Case No. D17/94

Penalty tax – failure to file return in time – attempt by taxpayer to comply – quantum of penalty.

Panel: T J Gregory (chairman), David Ling Dah Wai and Edwin Wong.

Date of hearing: 10 May 1994.
Date of decision: 16 June 1994

The taxpayer was required to file its tax return before 15 November 1992. The taxpayer filed all information with the Inland Revenue Department on 23 December 1992 save and except for the tax return itself. The taxpayer requested that the Inland Revenue Department provide a duplicate tax return form for completion. The duplicate was not supply by the Inland Revenue Department until 4 February 1993. The same was completed and filed on 17 February 1993. In a previous year the taxpayer had been late in filing its profits tax return and had been penalised. The taxpayer appealed to the Board of Review against the penalty imposed which was approximately 20% of the amount of tax involved.

Held:

The Inland Revenue Department had contributed to the delay by not promptly issuing a duplicate return as requested. The penalty of approximately 20% was too harsh. A penalty of approximately 10% of the tax involved would be appropriate in the circumstances.

Appeal partly allowed.

Cases referred to:

D2/90, IRBRD, vol 5, 77
D2/92, IRBRD, vol 7, 56
D53/88, IRBRD, vol 4, 10
D34/88, IRBRD, vol 3, 344, 336
D61/90, IRBRD, vol 5, 449
D2/88, IRBRD, vol 3, 125
D43/88, IRBRD, vol 3, 405

Ngai See Wah for the Commissioner of Inland Revenue.
Taxpayer represented by his auditor.

Decision:

1. THE SUBJECT MATTER OF THE APPEAL

The Taxpayer appealed against an assessment to additional tax raised under section 82A of the Ordinance on 9 November 1993 in respect of the year of assessment 1991/92.

2. THE FACTS

A statement of agreed facts was handed in to the Board and this reads as follows:

‘ 1. Company A Limited was incorporated in Hong Kong in April 1986.

2. Profits tax return of the year of assessment 1991/92 was issued to the Taxpayer on 1 April 1992 which should be completed and returned to the Inland Revenue Department (the IRD) within one month.

3. On 19 August 1992, an estimated assessment for the year of assessment 1991/92 with estimated assessable profits in the amount of $2,180,000 was issued to the Taxpayer in the absence of return. The estimated assessment was raised with the information that the Taxpayer’s accounting year end date was 31 December.

4. By a letter dated 14 September 1992, the tax representative, [identified], requested the IRD to cancel the estimated assessment for the year of assessment 1991/92 on the ground that the Taxpayer had changed its accounting year end date from 31 December to 31 March and further asked for an extension of time to submit the profits tax return of year of assessment 1991/92 until 15 November 1992.

5. On 25 September 1992, the assessor informed the Taxpayer that since the IRD had been notified of the change of accounting date, the estimated assessment for the year of assessment 1991/92 had been erroneously issued and was cancelled. Furthermore, the Taxpayer’s request for extension to 15 November 1992 for filing the profits tax return of year of assessment 1991/92 was accepted.

6. By a letter dated 23 December 1992, the tax representative submitted the audited accounts for the year ended 31 March 1992, profits tax computation of year of assessment 1991/92, supporting schedules and requested for a duplicate of the profits tax return. The duplicate profits

tax return of the year of assessment 1991/92 was subsequently issued by the IRD on 4 February 1993.

7. Profits tax return of the year of assessment 1991/92 was received on 17 February 1993 with returned profit in the amount of $1,320,850.

8. On 26 March 1993, with adjustments of depreciation allowance, balancing charge and balancing allowance, the assessor raised an assessment on the Taxpayer with assessable profits in the amount of $1,417,890. There was no objection to the assessment.

9. On 27 September 1993, the Commissioner gave notice to the Taxpayer in terms of section 82A(4) of the Inland Revenue Ordinance (the Ordinance) that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the year of assessment 1991/92.

10. By a letter dated 25 October 1993, the tax representative submitted to the Commissioner representation in the pursuance of section 82A(4)(a)(ii) of the Ordinance.

11. On 9 November 1993, the Commissioner, having considered and taken into account the representations made, issued a notice of assessment and demand for additional tax in respect of the year of assessment 1991/92 in the sum of $46,500.

12. By a letter dated 8 December 1993, the tax representative gave notice to the Board of Review on behalf of the Taxpayer to appeal against the notice of assessment and demand for additional tax.'

