

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D41/89

Penalty tax assessment – persistent failure to file returns on time – criteria to be applied – penalty substantially increased – section 82A of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), Graeme Large and Norman Leung Nai Pang.

Date of hearing: 21 June 1989.

Date of decision: 24 August 1989.

The taxpayer was a company incorporated in Hong Kong which traded in land or rights to land. Commencing in respect of the year of assessment 1981/82 and through until the year in question 1984/85 and thereafter through to the year 1987/88 the taxpayer persistently failed to file tax returns on time. In respect of the year 1984/85 an estimated assessment was issued and the tax assessed therein pay without objection. The tax assessed was substantially less than ultimately assessed after the tax return was eventually filed. A penalty of approximately 65% of the tax undercharged was imposed by way of penalty. At the hearing of the appeal it was argued that the additional penalty tax was harsh and excessive because the directors of the taxpayer had misconceived its obligations and mistakenly thought that the taxpayer had no further duty to file a tax return. The directors of the taxpayer further submitted that it had been a victim of adverse business circumstances.

Held:

The taxpayer had persistently failed to file its tax returns in a timely fashion. There was no substance in the grounds of appeal. The taxpayer had taken the benefit of a substantially lower tax assessment than they should have known was the true liability of the taxpayer. Taking into account the criteria refer to in decision D56/88 the Board was of the opinion that the penalty imposed was too low and that an appropriate penalty should be an amount equal to 100% of the tax undercharged in consequence of the failure to submit the return in time.

Cases referred to:

D56/88, IRBRD, vol 4, 25

D43/88, IRBRD, vol 3, 405

Wang Tsang Yuk Ling for the Commissioner of Inland Revenue.

Taxpayer represented by the directors.

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### Decision:

This is an appeal against penalty tax (that is, additional tax) assessed pursuant to section 82A of the Inland Revenue Ordinance, in the amount of \$470,000 in relation to the year of assessment 1984/85.

1. The Taxpayer company ('the company') was represented at the hearing by Mr A and Mr B, directors of the company.

2. Facts

From the statement of agreed facts produced to the Board and unsworn statements and sworn answers to questions put to Mr A by the Commissioner's representative and the members of the Board, we find the following facts:

2.1 The company was incorporated in 1980 and late in that year or early in 1981 it bought a piece of land. On resumption of that land by the Government the company received compensation, partly in cash and partly by way of letter B entitlements of about 50,000 square feet. Some of the letters B were sold over the years and the remainder was turned over to the Government in 1984 and/or 1985.

2.2 From the outset the company appointed a firm of accountants as its tax representative.

2.3 The history surrounding the company's profits tax returns for the following years of assessment can be summarized as follows:

#### 1981/82

Pursuant to section 51(1) a return was sent to the company by the IRD. No return having been filed the company was given a final warning on 24 August 1982. As there was no response to this an estimated assessment was raised. In addition on 14 December 1984 the IRD gave notice that the company had committed an offence under section 80(2)(d) but offering to compromise (section 80(5)), conditional upon payment of \$600 and the lodging of the completed return. The completed return was submitted on 1 February 1985.

#### 1982/83

The same as for 1981/82 except that the estimated assessment became final as no objection was raised.

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### 1983/84

The same as for 1981/82 except that the return was submitted on 5 January 1985.

### 1984/85

On 1 April 1985 a section 51(1) return was sent to the company for completion. On 14 April 1985 a remainder was sent. On 27 August 1985 the tax representative asked for an extension to the end of September. This request was rejected on 25 September 1985 and as the completed return was still not forthcoming by 11 October 1985 the assessor raised an estimated assessment under section 59(3) in the amount of \$236,417 (which is to say an estimated profit of \$500,000 less \$263,583 loss, presumably shown in the 1983/84 completed return). The company lodged no objection to this estimated assessment and paid the tax accordingly.

### 1985/86

The company having failed to file a profits tax return for 1985/86 was prosecuted on 12 January 1987. The court ordered the company to file a return which it did on 11 February 1987.

### 1984/85

The profits disclosed by the 1985/86 return caused the assessor to re-examine the 1984/85 estimated assessment of \$500,000 mentioned above. On 8 September 1987 he therefore issued an additional assessment (section 60) for the year of \$7,000,000. On 13 September 1987 the tax representative objected to the 1984/85 additional assessment and, as required by proviso (b) to section 64(1), lodged the outstanding return in the amount of \$4,429,818 together with the company's accounts for the year ended 31 December 1984 – those accounts were in fact dated 28 February 1986. This return was accepted by the assessor and the tax for 1984/85 revised accordingly.

### 1986/87 & 1987/88

In the case of these two post-1984/85 years of assessment the company failed to file returns until estimated assessments were raised whereupon it objected and filed the completed returns.

### 3. The law

The pertinent provisions of the Inland Revenue Ordinance read, in material part, as follows:

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### section 82A(1)

‘ Any person who without reasonable excuse –

...

(d) fails to comply with the requirements of a notice given to him under section 51(1) ...

shall ... be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which –

...

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

### Section 82B

‘ (1) Any person who has been assessed to additional tax under section 82A may, within one month after notice of assessment is given to him, give notice of appeal to the Board ...

