Case No. D53/88

Penalty assessment – calculation of tax undercharged due to late return – whether payment made pursuant to estimated assessment could be taken into account – s 82A of the Inland Revenue Ordinance.

Penalty assessment – whether penalty excessive – statement of relevant criteria – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Della P H Chan and E M I Packwood.

Date of hearing: 7 October 1988.
Date of decision: 1 December 1988.

The taxpayer company carried on the business of manufacturing garments. It did not submit a profits tax return for the 1983/84 tax year. In the meantime, it paid an estimated assessment which was lower than its true liability. Finally, the taxpayer submitted a return which was accepted by the IRD, and an additional assessment was issued.

The Commissioner assessed a penalty equal to about 5% of the maximum permitted (being about 15% of the tax underpaid).

The taxpayer appealed against the penalty. It explained that, because of a rapid growth in its business and problems with its accounts personnel, it had been unable to maintain proper accounts and file its return on the due date.

Held:

The penalty was not excessive.

(a) In assessing a penalty as a result of the taxpayer's lateness in filing its return, the payment which had been made under the estimated assessment was to be disregarded. This is because the tax undercharged as a result of the lateness of the return was the taxpayer's full tax liability.

(b) The general rule established in other cases is that a starting point for assessing penalties should be 100% of the tax undercharged (or 33.3% of the maximum permitted) in cases where
    (i) a taxpayer has totally failed to comply with its obligations but without criminal intent;

(ii) the IRD has had to resort to an investigation or the preparation of an assets betterment statement or has otherwise had difficulty in assessing the tax; and
(iii) a taxpayer's default has persisted for a number of years.

(c) In the present case, a substantially less penalty was appropriate because the default related to one year only. Also in the taxpayer's favour was the fact that its return was accepted by the IRD without requiring an investigation.

(d) A penalty of 15% of the tax underpaid (or 5% of the maximum permitted) is not unreasonable given the delays in this case. This is particularly so in view of the fact that a surcharge of 5% is routinely imposed on taxpayers who fail to pay their tax on the due date after an assessment is made without there having been any default.

Appeal dismissed.

Chung Sik Keung for the Commissioner of Inland Revenue.
Thomas Lai of Chan, Lai, Pang & Co for the taxpayer.

Decision:

This appeal is by a company against the amount of the penalty imposed by the Commissioner under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer is a limited company incorporated in Hong Kong which was carrying on business as a manufacturer of garments.

2. The Taxpayer was incorporated in 1980 when it commenced business. In respect of the years of assessment from the commencement of business up to and including 1982/83, the Taxpayer maintained its accounts properly and duly filed its tax returns.

3. The Taxpayer closed its accounts on 31 March in each year.

4. In respect of the year of assessment 1983/84, the Taxpayer's business grew dramatically in size and profitability. The Taxpayer was unable to cope with the dramatic increase in its business and allegedly had certain problems with its accounts personnel. As a result of these factors, the Taxpayer was not able to maintain its accounts properly and was not able to file its tax returns for the year 1983/84 in accordance with the requirements of the Inland Revenue Ordinance.

5. A tax return was issued in the usual way to the Taxpayer on 2 April 1984. The Taxpayer did not file this return within the one month period permitted and did not apply for any extension of time prior to the expiry of the one month period.

6. By letter dated 10 December 1984, the accountants for the Taxpayer who were its tax representative wrote to the Commissioner requesting an extension of time for filing the tax return up to 31 December 1984. The Commissioner by letter dated 10 December 1984 replied, refusing to grant the extension of time.

7. On 28 February 1985, in default of receiving a tax return from the Taxpayer, the Commissioner issued an estimated assessment in the amount of $2,000,000. The Taxpayer did not file any objection to this estimated assessment and the same was duly paid by the Taxpayer.

8. From 28 February 1985 until 16 December 1985, it would appear that there were no further developments other than that on 1 April 1985 the Commissioner issued a profits tax return for the year 1984/85.

