Case No. D42/89

Penalty tax assessment – powers and duties of Board of Review – necessity for consistency – sections 82A and 82B of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), David Wong Shou Yeh and Alexander Chung Ho Woo.

Date of hearing: 20 July 1989.
Date of decision: 29 August 1989.

The taxpayer carried on business in Hong Kong. Following the filing of an incomplete tax return for the year of assessment 1986/87, the assessor issued two estimated assessments, one in respect of assessable profits of $1,500,000 and the other in respect of further assessable profits of $500,000. These additional assessments were issued in February and May 1988 respectively. A duplicate profits tax return with audited financial statements was filed by the taxpayer in June 1988 showing assessable profits of $5,057,075 and requesting the assessor to issue a further additional assessment. The Commissioner imposed a penalty of $600,000 on the taxpayer for failure to file the tax return on time.

Held:

The penalty was excessive and should be reduced to $425,000 representing approximately 15% of the maximum penalty permitted or 45% of the tax undercharged. The Board analysed the powers and duties of a Board of Review under section 82B of the Inland Revenue Ordinance and stated that the Board was not empowered to review the Commissioner's exercise of his discretion but only to decide whether or not it is excessive and if it is excessive then to make appropriate adjustments.

Appeal allowed in part.

Cases referred to:

D24/84, IRBRD, vol 2, 136
D24/85, IRBRD, vol 2, 190
D1/82, IRBRD, vol 1, 407
D2/88, IRBRD, vol 3, 125

Woo Sai Hong for the Commissioner of Inland Revenue.

Taxpayer company represented by the chief accountant.

Decision:

This is an appeal by a company against an assessment to additional tax imposed by way of penalty under section 82A of the Inland Revenue Ordinance by the Commissioner.

The facts of this appeal are as follows:

1. The Taxpayer commenced business in Hong Kong in March 1976. Its nature of business is 'dealing of fashion goods and import and export'.

2. A profits tax return for final assessment 1986/87 and provisional payment 1987/88 was issued on 1 April 1987.

3. By letter of October 1987, the Taxpayer's representative made a request on behalf of the Taxpayer for extension of time to late November 1987 for submission of the return. The reason stated was 'waiting to gather the related information'. The request was turned down by the assessor's letter in early November 1987.

4. An incomplete return (BIR 51) without any balance sheet, auditor's report and profit and loss account was filed in December 1987. In the statement of assessable profits or loss of the form BIR 51, only the words 'per computation' were filled in. The said computation was also not submitted.

5. An estimated assessment of $1,500,000 was raised on the Taxpayer in February 1988 under section 59(3) of the Inland Revenue Ordinance. The Taxpayer did not object against the estimated assessment, nor file a complete return in response.

6. An additional estimated assessment for 1986/87 in the amount of $500,000 was issued in May 1988.

7. A duplicate profits tax return for the year of assessment 1986/87 and the Taxpayer's audited financial statements for the year ended 31 March 1987 were submitted to the Inland Revenue Department in June 1988 under cover of the representative's letter with the postscript of 'kindly make further additional assessment to your estimated and additional assessments shown in the form IRC 1701 and, IRC 1703 issued in February 1988 and May 1988 respectively.' The proposed profits tax computation attached with the above return showed an assessable profit of $5,057,075. The assessor made some adjustments to the

proposed computation and re-computed the assessable profit for the year to be $5,107,531. As estimated assessments of $2,000,000 had already been raised on the company, a second additional assessment of $3,107,531 was issued in July 1988.

8. No objection was lodged against the two additional assessments.

9. In September 1988, the Commissioner of Inland Revenue gave notice to the Taxpayer in terms of section 82A(4) that he proposed to assess the Taxpayer to additional tax under section 82A of the Inland Revenue Ordinance in respect of the year of assessment 1986/87.

10. In late September 1988, the Taxpayer submitted to the Commissioner its representations in pursuance of section 82A(4)(a)(ii).

11. In November 1988 the Commissioner, having considered and taken into account the representations, issued a notice of assessment for additional tax in respect of the year of assessment 1986/87 in the sum of $600,000.

12. In December 1988 the Taxpayer gave notice of appeal to the Board against the said section 82A assessment for additional tax.

At the hearing of the appeal the Taxpayer was represented by its chief accountant. He frankly admitted that the Taxpayer had failed to file its tax return on time and that he understood the responsibility of the management of the Taxpayer to comply with the tax laws of Hong Kong. He admitted that the Taxpayer had been negligent in the way which it had handled its tax affairs. However he went on to say that the quantum of the penalty imposed was excessive bearing in mind the following factors:

(i) This was the first offence by the Taxpayer.

(ii) The Taxpayer had no intention to evade or delay payment of tax.

(iii) The Taxpayer had eventually disclosed the full amount of its profits which had been accepted by the assessor.

(iv) The reasons for the delay were because of shortage of staff and problems with the computer of the Taxpayer. He said that the financial year of the Taxpayer ended on 31 March 1987. The Taxpayer had been able to finalise its management accounts by December 1987 and had given the accounts to the Taxpayer's auditors and tax representative in early December 1987.