3. THE CASE FOR THE TAXPAYER

The Taxpayer was represented by a tax representative other than the tax representative identified in paragraph 4 of the statement of agreed facts. No evidence was called. His submission was as follows:

3.1 That in the particular circumstances of this case, the responsibility for the late submission of the profits tax return and audited accounts for the year of assessment 1991/92 rested with the then auditor.

3.2 The accountant of the Taxpayer had finalised the accounts of the Taxpayer for its year ended 31 March 1992 on or about 15 June 1992 and had handed the same to the company [identified] responsible for the provision of secretarial services to the Taxpayer for onward transmission to the auditor [identified] for auditing.

3.3 The auditor had advised the Taxpayer's accountant that by the end of September 1992 he had collected all information necessary for the audit of the accounts.

3.4 The audited accounts for the year ended 31 March 1992 were submitted to the IRD on 23 December 1992, which was about one month after the extension to 15 November 1992, refer paragraph 5 of the statement of agreed facts. At the same time the auditor had requested a duplicate profits tax return from the IRD, but the duplicate return was not issued until 4 February 1993, refer paragraph 6 of the statement of agreed facts. The date of the auditor's report was 23 December 1992. The Board was referred to the auditor's report.

3.5 The auditor had been requested by the Taxpayer to appear before the Board and give evidence but had refused.

3.6 In the circumstances there was a reasonable excuse for the late submission of the profits tax return for the year of assessment 1991/92 in that:

3.6.1 the Taxpayer had no control over the audit progress after finalising the accounts and handing over the same to the auditor on 15 June 1992.

3.6.2 the Taxpayer has no intention to evade tax or deliberately delay the submission of the tax return since its accounts had been finalised on 15 June 1992 and handed over to the auditor, which was long before the due date for submission. No estimated assessment has been issued by the IRD.

3.7 If the IRD had issued a duplicate profits tax return earlier than 4 February 1993, the completed tax return would have been submitted correspondingly earlier.

3.8 If the Board did not consider the circumstances stated as sufficient to constitute a reasonable excuse, the Taxpayer asked the Board to review the appealed assessment, which the tax representative considered excessive in the particular circumstances of the case and in the light of two previous Board cases:

3.8.1 D2/90, IRBRD, vol 5, 77, where the facts were similar but the penalty tax was 10% of the tax involved for two successive years.

3.8.2 D2/92, IRBRD, vol 7, 56, where the facts were similar and the penalty tax was also 10% of the tax involved.

In reply to questions from the Board the representative stated that the auditor had been requested to resign but, as of the date of the hearing, had not done so and that he believed that the reason why a duplicate return was requested was because the original had been lost or misplaced.

4. THE CASE FOR THE REVENUE

Having identified that the appeal was against an assessment to additional tax imposed under section 82A of the Ordinance in respect of the year of assessment 1991/92 and having referred the Board to the relevant provisions of the Ordinance, the representative's submissions were to the following effect:

4.1 A profits tax return for the year of assessment 1991/92 (the return) was issued to the Taxpayer on 1 April 1992 and this return required the Taxpayer to complete and return it to the IRD within one month from the date of issue. A copy of the return was attached to the submission.

4.2 A request for an extension for submitting the return was granted, the date being 15 November 1992. The Taxpayer did not request any further extension for submitting the return.

4.3 On 23 December 1992, that is thirty-nine days after the extended due date, 15 November 1992, the then auditor and tax representative submitted on behalf of the Taxpayer the audited accounts for its year ended 31 March 1992 together with a profits tax computation for the year of assessment 1991/92 and supporting schedules. The return was not attached. Factually, the return was submitted and received by the IRD on 17 February 1993.

4.4 The Taxpayer's grounds of appeal contend that there had been a significant improvement in meeting deadlines for submission of the Taxpayer's audited accounts for the years of assessment 1990/91 to and including 1992/93 together with the returns. Was this relevant? Complying with the Ordinance is the duty of each and every taxpayer. Further, this point has been mentioned in the Taxpayer's representation dated 25 October 1993 made in response to the Commissioner's notice under section 82A(4) dated 27 September 1993 and had been taken into account when the Commissioner assessed the additional tax.

4.5 The additional tax of $46,500 was approximately 20% of the tax liability of $233,951 and this amount could not be said to be unreasonable or excessive. The Board was referred to paragraph 9 of the IRD's Circular entitled 'Block Extensions for Lodgement of 1991/92 Profits Tax and 1991/92 Salaries Tax Return' which had been sent to tax representatives on 2 March 1992. It was pointed out that this circular reminded tax representatives that failure by their clients to file returns in a timely manner or to report chargeability may result in section 82A action or compound penalty action being taken against them and that failure to lodge a profits tax return when required to do so is a serious offence.

