INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D2/90

Penalty tax – failure by professional advisers to file returns in time – quantum of penalties – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Chan Pang Fee and Foo Tak Ching.

Date of hearing: 19 December 1989.
Date of decision: 6 April 1990.

The taxpayer was a private limited company incorporated in Hong Kong which earned substantial profits in Hong Kong but which failed to file its tax returns on time in respect of the years of assessment 1986/87 and 1987/88. As a result estimated assessments were issued. In both years in question the tax return when filed disclosed assessable profits substantially in excess of the estimated assessments. The tax representative for the taxpayer appeared before the Board and accepted full responsibility for the delay in filing the tax returns. He submitted that his professional firm had not been able to keep pace with the volume of work because of shortage of staff.

Held:

The quantum of the penalties was approximately 10% of the tax involved and though the Board had sympathy for the taxpayer, the quantum of the two penalties was not excessive and could not be reduced. However, the Board did express some concern with regard to the possibility that the Commissioner might impose further additional penalties which would be paid by the professional firm in question in respect of many similar cases. In such circumstances the Board was of the opinion that the Commissioner might take into consideration the surrounding circumstances and facts when considering whether or not to impose further penalties in other cases knowing that the professional firm in question had accepted full responsibility for its failure to file tax returns on time for its various clients.

Appeal dismissed.

Chan Kin Mou for the Commissioner of Inland Revenue.
Taxpayer represented by its tax representative.

Decision:

This is an appeal by a private limited company against two additional tax assessments levied on it under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer was incorporated in 1983. The Taxpayer closes its accounts on 31 March each year.

2. On 1 April 1987, a profits tax return for the year of assessment 1986/87 was issued to the Taxpayer. The expiry date for the submission of this return was 31 October 1987, as allowed under a block extension arrangement granted to the tax representative of the Taxpayer who was also the auditor of the Taxpayer.

3. In the absence of a properly completed return for the year of assessment 1986/87 by the expiry date, an estimated assessment for 1986/87 was issued on 30 December 1987 under section 59(3) of the Inland Revenue Ordinance in the sum of $5,000,000.

4. On 8 January 1988, the Taxpayer filed a completed profits tax return for 1986/87 showing assessable profits of $8,136,966. This return was dated 7 January 1988 and the auditor's report on the accounts was dated 1 September 1987.

5. On 9 January 1988, the tax representative on behalf of the Taxpayer lodged on objection against the estimated assessment for 1986/87. The objection was later settled and a revised assessment for 1986/87 under section 64(3) of the Inland Revenue Ordinance with revised assessable profits of $8,136,966 was issued to the Taxpayer on 30 March 1988.

6. On 6 April 1988, a profits tax return for the year of assessment 1987/88 was issued to the Taxpayer. The expiry date for the submission of this return was 31 October 1988 as allowed under a block extension arrangement similar to the previous year.

7. In the absence on a properly completed return for 1987/88 by the expiry date, an estimated assessment for 1987/88 was issued to the Taxpayer on 22 December 1988 under section 59(3) of the Inland Revenue Ordinance in the sum of $8,500,000.

8. By a letter dated 12 January 1989, the tax representative on behalf of the Taxpayer lodged an objection against the estimated assessment for 1987/88. In support of the objection, the Taxpayer filed a profits tax return for 1987/88 showing assessable profits of $26,836,924. The return was dated 12 January

1989 and the auditor's report on the financial statements in support was dated 8 August 1988.

9. Since the amount of returned profits exceeded the amount of estimated profits, the objection was subsequently withdrawn and an additional assessment for the year of assessment 1987/88 was raised in the sum of $18,336,924 on 20 January 1989.

10. On 7 July 1989 the Commissioner gave notice to the Taxpayer under section 82A(4) of the Inland Revenue Ordinance that he proposed to assess additional tax by way of penalty in respect of the Taxpayer's failure to comply with the requirements of notices given under section 51(1) of the Inland Revenue Ordinance for the years of assessment 1986/87 and 1987/88.

11. On 11 August 1989 the Taxpayer submitted representations to the Commissioner. On 25 August 1989 the Commissioner having considered and taken into account the representations issued notices of assessment for additional tax for the years of assessment 1986/87 and 1987/88 in the amounts of $150,000 and $400,000.

12. On 22 September 1989 the Taxpayer gave notice of appeal to the Board of Review under section 82B of the Inland Revenue Ordinance against the said two assessments for additional tax.

At the hearing of the appeal, the Taxpayer was represented by a partner of its tax representative who is a firm of certified public accountants in Hong Kong. The representative informed the Board that his firm had been the auditors and authorised tax representative of the Taxpayer since 1984. He said that the reason for the failure to comply with the notices issued by the Inland Revenue Department was entirely the fault of his firm and that any penalties imposed would be borne by his firm.