9. The next fact is that, under cover of a letter dated 16 December 1985, the accountants for the Taxpayer filed with the Commissioner two tax returns, one in respect of the year 1983/84 and the other in respect of the year 1984/85. Audited accounts were submitted together with these two tax returns and the same were accepted by the Commissioner. The tax return and accounts for the year 1983/84 disclosed that the Taxpayer's profits had substantially increased and were $4,588,092, well over double the amount of the estimated assessment issued on 28 February 1985. An additional assessment was issued on 17 January 1986 for the year 1983/84 based on the return which had now been filed.

10. After giving due notice to the Taxpayer of his intention to make an assessment to additional tax under section 82A, and after receiving representations from the Taxpayer, the Commissioner issued an additional assessment under section 82A in the sum of $115,000.

Taxpayer's submissions

At the hearing of the appeal, the Taxpayer was represented by its tax representative who submitted that the assessment was excessive in all of the circumstances. The representative pointed out that the Taxpayer had duly filed its tax returns each year with only the exception of this particular year. He explained that in this particular year the Taxpayer had encountered difficulties in maintaining its accounts because of the dramatic increase in business and the personnel problems. He pointed out that an estimated assessment had been issued and that the Taxpayer had filed a tax return which had been accepted by the Commissioner. He pointed out further that the loss to the revenue was not substantial.

Commissioner's submissions

The representative for the Commissioner submitted that the Commissioner had already taken a lenient view of this case. He disputed the statement that there had been no significant loss of revenue. He pointed out that, if the Taxpayer had submitted its tax return promptly, an assessment would have been issued at an earlier date than the estimated assessment and the tax assessed would have been paid at an earlier date. The additional tax which was levied following the filing of the tax return which was over 12 months late would likewise have been paid at a much earlier date. Furthermore, under the provisions of the Inland Revenue Ordinance whereby provisional tax for the following year is assessed in advance based on the previous years assessed income, the Taxpayer had had a double benefit. Not only had the Taxpayer paid the tax in respect of the year in question at a much later date than would have been the case in normal circumstances, but also the next year's estimated tax was likewise substantially lower than it would have been in normal circumstances.

Conclusion

We find in favour of the Commissioner and dismiss this appeal. The amount of the penalty imposed is $115,000. The amount of the tax undercharged as a result of the delay in the filing of the return was $770,235. It has already been held in previous Board of Review decisions that it is not relevant to take into account the amount of the estimated tax assessed. The amount of the penalty is calculated with reference to the amount of tax which was not charged as a result of the tax return not being filed on the due date. In this case, the amount of tax undercharged was 100% of the tax which was eventually assessed for that year.

In other cases, the Board of Review had said that the starting point for assessing penalties where a taxpayer has failed in his or its obligations under the Inland Revenue Ordinance is 100% of the amount of the tax undercharged. That penalty is appropriate to those cases where there has been no criminal intent and the Taxpayer has totally failed in his or its obligations under the Inland Revenue Ordinance, and where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax.

Furthermore, in cases where the Board has ruled that a 100% penalty is appropriate, the failure by the Taxpayer to fulfill his or its obligations under the Inland Revenue Ordinance has persisted for a number of years, usually the full statutory limitation period of six years. In the present case, the Taxpayer has failed in respect of one year only and it is appropriate that the amount of penalty should be substantially less than in other more serious cases.

It must also be taken into account that previous tax returns and this particular tax return (when it was eventually filed) were accepted by the assessor and it was not necessary to resort to instituting an investigation.

These factors the Commissioner has already taken into account when he imposed a penalty of approximately 15% of the amount of the tax undercharged. This appears to us to be reasonable. The Taxpayer failed to file this return for a period of more than one year. A surcharge of 15% of the amount of the total tax payable is not unreasonable for such a long delay. It is worth bearing in mind that a surcharge of 5% is imposed on anyone who fails to make payment of tax on the due date when it has been routinely assessed after the Taxpayer has duly filed his tax return in accordance with his obligations under the Inland Revenue Ordinance.

In all of the circumstances we find that the penalty imposed, which is approximately 15% of the total amount of the tax undercharged, is reasonable and not excessive in the circumstances. We therefore dismiss this appeal.