a 20% penalty was imposed).

In the circumstances, we are unable to agree with the Representative that the penalty imposed in this case is excessive. The Commissioner properly took into account the fact that the Taxpayer has a record of not filing its profits tax returns on time (fact 7 refers). Indeed, it seems to us that the Commissioner has discounted the Taxpayer's somewhat poor record: otherwise, he may have been justified in imposing an even higher level of penalty tax.

Finally, the Representative submitted that the Taxpayer has now put its house in order and was able to file its return for the year of assessment 1994/95 in time. In this regard, we can do no better than adopt the answer of the Board in D53/93, IRBRD, vol 8, 383 at 390:

*'That again is irrelevant because (1) it related to a different year and (2) the punctual filing of a return is something every dutiful taxpayer is expected to do.'*

Before concluding, we note that there seems to be an increase in appeals to the Board of Review in cases involving section 82A assessments where the Taxpayers simply argue that the additional or penalty tax assessed is 'unfair' or involves 'hardship'. We appreciate that, while Boards of Review have established standard 'tariffs' for certain types of cases, penalties do vary across a spectrum depending upon individual facts. Professional advisers should, however, be aware of these tariffs (they are readily ascertainable from reported decisions) and be prepared to justify their submissions in light of established precedents. Disregarding these issues may, as advisers should also be aware, lead to the Board increasing penalties in certain cases and, in hopeless cases, awarding costs of the Board under section 68(9).

For the reasons set out above we order that this appeal should be dismissed.

INLAND REVENUE BOARD OF REVIEW DECISIONS