Case No. D29/88

Penalty assessment – whether penalties excessive – reasonable belief of taxpayer that he was not liable to pay tax – ignorance of penalties – s 82A of the Inland Revenue Ordinance.

Penalty assessment – whether taxpayer could argue that he was not liable to pay tax – ss 70 and 82A of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), David B K Lam and David Ling Dah Wai.

Date of hearing: 25 July 1988.
Date of decision: 24 August 1988.

The taxpayer company had submitted profits tax returns over three years. In 1980/81, it derived a profit of $25,554,966. It failed to lodge a profits tax return for that year but was content to pay an estimated assessment and an additional assessment (which amounted to less than its true liability). It finally objected to another additional assessment for a high amount. This resulted in a revised assessment being issued for its true liability.

The Commissioner issued a penalty assessment equal to 17.2% of the maximum permitted.

The taxpayer appealed, and claimed that the penalty was excessive in view of the ignorance of the taxpayer's directors, the executive director's frequent (but immaterial) absences from Hong Kong and the fact that tax had been collected. The taxpayer also claimed that it was not liable to tax at all.

Held:

(a) It was not open to the taxpayer to submit that it was not properly charged to profits tax, in view of the fact that the assessment against it was final and conclusive.

(b) In rare cases, it might be grounds for relief if a taxpayer failed to lodge returns because it had had a reasonable belief that it was not subject to profits tax. However, such a submission carries no weight if the taxpayer has acceded to an assessment by failing to object to it.

(c) The fact that the taxpayer had submitted returns in previous years diluted its plea of ignorance.

(d) Ignorance of the penalties which might be levied for failing to lodge returns is no ground for relief.

Appeal dismissed.

Cases referred to:

D3/82, IRBRD, vol 2, 1
D60/86, IRBRD, vol 2, 354
D2/88, IRBRD, vol 3, 125

Fung Yun Chi for the Commissioner of Inland Revenue.
Kenneth K W Lo of Kenneth Lo & Co for the taxpayer.

Decision:

The taxpayer company appealed to the Board of Review against additional tax levied by the Commissioner of Inland Revenue pursuant to section 82A of the Inland Revenue Ordinance on the ground that the penalty was excessive (section 82B(2)(c)).

The circumstances leading up to this levy are straightforward. On 6 April 1981, the Revenue sent the company a tax return for completion for 1980/81. The company did nothing. About 2 years later, the Assessor raised an estimated assessment (section 59(3)) of $150,000 (tax $24,750) ('the First Estimated Assessment') to which the company took no objection but still did not file the relevant return.

On 29 August 1983, the assessor was minded to raise an additional assessment ('the First Additional Assessment') of $9,850,000 (making $10,000,000 when taken together with the previous $150,000). Again, the company took no objection.

On 10 October 1983, the assessor raised yet another additional assessment ('the Second Additional Assessment') of $20,000,000 (making a total $30,000,000 when added to the previous assessments). This assessment at last prompted the company to object to the Second Additional Assessment and to file its return in the amount of $25,390,907 (after deduction of $1,540 commission).

On 12 February 1985, based on that return (but adding back the commission), the assessor advised the company that he proposed, subject to the company's agreement, a revision of the Second Additional Assessment at $15,554,966 (thereby reaching a total of $25,554,966).

As there was no response to this proposal, on 19 November 1985 the Commissioner pursuant to section 64(4) dealt with the outstanding objection and revised the Second Additional Assessment in accordance with the assessor's last mentioned proposal.

In February 1986, after receiving representations from the company and its tax representatives, the Commissioner raised the section 82A penalty tax of $2,178,000 which is the subject of this appeal. This figure represents about 51.6% of the total 1980/81 tax of $4,216,569 or 17.2% of treble the tax (section 82A(1)).

No person appeared to give evidence for the company. The company's representative submitted that the company's directors were ignorant; that, having regard to that circumstance and the fact that the Revenue lost no tax, there was no evasion involved; that possibly his client was not liable to tax; and that therefore the penalty was excessive. He referred us to the D3/82, IRBRD, vol 2, 1 where the additional tax represented 6% of the maximum treble penalty. The representative also produced a list showing that the executive director was absent on 11 occasions for a total of 115 days during the two years and three months between 1981 and 1983. No evidence was given on these absences but, even if accurate, they cover so little of the period as to be of no material significance.

As regards the aforementioned reference to the possibility of the company not being liable to profits tax, we do not consider that we are entitled to entertain such a submission because we are bound by section 70 and consequently must accept that the company was indeed liable. In short, that argument is not one of the extenuating circumstances to which we might have regard. We can see that an argument could be mounted in some rare situations that a taxpayer's reasonable belief that he was not liable to profits tax had led him into failing to submit a return. That type of submission would, however, cease to carry any weight once the taxpayer had acceded to profits tax liability – as the company did on two occasions in this case by failing to object to the First Estimated Assessment and the First Additional Assessment. We would also bear in mind that the company commenced business in 1975 and had duly filed returns for the years prior to that under review. We do not know whether those returns resulted in profits tax assessments, but their very existence tends to dilute the plea of ignorance. As presented by the company's representative, the ignorance pleaded was not so much of its taxable position or need to file returns but rather ignorance of the substantial penal consequences.

The Revenue's representative referred us to two Board of Review Decisions, namely D6/86, IRBRD, vol 2, 354 where the additional tax represented 22.23% and D2/88, IRBRD, vol 2, 125 where the penal taxes ranged from 11.6% to 20%.

We can find nothing in the circumstances proposed to us by the company's representative to suggest that the additional tax was excessive and accordingly we dismiss this appeal.