

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D41/99

Penalty Tax – quantum – delay in filing tax return – whether no intention to evade tax a mitigating factor.

Panel: Mathew Ho Chi Ming (chairman), James Julius Bertram and Duffy Wong Chun Nam.

Date of hearing: 24 February 1999.

Date of decision: 28 July 1999.

The taxpayer failed to submit the profits tax return within the time stipulated, as extended, by the Commissioner. The Commissioner gave notice to the taxpayer that he proposed to assess the taxpayer to additional tax for his failure. Representations, with no documentary evidence provided, were made to the Commissioner that the delay was due to unforeseen management deadlock, conflict of business opinion of the directors and impossibility of holding any valid directors meeting. The Commissioner, having considered the representations, assessed the taxpayer to additional tax of \$120,000, that is, 9.6% of the tax undercharged. The taxpayer appealed on quantum only.

At the hearing, the taxpayer argued that the delay was neither intentional nor deliberate. There was no intention to evade tax or postpone payment of tax. The delay was mainly caused by the fact that the director who was responsible for the tax matters could not be reached.

Held:

The absence of any intention to evade tax is not a mitigating factor. (D53/93, D69/97 considered) The assertions of unforeseen management deadlock or conflict of directors' opinion did not amount to a reasonable excuse not to file the tax return within the extended deadline.

The Board also found the penalty not excessive in the circumstances. (D59/96, D69/97, D53/93 considered)

Appeal dismissed.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Cases referred to:

D53/93, IRBRD, vol 8, 383
D69/97, IRBRD, vol 12, 398
D59/96, IRBRD, vol 12, 8

Ching Lo Lai Ngor for the Commissioner of Inland Revenue.
Dominic Ko of Francis Wong C P A Co Ltd for the taxpayer.

Decision:

Nature of appeal

1. Company A ('Taxpayer') has appealed against the additional tax assessment raised on it under section 82A of the Inland Revenue Ordinance ('the IRO') for the failure to comply with the requirements of a notice under section 51(1) of the IRO for the year of assessment 1995/96 by failing to submit a profits tax return within the time stipulated, as extended, by the Commissioner.
2. The Taxpayer is appealing on quantum only.

The law

3. The applicable sections of the IRO are as follows:

'Section 51(1) An assessor may give notice in writing to any person requiring him within a reasonable time stated in such notice to furnish any return which may be specified by the Board of Inland Revenue for ... profits tax ...

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 a notice under Section 51(1) or a failure to comply with Section 51(2), or which

INLAND REVENUE BOARD OF REVIEW DECISIONS

would have been undercharged if such failure had not been detected.

Section 82B(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.'*

Findings of fact

4. The parties have agreed to a statement of facts with appendices. One of the Taxpayer's director, Mr B gave oral testimony at the appeal hearing in addition to his witness statement which was helpfully prepared and submitted by the Taxpayer's representative prior to the hearing. Based on these, our findings of fact are as follows.

5. The Taxpayer is a company incorporated in Hong Kong on 4 May 1979 and commenced business in 1980. During the relevant period, it carried on the business of property development.

6. Mr B is a shareholder holding 18.33% of the Taxpayer issued share capital. He represents 4 other shareholders who together with Mr B's own shareholding represents 50% of the issued share capital of the Taxpayer. Mr B was originally in control of the Taxpayer during which time a piece of land in the New Territories ('the Property') was acquired by the Taxpayer through the financial resource of Mr B.

7. However, Mr B was unable to provide the funds to the Taxpayer to develop the Property. In 1991, he admitted Mr C and 2 other shareholders as directors of the Taxpayer. Mr C and the 2 new shareholders held the balance 50% of the issued share capital of the Taxpayer. Mr C represented the interest of the new additional shareholders.

8. Mr C took charge of the company secretarial, book-keeping and accounting responsibilities of the Taxpayer. The Property was developed by the Taxpayer.

9. There were 6 directors of the Taxpayer during the period ended 31 March 1996. Mr B and Mr C were two of the directors.

INLAND REVENUE BOARD OF REVIEW DECISIONS

10. Mr B was unable to have access to the accounting records of the Taxpayer since 1993 as Mr C refused to allow him access. In any event, Mr B relied on Mr C completely on the accounting of the books of the Taxpayer.

11. The Taxpayer closes its accounts annually on 31 March in each year.

12. On 2 April 1996, a profits tax return for the year of assessment 1995/96 ('Tax Return') was issued to the Taxpayer under section 51(1) of the IRO. The Tax Return should have been completed and returned to the Inland Revenue Department ('IRD') within one month from the date of issue.

13. The Taxpayer failed to observe the deadline. The Taxpayer applied for an extension of time to file the Tax Return on 3 separate occasions as follows:

- a. By letter dated 18 June 1996, the former tax representative (the 'Former Representative') of the Taxpayer, applied for an extension to 15 November 1996 for submitting the Tax Return. The request was accepted by the IRD on 4 July 1996.
- b. By letter dated 1 November 1996, the Former Representative requested for further extension till 31 January 1997 to lodge the Tax Return. The ground was that the Taxpayer had incurred loss for the year of assessment 1995/96. The request was accepted by the IRD on 14 November 1996 as it is the normal practice of the IRD to allow further extension to 31 January 1997 for a company incurring a loss for the year with accounting date on 1 January to 31 March.
- c. By letter dated 26 March 1997, the Former Representative requested for another further extension to 30 April 1997 for submission of the Tax Return. The request was rejected by the IRD on 18 April 1997.

