INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D43/95

Penalty tax – late filing of return – quantum of penalty.

Panel: William Turnbull (chairman), Andrew J Halkyard and Benjamin Kwok Chi Bun.

Dates of hearing: 27 October 1994 and 27 April 1995.
Date of decision: 3 August 1995.

The taxpayer was two weeks late in filing its tax return. In previous years the taxpayer had also been late in filing its tax return.

Held:

A penalty of not more than 5% of the tax involved would be appropriate.

Appeal partly allowed.

Cases referred to:

D74/89, IRBRD, vol 6, 169
D53/93, IRBRD, vol 8, 383
D2/90, IRBRD, vol 5, 81

Ngai See Wah for the Commissioner of Inland Revenue.
Lam W H of Messrs W H Lam for the taxpayer.

Decision:

This is an appeal by a taxpayer against a penalty tax assessment imposed upon it for the year of assessment 1992/93. The case came before the Board of Review for hearing. The representative for the Taxpayer duly appeared and submitted, inter alia, that the Taxpayer had not failed to comply with the requirement of a notice given by the Commissioner of Inland Revenue and that accordingly no penalty should be imposed.

The penalty had been imposed by the Commissioner pursuant to section 51(1) of the Inland Revenue Ordinance (the IRO) because the Taxpayer had failed to file its profits tax return for the year of assessment 1992/93 within the one month period specified

in the tax return sent to the Taxpayer as extended by the block extension scheme operated by the Commissioner in favour of professional accountants.

At the hearing of the appeal the Taxpayer was represented by its tax representative who submitted that the Taxpayer had a reasonable excuse.

The representative for the Taxpayer placed emphasis on the words 'within a reasonable time' which appear in section 51(1) of the IRO when making his submission that the Taxpayer had a reasonable excuse for being late in filing its profits tax return.

In view of the emphasis placed by the representative of the Taxpayer on the words 'reasonable time' the Board referred to the tax return form which had been issued and noted that the time stated therein was one month. The Commissioner customarily grants to professional accounting firms extensions of the specified time under a block extension scheme which is operated by the Commissioner. The Taxpayer is a private limited company and the Board noted that few private limited companies would be able to file profits tax returns within the stipulated period of one month because the Commissioner requires profits tax returns to be accompanied by audited accounts. In these circumstances the Board queried whether the notice issued by the Commissioner under section 51(1) of the IRO was valid. The notice can only require a Taxpayer to do something 'within a reasonable time stated in such notice'. If as a matter of routine the Commissioner extends the one month period it would appear, prima facie, that such period is not a reasonable time within which to do something.

Clearly this raised a very wide ranging question which could have major consequences. Accordingly the Board decided to adjourn the case to enable the Commissioner's representative to take legal advice on the question which had arisen.

The Board reconvened to hear the appeal and a legal opinion from the Attorney General's Department was submitted to the Board. Unfortunately the legal opinion did not dispel the queries troubling the Board. The Board did not, however, feel it appropriate to grant a further adjournment of the case for the Commissioner to seek further legal advice. The Board thus proceeded to hear and dispose of the appeal.

As mentioned above the representative for the Taxpayer did not take the point with regard to lack of reasonable time making the notice invalid. It was the Board which raised the point because it appeared to be implicit in the submission being made by the representative. When the Board proceeded to hear the case the representative for the Taxpayer said that the Taxpayer did not wish to incur additional expense in seeking legal advice on this point and did not wish to pursue the same.

The Board took the opportunity of carefully studying the grounds of appeal of the Taxpayer and has decided that the legal point, as to whether the notice given by the Commissioner is valid, does not come within the grounds of appeal and accordingly does not fall for decision by this Board. Accordingly the Board, which has residual doubts about the validity of the Commissioner's notice contained in the tax return, makes no

determination with regard thereto. The Board notes that it has power under the IRO to allow the Taxpayer to amend its grounds of appeal but in the circumstances does not consider it appropriate so to do. No such request was made by the Taxpayer.

With regard to the substance of this case the facts are as follows:

1. The Taxpayer was incorporated in Hong Kong on 13 August 1974.

2. On 1 April 1993 a profits tax return for the year of assessment 1992/93 was issued to the Taxpayer under section 51(1) of the IRO. The return required the Taxpayer to complete and return it to the Inland Revenue Department within one month from the date of issue. However under a block extension scheme operated by the Inland Revenue Department an extension of time for submitting the return was automatically granted up to and including 15 November 1993. This was pursuant to a letter from the Inland Revenue Department sent to the professional firm of accountants representing the Taxpayer dated 9 March 1993.

3. On 26 November 1993 an estimated assessment for the year of assessment 1992/93 with assessable profits of $6,360,000 and tax payable thereon of $1,113,000 was issued to the Taxpayer in the absence of the profits tax return. No objection was lodged against this estimated assessment.

4. On 3 December 1993 the Taxpayer filed its tax return with the Inland Revenue Department showing assessable profits of $8,404,294. This tax return was accompanied by the audited accounts of the Taxpayer.