4.6 For the year of assessment 1990/91 the Taxpayer had failed to comply with the requirements of a notice given to him under section 51(1). The subsequent Commissioner's notice under section 82A(4), dated 9 September 1992, a copy of which was produced to the Board, and the subsequent notice of assessment

and demand for additional tax under section 82A(4), issued on 3 November 1992, a copy of which was produced to the Board, should have made it crystal clear to both the Taxpayer and its tax representative that failure to comply with the requirements of a notice given to the Taxpayer under section 51(1) of the Ordinance would attract a severe penalty. No one should expect that a subsequent offence, namely the failure to comply with the requirements of the notice contained in the year of assessment 1991/92 profits tax return given under section 51(1) of the Ordinance, would receive only the same degree of penalty as the same offence committed previously.

4.7 In previous decisions the Board had held that the failure by a company to make arrangements for the proper management of its affairs did not constitute a reasonable excuse for the purpose of section 82A.

4.7.1 In D53/88, IRBRD, vol 4, 10, the Board rejected as valid excuses the taxpayer's statements that it was unable to cope with the dramatic increase in its business and that it had had problems with its accounts personnel whereby it had not been able to maintain its accounts properly and was not able to file its tax return in accordance with the requirements of the Ordinance.

4.7.2 In D34/88, IRBRD, vol 3, 344, the Board made the following comment:

'It is no excuse for the managing director to say that he relied upon his wife and one of his employees and that they were not competent. It was his responsibility to ensure that competent staff were employed. The Taxpayer was not a small family business but a highly successful industrial undertaking with a large factory and turnover.'

4.7.3 The following comment was made by the Board in D61/90, IRBRD, vol 5, 449:

'The excuse that accounting staff were difficult to obtain in 1989 has been put to the Board on many occasions. The Board has consistently stated that it is the duty of a taxpayer to ensure that its accounting records are maintained up-to-date and that the returns required to be made by taxpayers under the Ordinance are made within the time limits specified in the Ordinance. Difficulties in recruiting staff do not excuse taxpayers from fulfilling their statutory obligations.'

4.8 The Board was reminded that section 82A of the Ordinance empowers the Commissioner to impose additional tax in an amount not exceeding three times 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 under charged if such failure had not been detected. In several cases, refer D2/88, D34/88, D43/88 and D53/88, the Board had said that the starting point or yardstick for assessing penalties where a taxpayer has failed in its obligations to lodge returns on time should be equal to 100% of the amount of tax

undercharged. In the present case, the Commissioner, after giving full consideration to the representations made, had imposed additional tax in the amount of $46,500 which totals only 19.9% of the amount of the tax undercharged $233,951 or 6.6% of the maximum penalty $701,853 (that is $233,951 x 3).

4.9 The Taxpayer was liable to a penalty under section 82A. For this repeated offence additional tax was properly imposed and the amount was not excessive. For those reasons the Board should dismiss the appeal.

5. REPLY OF THE TAXPAYER

The representative declined the opportunity to respond to the submission on behalf of the Revenue. However, he reiterated that the fault lay not with the Taxpayer but its then auditor.

6. REASONS FOR THE DECISION

6.1 It is agreed by the parties that the Taxpayer's profits tax return for the year of assessment 1991/92 should have been filed on 15 November 1992 and that a partial compliance took place on 23 December 1992, namely all save for the return itself was filed on that date. The return itself was, apparently, lost or misplaced. A request for a duplicate was made when the partial compliance took place but this duplicate was not supplied until 4 February 1993. The duplicate was filed, completed, on 17 February 1993.

6.2 It is an agreed fact that the profits tax assessment for the year of assessment 1991/92 was issued on 26 March 1993 and that no objection was taken to this assessment. There was no suggestion from the Revenue that collection of profits tax from the Taxpayer in respect of the year of assessment 1991/92 was in any way delayed.

6.3 It is not in dispute that the Taxpayer's failure to file a profits tax return for the year of assessment 1991/92 within the agreed extension was not the first occasion on which it had failed to comply with section 51 of the Ordinance; a penalty of $34,000 was imposed in respect of the year of assessment 1990/91 on 3 November 1992.

6.4 Section 82A of the Ordinance empowers the Commissioner to impose additional tax in an amount not exceeding three times 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 under charged if such failure had not been detected.'

The Board notes that in this case there is no suggestion that any tax was undercharged as a consequence of the delay. The return was not lodged after an estimated assessment in an amount less than the tax disclosed by the tax computation and detection of a failure to lodge a return does not apply.