He explained that a mistake might have been made by the Commissioner when imposing the penalties because the Commissioner appeared to have been under the misapprehension that the audited accounts had been completed much earlier than the tax returns had been submitted. The representative said that the dates appearing on the auditor's certificate represented the dates when the audit work had been initially completed but was long before the actual completion of all of the work necessary including approval of the accounts by the board of directors of the Taxpayer. He said that this might have given the Commissioner the impression that the filing of the tax returns had been deliberately delayed. He assured the Board that this was not the case and we fully accept this assurance.

The representative went on to explain that the failure to file the tax returns within the extended time limit stipulated was because of extreme pressures placed upon his professional firm by their existing clients which his firm had not been able to meet because of shortage of staff. He explained that his firm had turned down new customers but,

notwithstanding, has still not been able to meet the commitments of the existing clients. He said that his firm had used their best endeavours to recruit additional staff including paying substantially higher wages but it had proved impossible for his firm to comply with the deadlines.

In support of his submission, he pointed out that subsequent to the years in question, the Hong Kong Society of Accountants had taken up with the Commissioner the problems which accountants were having in meeting deadlines and had been able to negotiate extensions of time for the future. However, this more liberal policy of the Inland Revenue Department did not apply retrospectively.

The representative went on to explain that in previous cases administrative penalties of only a few thousand dollars had been imposed in similar circumstances and he said that it was unfair for the Commissioner to have imposed such very substantial penalties in the present case. He also mentioned that his firm had a very large number of other similar cases pending which would also be for the account of his firm as his firm would accept full responsibility.

We have very great sympathy for the Taxpayer and its professional certified public accountants in this case. However, unfortunately for them we do not think that the penalties imposed are excessive in the circumstances. It may well be that the Commissioner could have chosen to impose a nominal penalty by way of compounding the matter as suggested by the representative for the Taxpayer. However, he has exercised his discretion and has chosen to invoke the provisions of section 82A of the Inland Revenue Ordinance. It appears to us that there is no right of appeal to the Board of Review relating to this decision by the Commissioner to exercise his discretion under section 82A as opposed to any other action that he might or might not have taken. All that we can do is to look at the amount of the penalties and decide whether or not they are excessive in the circumstances.

The quantum of the penalties is approximately 10% of the tax involved or 3% of the maximum penalties permitted under the Ordinance. It appears to us that the Commissioner has in determining these penalties already taken into account the extenuating circumstances and has been lenient. For mere delay in payment of tax which is duly assessed after a proper tax return has been promptly submitted, a penalty of 5% is imposed. The failure to file tax returns until some months after the extended period has expired must merit more serious penalties. The representative for the Taxpayer argued that reference should not be made to percentages but instead lump sum figures should be considered. Whilst we agree that it is possible to use lump sum figures and in certain circumstances it would be appropriate to do so, we cannot agree that it is appropriate to use lump sum figures as the general yardstick. The legislature has chosen to enact the provisions of section 82A of the Inland Revenue Ordinance and to stipulate in that section that penalties are related to a multiple of the tax involved. This must indicate that the quantum of penalty in dollar terms will be substantially more where the amount of tax is large. If the legislature had intended a different result, they would have specified a penalty in a maximum lump sum figure and not a multiple of the tax involved. Accordingly, we consider that the Commissioner has taken

the right approach in this case when he imposed penalties which related to the amount of tax involved.

For the reasons given we are unable to accept the appeal which we dismiss and affirm the quantum of the two additional assessments appealed against.

However, in dismissing the appeal, we have some concern because of the frank open manner in which the partner of the certified public accountants representing the Taxpayer addressed the Board. As stated, we have considerable sympathy for him and his firm. However, it has been held in many previous Board of Review cases that the penalties are imposed upon the Taxpayer and not upon the agents of the Taxpayer. It is totally inappropriate for us to take into account that the certified public accountants have acknowledged their liability because the Inland Revenue Ordinance imposes the obligation on the Taxpayer and the Taxpayer alone. Furthermore, even if one takes into account the problems of the tax representative, it has been held in many previous cases that an approximate penalty in such cases as the present would be in the order of 10% to 20% of the amount of the tax included. In this case, the Commissioner has already been lenient by imposing penalties of only approximately 10% of the tax involved.

What gives us concern is the reference which the representative made to his firm having many other similar cases pending and the suggestion that there may have been a change in policy in the Inland Revenue Department. If there has been a change in policy, then it would appear to us that the Commissioner has the power to impose penalties similar to those in the present case in all of the other cases but it would appear to us not to be good administrative law or practice for the Commissioner to impose multiple penalties of such quantum knowing that the fault lies with the certified public accountants who in turn were not aware that he was likely to be imposed such substantial penalties. It would appear to us that it might be appropriate for the Commissioner to give special one off consideration to the way in which he exercises his discretion in the other many cases which the tax representative said were pending. We mention this point as it does give us some concern but we must also point out that we have no power or authority to interfere in any way with the manner in which the Commissioner chooses to exercise the many discretions given to him under the Inland Revenue Ordinance, and obviously he must consider all cases on their respective merits.