5. On 6 December 1993 the tax representative for the Taxpayer wrote to the Inland Revenue Department and requested the Department to raise an additional assessment for the year of assessment 1992/93 in amount of $2,044,294.

6. On 14 February 1994 an additional assessment for the year of assessment 1992/93 showing additional assessable profits of $2,044.294 and tax payable thereon of $357,751 was issued to the Taxpayer. This was in accordance with the tax return which the Taxpayer had filed on 3 December 1993.

7. In respect of the year of assessment 1989/90 the Taxpayer was late in filing its profits tax return and was prosecuted under section 80(2)(D). The Taxpayer was convicted on 17 January 1992 and was fined $2,200. In respect of the years of assessment 1990/91 and 1991/92 the Taxpayer was also late and filed its return on 31 January 1992 and 21 January 1993 respectively.

8. On 11 April 1994 the Commissioner of Inland Revenue gave notice to the Taxpayer pursuant to section 82A of the IRO that he proposed to assess the

Taxpayer to additional tax in respect of the Taxpayer's failure to comply with the requirement of notice given under section 51(1) of the IRO (fact 2 above).

9. By letter dated 23 May 1994 the tax representative made representations to the Commissioner. On 15 June 1994 the Commissioner after taking into account the representations issued a notice of assessment and demand for additional tax for the year of assessment 1992/93 in the sum of $100,000.

10. On 6 July 1994 notice of appeal was given to the Board of Review.

At the time and date fixed for the hearing of the appeal the tax representative appeared before the Board and as mentioned above the case was adjourned to enable the Commissioner to take legal advice. When the Board was reconvened the representative for the Taxpayer was invited to make submissions with regard to the substance of the appeal.

The representative for the Taxpayer having informed the Board that the Taxpayer was no longer pursuing its ground of appeal relating to not filing its profits tax return within a reasonable time went on to submit that the amount of the penalty was excessive in the circumstances.

The representative pointed out that the Taxpayer was only just over two weeks late in filing its profits tax return. The short delay had been caused because there was a disagreement between the Taxpayer and its auditors relating to certain qualifications which the auditor wanted to include in the audit report. A bank confirmation was required but was not given to the Taxpayer and its auditor in time for the disagreement to be resolved. The decision was taken by the Taxpayer to accept the auditor's qualification so that the tax return could be filed quickly. The representative then went on to explain that audit firms in Hong Kong had problems in relation to employing trained staff. He then referred to the United Kingdom practice which is not relevant to Hong Kong.

The representative for the Taxpayer went on to point out that the Taxpayer had made full disclosure of its assessable profits on 3 December 1993 and on 6 December 1993 had drawn this to the attention of the Commissioner and requested an additional assessment be issued.

The representative pointed out that where a Taxpayer fails to make due payment of assessed tax a surcharge of 5% of the amount in default is added to the amount payable but a grace period of two weeks is normally granted. It was pointed out that there was no attempt by the Taxpayer to evade or delay the payment of tax. It was pointed out that the Taxpayer had improved its record of filing tax returns year on year and the representative mentioned that for the year of assessment 1993/94 the profits tax returns had been filed on 15 October 1994. The attention of the Board was drawn to D74/89, IRBRD, vol 6, 169.

The representative for the Commissioner submitted that the penalty of $100,000 was 6.8% of the tax undercharged and was not excessive. Our attention was

drawn to the past record of the Taxpayer in filing its tax returns out of date. Our attention was drawn to D53/93, IRBRD, vol 8, 383 and D2/90, IRBRD, vol 5, 81.

Having given this matter careful consideration we have come to the decision that a penalty of $100,000 is in all of the circumstances excessive.

We have disregarded the reference made by the representative for the Taxpayer relating to a subsequent year of assessment.

The Taxpayer was just over two weeks late in filing its tax return and immediately drew the attention of the Commissioner to the fact that the returned profits were substantially more than the estimated assessment which had already been issued a few days before. The return was due on or before 15 November 1993, an estimated assessment was issued on 26 November 1993, the return was lodged on 3 December 1993 and a request for an additional assessment was sent on 6 December 1993. Nothing then happened for over two months. The requested additional assessment was not issued until 14 February 1994. The issuance of an estimated assessment ten days after the expiry of the date in the block extension scheme is presumably computer generated and showed commendable efficiency on the part of the IRO but it has no real relevance.

It seems to us that there are two real factors in this case. On the one hand the tax return was filed just over two weeks out of time. We would assume that in an ordinary case the Commissioner would at most issue a warning letter in such circumstances and would not seek to impose substantial penalties. However in this case there is an aggravating factor. That is that the Taxpayer has been repeatedly late in the past in filing its tax returns. This is no doubt why the Commissioner has taken the decision to impose a penalty in the present case. It is not for us to challenge the exercise of a discretion by the Commissioner. He has full right and power to do so. Our duty is to consider whether or not the quantum of the penalty is excessive in the circumstances.

In the circumstances we feel that a penalty of not more than 5% of the tax involved would be appropriate. Accordingly we direct that the penalty assessment against which the Taxpayer has appealed should be reduced from $100,000 to $70,000.