(2) On an appeal against assessment to additional tax, it shall be open to the appellant to argue that –

(a) he is not liable to additional tax;

(b) the amount of additional tax assessed on him exceeds the amount for which he is liable under section 82A;

(c) the amount of additional tax, although not in excess of that for which he is liable under section 82A, is excessive having regard to the circumstances.

(3) Section 66(2) and (3), 68, 69 and 70 shall, so far as they are applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax.’

### Section 68(4)

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‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

### 4. Grounds of Appeal

These may be summarized as follows. The additional tax of \$470,000 is harsh and excessive having regard to the circumstances. The circumstances were that the company’s directors ‘misconceived its obligations’ and believed that having paid tax on the 1984/85 estimated assessment it was under no further duty to file the return of its actual profits. However on learning of its mistake it ‘immediately made submissions’ to the Inland Revenue Department. The grounds of appeal go on to say that the company was a victim of the economic crises and the recession of 1983/84, 1984/85 and 1985/86 and that the company made profits of \$4,647,018 and \$4,373,218 in 1981/82 and 1984/85 after disposing of its land investments but funds thus generated were borrowed by directors for their personal investments. In consequence of the said crises and recession the directors lost their own personal investments and were unable to repay what they owed to the company. In addition they owed banks in Hong Kong more than \$5,000,000. The company asked for and were given time to pay outstanding taxes by instalments and those instalments have been met on due dates for payment.

### 5. Decision

There is no question that the company persistently failed to file any of the returns referred to above in a timely fashion. Returns were only filed in response to fines, an order of the court to do so or as a result of estimated assessments which were higher than the company’s actual profits.

We can find no substance whatsoever in any of the grounds of appeal and reject entirely the suggestion that the company had misconceived its obligations. By the time of the 1984/85 estimated assessment in August 1985 the company had three recent experiences which must have alerted the directors to the true state of their obligation to file returns, estimated assessments notwithstanding, or (as intended by the fines) should have done so. Moreover the company had the benefit of qualified tax representatives and there was no suggestion that they were to blame.

It is reasonable to infer from the history of the events preceding the 1984/85 estimated assessment that it was only when the estimated assessments were greater than the actual profits that the company felt compelled to take immediate steps to raise objection and to file returns. We have no doubt therefore that had the first estimated assessment for the year 1984/85 been in the amount of \$7,000,000 the company would have immediately objected and filed a correct return. We conclude therefore that the company was suffering

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from no misconception, rather it hoped to take advantage of the fact that the first estimated assessment was well below (\$500,000 v \$4,429,818) the anticipated profits. We say 'anticipated' because the accounts to the year ended 31 December 1985 were not signed until 28 February 1986. Even allowing for the fact that at the time of the estimated assessment in October 1985 the accounts had not been signed off the company should nevertheless have filed the return immediately to enable the assessor to revise the assessment accordingly, especially as the accounts themselves contained a provision for tax of \$770,753.

It is obvious that the past fines have been insufficient to make the point clear to the company and the time has come when it should be brought home to the company that it must file returns timeously.

We have reminded ourselves of the criteria concerning section 82A cases referred to in D56/88, IRBRD, vol 4, 25 upon which we comment as follows:

- (a) Gravity of the case. The profits for the year in question were considerable.
- (b) Loss suffered by the Revenue. This was \$727,016 for a period of about two years.
- (c) Co-operation given by the Taxpayer. There was none other than under compulsion. The suggestion in the grounds of appeal that on learning of its mistake the company 'immediately made submissions' avoids this element of compulsion.
- (d) Sophistication of the Taxpayer. Neither Mr A nor Mr B struck us as being unsophisticated.
- (e) Sophistication of the Taxpayer's business. From the evidence before us, the company's business operation were not sophisticated.
- (f) Absence of evidence that the scheme was deliberate or designed to conceal profits. There was only the inference that the directors sought to take advantage of the low estimated assessment.

In amplification of (d) above Mr A acknowledged that he had been involved in business of other companies, though he claimed his friends in those companies engaged accountants and lawyers. It seemed to us that Mr A wished to appear naive but that was not the impression given to the Board, on the contrary he appeared to be a capable person. In his opening address, he readily acknowledged that the directors had been negligent, we believe that he hoped thereby to persuade the Board that the omission was innocent rather than

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deliberate. However when viewed against the background of the history of earlier returns we cannot accept that the omission of the 1984/85 return was innocent.

For the foregoing reasons we reject this appeal and in the light of the company's persistent derelictions, both past and continuing, we consider the Commissioner's additional tax assessment to be inadequate. Accordingly, pursuant to the power contained in section 68(8)(a) (made specifically applicable to the penalty taxed by section 82B(3)), we hereby increase the additional tax assessment for the year 1984/85 from \$470,000 to \$727,016, which latter amount represents 100% of the tax which was undercharged in consequence of the failure to submit the return in time. In the circumstances of this case we believe 100% represents the minimum penalty which ought properly to be assessed (see the remarks in D43/88, IRBRD, vol 3, 405).

We therefore refer the present assessment back to the Commissioner for revision in accordance with this decision.