

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D42/93

Penalty tax – late filing of profits tax return – quantum of penalty – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Sydney Leong Siu Wing and Patricia Loseby.

Date of hearing: 14 September 1993.

Date of decision: 2 December 1993.

The taxpayer carried on a wholesale and retail business. As a result of failing to complete its audited accounts on time the taxpayer was not able to file its tax return within the period specified. An estimated assessment was issued and was duly paid. Subsequently the taxpayer completed its accounts and filed its tax return which disclosed that it had actually paid more tax than would otherwise have been due when it paid the estimated assessment. The Commissioner then imposed a penalty upon the taxpayer for failing to file its tax return within the time stipulated. The penalty was \$30,000 equal to 14.66% of the amount of tax involved. The taxpayer had paid \$38,164 more profits tax than it should have paid. The taxpayer appealed to the Board of Review against the quantum of the tax.

Held:

In the unusual circumstances of this case it was relevant to consider that the taxpayer had paid more tax than would otherwise have been the case and that in the circumstances a penalty of 10% was appropriate. Furthermore the penalty should be assessed not on the amount of tax paid but the amount which would have been paid if the taxpayer had properly filed its tax return which was a lower figure. Accordingly the penalty was reduced from \$30,000 to \$16,600.

Appeal allowed in part.

Cases referred to:

D42/89, IRBRD, vol 4, 479

D74/89, IRBRD, vol 6, 169

D65/90, IRBRD, vol 5, 455

D53/88, IRBRD, vol 4, 10

Ngai Ngai Nui Leung for the Commissioner of Inland Revenue.

Peter Chan Po Fun of Messrs Peter Chan Po Fun & Co for the taxpayer.

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Decision:

This is an appeal by a private limited company against a penalty tax assessment levied on it under section 82A of the Inland Revenue Ordinance in respect of its late filing of a profits tax return in respect of the year of assessment 1991/92. The facts are as follows:

1. The Taxpayer was incorporated in Hong Kong in early 1964 and since then has carried on a wholesale and retail business. The Taxpayer closes its accounts on 31 March in each year.
2. On 1 April 1992 the Assistant Commissioner issued a profits tax return for the year of assessment 1991/92 and the Taxpayer was required to submit the same to the Commissioner within one month from 1 April 1992.
3. The certified public accountants of the Taxpayer obtained an automatic extension for the time for submission of the 1991/92 profits tax return up to 15 November 1992.
4. On 27 November 1992 the assessor not having received the 1991/92 profits tax return from the Taxpayer raised on the Taxpayer an estimated profits tax assessment for the year of assessment 1991/92 in the amount of \$1,240,000 with profits tax payable thereon of \$204,600.
5. The Taxpayer did not object to this estimated profits tax assessment and the same was duly paid.
6. On 2 March 1993 the tax representative for the Taxpayer submitted the profits tax return for the year of assessment 1991/92 on behalf of the Taxpayer which showed assessable profits of only \$1,008,702. If this profits tax return had been duly filed on time it is probable that the assessor would have issued an assessment based thereon in the sum of \$166,435 being \$38,165 less than the estimated assessment which was issued and accepted by the Taxpayer.
7. The Taxpayer had been late in submitting its profits tax returns in respect of a number of previous years namely, the years of assessment 1984/85, 1987/88, 1988/89, 1989/90, 1990/91.
8. On 1 April 1993 the Commissioner gave notice to the Taxpayer under section 82A of the Inland Revenue Ordinance that he proposed to assess it to additional tax by way of penalty for the year of assessment 1991/92 in respect of its late filing of its profits tax return.
9. On 14 April 1993 the Taxpayer submitted representatives to the Commissioner. On 10 May 1993 the Commissioner having considered and taken into account the

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representations of the Taxpayer, assessed the Taxpayer to additional tax under section 82A of the Inland Revenue Ordinance in the sum of \$30,000 for the year of assessment 1991/92.

10. On 28 May 1993 the Taxpayer gave notice of appeal to the Board of Review against the assessment to additional tax imposed under section 82A of the Inland Revenue Ordinance.

At the hearing of the appeal the Taxpayer was represented by its tax representative who submitted that the Taxpayer had a reasonable excuse for not filing its profits tax return on time and that the quantum of the assessment was excessive.

The representative for the Taxpayer submitted that the Taxpayer had been a good Taxpayer accounting for its profits to the Commissioner of Inland Revenue promptly and paying its tax on due dates over the past years. He said that the Taxpayer was unable to finalise its accounts to make them available for audit before the target date and the complete books were not received for audit until 21 January 1993. He pointed out that the estimated assessment had been paid before the due dates prescribed by the Inland Revenue Department. He said there was no intention to understate any profit and that as a matter of fact the Taxpayer had paid more because it had not objected to the estimated assessment.