The representative for the Commissioner drew our attention to the fact that no extension of time had been requested by the Taxpayer until the letter of October 1987 was submitted to the Inland Revenue Department. He pointed out that was long after the original

one month period had expired and that the requested extension for time up to late November 1987 had been rejected. He said that the Taxpayer should have explained the position to the assessor if the Taxpayer was having problems and should not have simply arranged for its tax representative to inform the Inland Revenue Department that the tax representative was 'waiting to gather the related information'. The representative for the Commissioner drew our attention to D24/84, IRBRD, vol 2, 136, D24/85, IRBRD, vol 2, 190 and D1/82, IRBRD, vol 1, 407. He said that on the authority of those cases it was quite clear that anyone who carries on business has obligations under the Inland Revenue Ordinance and it is no excuse to say that auditors have been employed. The employment of auditors does not exonerate the Taxpayer.

He drew our attention to D2/88, IRBRD, vol 3, 125 in which the Board had indicated that the starting point for imposing additional tax in cases of this nature should be the amount of tax undercharged. He said that the Commissioner had taken into account the mitigating factors in this case and had accordingly decided to charge substantially less than the amount of the tax involved. The Commissioner had imposed additional tax of $600,000 as opposed to the amount of tax which would have been undercharged if the failure to file a tax return had not been detected that is $944,893.

In cases of this nature it is important that the Board should approach the matter carefully and methodically. The Inland Revenue Ordinance does not empower the Board of Review at large to look at and review decisions of the Commissioner and deputy Commissioner relating to section 82A additional tax penalties. What the Ordinance provides is that in certain limited areas the Board has the right of review. Under section 82B of the Inland Revenue Ordinance a taxpayer is entitled to argue that the penalty should not have been imposed that is the taxpayer had a reasonable excuse, or that the amount of the penalty exceeds the maximum permissible under the Inland Revenue Ordinance, or that the amount of the penalty is excessive 'in the circumstances'.

In the present case the representative for the Taxpayer does not challenge the authority of the Commissioner to impose a penalty under section 82A. He accepted that the Taxpayer had failed to file a return on time and had no reasonable excuse for its failure. His argument was limited to whether or not the amount is excessive in the circumstances and that is the first question which this Board of Review must answer.

A Board of Review cannot simply proceed to decide whether or not, if they had been the Commissioner, they would have imposed a penalty of the same amount as he has imposed. The Board must look at the penalty and decide whether or not it is 'excessive'. It may well be that a Board of Review would have imposed a slightly lower (or higher) penalty but that is not the point. The question is whether the amount is excessive in the circumstances.

In the present case having carefully taken into account all of the circumstances we find that the amount of the penalty imposed is excessive. This is not an easy case and is close to the border line. However there are a number of mitigating factors. The

representative for the Taxpayer did not attempt to cover up the negligence or fault of the Taxpayer. He openly accepted that the Taxpayer had been wrong. However he pointed out that only one year of assessment was involved and this was not a case involving many years. In this regard he is correct because many of the cases which have come before previous Boards of Review have involved a number of years when the Taxpayer has not simply been late in filing a return but has totally failed to file any returns. He pointed out that the Taxpayer had made no attempt to conceal its profits and had made the fullest disclosure of its profits, albeit belatedly. He said that the Taxpayer had not realised the very serious consequences which could arise from failure to file tax returns on time.

In deciding whether or not the amount of the penalty is excessive it is necessary to try to equate one case with another. Obviously the facts of every case are unique and it is not possible to categorise cases with precision. Every case has its own good and bad points. The case before us is serious because it involves a sophisticated company making substantial profits and the payments of tax was delayed because the assessor could not assess the true profits about which he had no knowledge. The estimated assessments which he imposed were far below the real profit of the company because he only had historic information on which to base his estimated assessments. As the Board pointed out to the representative for the Taxpayer, the Taxpayer was able to conduct its business and substantially increase its profits notwithstanding the problems which he said it was encountering with its computer and its staff. He openly admitted that if the Taxpayer had known the severity of the likely penalty which could be imposed, the Taxpayer would have made greater and more successful efforts in filing its tax return.

Having carefully reviewed all of the facts we find that the penalty imposed by the Commissioner is excessive. As has been said in other Board of Review cases, it is appropriate to look at the percentage or multiple of the tax undercharged and not at the quantum in dollars. In this case the penalty is approximately 20% of the maximum which could have been imposed. For a case of this type we consider that an appropriate penalty is a figure of approximately 15% of the maximum. There is a substantial difference between 15% and 20% of the maximum and the difference is more pronounced when one relates the percentages to the amount of the tax undercharged that is 65% as compared with 45%. Such a difference we consider to be excessive.

Having decided that the penalty is excessive it is then appropriate for us to decide by how much the additional assessment should be reduced. As stated we consider that an appropriate percentage would be approximately 15% of the maximum for a case of this type. Accordingly we order the additional tax assessment against which the Taxpayer has appealed should be reduced from the sum of $600,000 to the sum of $425,000.