14. Finally, the Taxpayer lodged the Tax Return on 22 May 1997. The Tax Return showed assessable profits of \$7,545,367 instead of a loss as claimed by the Former Representative in the letter dated 1 November 1996. The assessable profits per computation was \$7,675,623 which was before set-off of loss brought forward.

15. The auditor's report in support of the Tax Return was dated 11 October 1996. According to note 9 of the notes to the financial statements in support of the Tax Return, the financial statements were approved by the board of directors of the Taxpayer on 11 October 1996.

16. On 7 November 1997, the assessor raised the following assessment on the Taxpayer:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Assessable profits for the year	\$7,675,623
<u>Less: Loss set-off</u>	<u>\$104,976</u>
Net assessable profits	<u><u>\$7,570,647</u></u>
Tax payable	<u><u>\$1,249,156</u></u>

17. On 5 May 1998, the Commissioner gave notice to the Taxpayer under section 82A(4) of the IRO that he proposed to assess the Taxpayer to additional tax in respect of its failure to comply with the requirements of the notice given under section 51(1) of the IRO and that the Taxpayer had the right to submit written representations with regard to the proposed assessment of additional tax.

18. In response to the notice, the Former Representative submitted written representations on 22 July 1998 stating that the delay was due to unforeseen management deadlock, conflict of business opinion of the directors and impossibility of holding any valid directors meeting.

19. On 7 August 1998, the Former Representative was requested by the IRD over the telephone to provide documentary evidence to prove the claim of serious conflicts among the Taxpayer's directors and shareholders making it impossible to conduct any valid directors meeting approving the audited accounts. On 12 August 1998, the Former Representative replied over the telephone that documentary evidence as requested could not be provided.

20. On 4 September 1998 the Commissioner, having considered and taken into account the representations, by notice assessed the Taxpayer to additional tax under section 82A (the Assessment) as follows:-

Year of assessment	Tax undercharged	Amount of additional tax	Percentage of tax undercharged
1995/96	\$1,249,156	\$120,000	9.6%

21. At the hearing, Mr B explained that Mr C had emigrated overseas. The accounts of the Taxpayer for the years ended 31 March 1994, 31 March 1995 and 31 March 1996 were left to Mr B to finalize. The only person who had the required knowledge to sign off the accounts was Mr C. But Mr C could not be located or contacted.

22. In addition, Mr B had two major concerns on the draft accounts. First, Mr C had withdrawn from the Taxpayer, as shareholders' drawing, more than 50% of the total shareholders' drawing which was more than the entitlement of Mr B and the 2 new shareholders which Mr B represents. Secondly, Mr C was not satisfied with the high development costs of the Property. He needed to obtain documents from the construction company to verify the reasonableness of the construction costs.

INLAND REVENUE BOARD OF REVIEW DECISIONS

23. The auditor of the Taxpayer sent the draft audited financial statements of the Taxpayer for the years ended 31 March 1994 to 1996 (We note the peculiarity that the audited accounts of the 3 years were drafted in 1997. This means that the profits tax return of the Taxpayer for the tax years of assessment 1993/94 and 1994/95 must have also been late. But in this appeal, we are only concerned with the late filing of the profits tax return for the year of assessment 1995/96.)

24. Mr C was requested to sign the auditor's request for confirmation of balances. He initially refused but later agreed. The audited accounts were then approved and signed for filing with the IRD on 22 May 1997.

25. The Taxpayer has one previous record of late submission of its profits tax return. There was a delay of 4 months and 20 days with a returned tax loss of \$23,446.

Reasons for decision

26. The Taxpayer's arguments at the hearing are that: (1) the delay was neither intentional nor deliberate. There was no intention to evade tax or postpone payment of tax. (2) Mr C could not be reached and no other directors except Mr B was willing to take up the responsibility to administer the Taxpayer's matters relating to tax, accounting and audit. Mr B took steps to verify the accounts, avoid delays and sell the last property to enable tax payments to be made. (3) Mr B was unaware that the Former Representative had informed the IRD of the Taxpayer incurring a loss in its second application to extend the time for filing the Tax Return. (4) In two previous Board cases, the penalties imposed were less than that imposed in this appeal.

27. In the Former Representative's written representation dated 22 July 1996, the delay was said to be due to unforeseen management deadlock, conflict of directors' opinion and inability to hold valid directors meeting. In the written ground of appeal, the Taxpayer stated that many supporting documents were kept by one of directors who had emigrated overseas and with whom the Taxpayer had lost contact, that at the time of the deadline of filing the Tax Return, the director concerned had not been located and the accounts could not be finalized.