6.5 That the Taxpayer was late in filing the return is not in dispute and, accordingly, it is within the discretion of the Commissioner to invoke section 82A and impose a penalty because of the delay. It is not for the Board to enquire whether or not the Commissioner should or should not have exercised his discretion under section 82A. The only question for the Board, therefore, is whether, in the circumstances of this case, the quantum of the penalty assessed by the Commissioner, namely 19.9% of the profits tax payable by the Taxpayer for the year of assessment 1991/92 or 6.6% of the maximum penalty which could have been imposed, was appropriate or excessive.

6.6 The first question for consideration is the period of delay. Should the Taxpayer's delay be calculated from 15 November 1992 to 23 December 1992 or from 15 November 1992 to 17 February 1993? If the latter then, to some extent, the IRD itself contributed to the delay by not providing the duplicate until 4 February 1993. Although the return was not filed on 23 December 1992, all documents which accompany a return were lodged and, accepting that the return itself had been accidentally lost or misplaced, fairness dictates that the delay should be regarded as having ended on 23 December 1992.

6.7 The Board does not regard the facts or passages cited from the cases referred to by the Revenue, namely D53/88 or D34/88 or D61/90, IRBRD, vol 5, 449, as being of assistance in this appeal. Further, so far as starting at a penalty equivalent to the tax is concerned, the Board considers that applicable to cases where the delay is considerable or where there may have been no recovery of tax had the failure to lodge a return gone undetected.

6.7.1 D2/88, IRBRD, vol 3, 125:

The taxpayers failed to file returns for several years, thereby deferring the tax payable by them. In each of the eight years of assessment the penalty assessed by the Commissioner was less than the actual tax involved.

6.7.2 D34/88, IRBRD, vol 3, 336:

The taxpayer failed to file returns for several years and was content to discharge the estimated assessments raised by the 1RD. For the first three of the six years of assessment the assessed penalty was almost equal to the tax involved. In the remaining three years the percentage of the penalty assessed by the Commissioner decreased to less than 100%.

6.7.3 D43/88, IRBRD, vol 3, 405:

Over the course of five years of assessment the taxpayer either failed to file returns or filed incorrect returns. The assessed penalties commenced at some 149.6% and concluded at some 7.7% of the tax ultimately assessed.

6.7.4 D53/88, IRBRD, vol 4, 10:

The taxpayer failed to file a return for the year of assessment 1983/84 until December 1985 but discharged an estimated assessment which amounted to less than the tax which would have been payable had a correct return been filed. The penalty was some 5% of the maximum or 15% of the tax.

6.8 In contrast, in the cases cited by the Taxpayer's representative the Board's approach to penalties for delay was to decline to interfere with the quantum of penalty determined by the Commissioner.

6.8.1 D2/90, IRBRD, vol 5, 77

The returns for each the years of assessment 1986/87 and 1987/88 were filed some ten weeks late and, in both years after estimated assessments, both in amounts far below the actual profits, were issued. The Board declined to interfere with the Commissioner's decision to impose penalties equal to some 10% of the tax involved, or some 3% of the maximum permitted penalty.

6.8.2 D2/92, IRBRD, vol 7, 56

The return for the year of assessment 1989/90 was filed some sixteen weeks late and after an estimated assessment in an amount far below the actual profits, was issued. The Board declined to interfere with the Commissioner's decision to impose a penalty equal to approximately 10% of the tax involved, or some 3% of the maximum permitted penalty.

The delay in both of those cases was longer than in the present case and the decisions disclose that the tax involved was greater than that in this appeal.

6.9 The Board accepts that the Taxpayer neither sought to evade tax nor to postpone liability to pay tax it knew it was obliged to pay. Whilst the default of the Taxpayer's auditors is not an excuse for the delay in lodging the return, the Board regards the delay from 15 November 1992 to 23 December 1992 as being minimal and is satisfied that the tax due was recovered within the period within which it would have been recovered had the return been filed on or before 15 November 1992. In these circumstances and having reviewed the penalties assessed in the cases drawn to the Board's attention, the Board considers that the Commissioner has dealt harshly with the Taxpayer and that the appropriate penalty would have been approximately 10% of the tax for the year of assessment 1991/92, namely a penalty of $23,500.

7. DECISION

The Board directs that the notice of assessment and demand for additional tax under section 82A dated and issued on 9 November 1993 and imposing a penalty of $46,500 on the Taxpayer be amended to impose a penalty of $23,500 in lieu of the penalty of $46,500.