The representative for the Taxpayer cited to us three Board of Review Decisions namely:

D42/89, IRBRD, vol 4, 479

D74/89, IRBRD, vol 6, 169

D65/90, IRBRD, vol 5, 455

The representative for the Commissioner submitted that the Commissioner had given due consideration to all of the facts before imposing the penalty. She particularly drew attention to the record of the Taxpayer in failing to submit its profits tax returns on time. She said that the Taxpayer had no reasonable excuse and cited to us D53/88, IRBRD, vol 4, 10.

She pointed out that the Taxpayer had due notice that heavy penalties may be imposed if a person fails to comply with the requirements to file a tax return on time. She pointed out that every taxpayer must pay tax on the due date and that it was up to the taxpayer to object to the estimated assessment if it had wished to do so. She submitted that in all of the circumstances the penalty of \$30,000 which totalled 14.66% of the amount of tax undercharged or 4.89% of the maximum penalty is not excessive in the circumstances.

This appeal is unusual because the Taxpayer has actually paid substantially more tax than it need have done if it had filed its profits tax return on time. In many cases in the past the representative for the Commissioner has drawn the attention of the Board to the fact that the Taxpayer has not objected to estimated assessments until such time as the

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estimated assessments have exceeded the amount of the actual assessable profit at which moment in time the Taxpayer has been able very promptly to file an objection to the assessment. Such is not the situation in the case before us. The Taxpayer has paid \$38,165 in excess of what it would have had to pay if it had filed its tax return promptly on time. It is of course quite true and correct to say, as the representative for the Commissioner submitted, that it was open to the Taxpayer to have objected to the estimated assessment. However surely that is what this case is all about. The Taxpayer was unable to file its tax return on time because it did not have its audited accounts ready in time. The failure to have its audited accounts available has led to two events happening. One was the issuing of an estimated assessment and in due course a penalty for delay in filing its profits tax return. The other is that it did not object to the estimated assessment and has paid too much tax. Both these factors come from the same origin namely that the Taxpayer failed to have its accounts audited within a reasonable period of time.

It is quite clear to us that there is no reasonable excuse in this case. We therefore must look to the quantum of the penalty to decide whether it is excessive.

It appears to us that the range of penalties in cases of this nature are somewhere between the minimum of the 5 % imposed where a person is late in paying tax duly assessed to 25 % where there are more aggravating circumstances. In practice the penalty is likely to fall between the limits of 10% to 20% of the amount of tax involved.

In the present case we have an unusual feature. Indeed it is unique. On the one hand the Taxpayer has been late in filing its tax return in respect of the year in question and has been persistently late in previous years. If that was an end of the matter then we feel that a penalty of approximately 15% of the tax involved would not be unreasonable or excessive. However we have an additional fact. The Taxpayer has actually paid as a direct result of its negligence or omission to have its accounts prepared on time a sum of \$38,164. The question which we ask ourselves is whether or not this fact and this sum should be taken into account. Our answer is that it should be taken into account but only to a limited extent. We should not focus on the sum of \$38,164 as a finite sum to be deducted from the amount of penalty which might otherwise have been imposed but at the same time should give the Taxpayer some benefit and consider the matter in an overall context. In these circumstances we feel that an amount of approximately 10% of the amount of the tax involved would be appropriate because we feel that the overpayment balances to some extent is the record of late filing of returns. Though the Taxpayer has been persistent in late filing of returns there is no indication that the filing of returns has been late by more than a few weeks in each case. Furthermore one must bear in mind that the imposition of substantial penalties for late filing of returns has only comparatively recently been introduced by the Commissioner.

Having reached 10% as a reasonable percentage quantum, we then have the unusual feature of deciding what is the tax involved in this case. The tax as we see is the amount of tax which would have been undercharged if the failure by the Taxpayer to file its tax return had gone unnoticed. We were told by the Commissioner's representative that the amount of the penalty imposed by the Commissioner was 14.66% of the amount of tax undercharged namely \$204,600. However that is of course not the amount of tax

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undercharged. That is the amount of the estimated assessment which we now know was excessive. The amount which should have been assessed if the return had been filed on time would have been only \$166,435. 10% of this amount is approximately \$16,600. We feel that in the case before us taking into account all of the relevant facts that the appropriate penalty should have been \$16,600 and that accordingly the penalty of \$30,000 is excessive.

For the reasons given the Board directs that the additional tax assessment against which the Taxpayer has appealed should be reduced from \$30,000 to \$16,600.