28. The absence of any intention to evade tax is not a mitigating factor. This is clear from previous Board decision D53/93, IRBRD, vol 8, 383 cited by the assessor and D69/97, IRBRD, vol 12, 398 [Case H28 (1998) HKRC 80-536] cited by the Taxpayer's representative. It follows that whether the delay was unintentional or deliberate is not relevant in mitigation. A taxpayer is expected to behave honestly.

29. A company cannot act on its own. It acts through its directors, employers and agents. The directors are charged with responsibilities of directing the policies of the Company and, at times, managing the Company. The directors owe fiduciary duties to the Company which means they must act with good faith towards the Company.

INLAND REVENUE BOARD OF REVIEW DECISIONS

30. Section 57(1) of the IRO provides that: '*... any director ... of a corporation ... shall be answerable for doing all such acts, matters or things as are required to be done under the provision of this Ordinance by such corporation*'.

31. The Taxpayer had 6 directors. It is not the question of whether they were willing or not to finalize the accounts to enable the Taxpayer to comply with section 51(1) of the IRO and file the relevant profits tax returns within time. It was their duty as directors to do so. It is simply not true that directors meetings could not be convened. Other than the absence of Mr C, there were still 5 other directors who would form a quorum for directors meetings. Further, out of these 5 other directors, there were 2 other directors (in addition to Mr B) who were in Mr B's camp.

32. Given the disputes relating to Mr C's shareholder drawings and the excessive development costs, it is even more incumbent on each of the directors to take matters into their own hands to resolve the disputes and, if incapable of resolution, to make proper contingencies and provisions in the accounts of the Taxpayer to account for these disputes. While it is commendable that Mr B took active steps to finalize the accounts and arrange tax payment, it was his duty as a director to do so.

33. A distinction must be made between Mr B (as an individual) and the Taxpayer which is a separate legal entity. Disputes between shareholders and directors of a company can be used as a reasonable excuse for the company not to submit tax returns on time but only under limited circumstances which may arise to give a reasonable excuse. The facts that Mr C withdrew more than what he was entitled to from the Taxpayer and that the construction costs of the Property were, in Mr B's view, too high could not have been major obstacles which prevented the finalization of the Taxpayer's audited financial statements (and hence the filing of the Tax Return). The Taxpayer had not put forward any further facts to the assertions of unforeseen management deadlock or conflict of directors' opinion. We are not satisfied that any of these facts gave the Taxpayer any reasonable excuse not to file the Tax Return within the extended deadline granted by the IRD.

34. Irrespective of whether the Taxpayer's Former Representative wrongly informed the IRD that there would be loss in the profit and loss accounts, the fact remains that there was a delay in the filing of the return. The Taxpayer has not submitted any evidence as to why the Former Representative had misinformed the IRD of the loss other than a mere assertion that this was so and whether Mr B was aware of this is immaterial. We are not satisfied that this is a mitigating factor at all.

35. The Taxpayer's representative referred two previous additional tax cases to us: (1) D59/96, IRBRD, vol 12, 8 [Case G42 (1997) HKRC 80-480] in which the penalty was reduced from 3.55% of the tax undercharged to 1% for a 4-month-and-10-day delay and (2) D69/97 [Case H28 (1998) HKRC 80-536] in which the penalty was 9.3% of the tax undercharged which the Board refused to reduce for a one year delay.

INLAND REVENUE BOARD OF REVIEW DECISIONS

36. On quantum, the Revenue representative referred us to D53/93, IRBRD vol 8, 383 where the Board reviewed several Board decisions and stated:

'The rule that has been consistently followed by the Board is that where there are neither aggravating factors nor mitigating ones, the penalty should be 100% of the tax undercharged. On the other hand, in cases of delay and default, it has been the view of the Board (see D53/88, IRBRD, vol 4, 10) that a substantially lower penalty was appropriate if the delay or default related to one year of assessment only and if the return was accepted by the Revenue without requiring an investigation. In D53/88, a penalty of 15% of the tax undercharged was held not excessive. In D11/93, IRBRD, vol 8, 143 a penalty of 20% of the tax undercharged was held not excessive, although probably the top end of the range for cases of this nature.'

37. In D59/93, the penalty of 13.83% of the tax undercharged was held not excessive. The Board had found that the delay in the company's tax return filing was due to the incompetence of the accounting manager but the Board was not satisfied that the company took all reasonable steps to avoid the delay.

38. In D59/96, the penalty of 3.55% of the tax undercharged was reduced to 1%. The company had submitted a profits tax return but it was not supported by audited accounts which were filed 4 months and 10 days after the deadline. The company's reason for the delay was that it had encountered difficulties in obtaining information and documentation from its overseas associated companies. This was rejected by the Board. On quantum, the Board had also reviewed a number of cases where with delays ranging from 1 month to 12 months and penalties from 3.2% to 37.18% of the tax undercharged.

39. Having regard to the findings of fact and the circumstances and in light of the cases cited to us, we are of the view that the additional tax of 9.6% of the tax undercharged is not excessive. This appeal is dismissed and the additional tax assessment in question is hereby confirmed.