

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/93

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

Panel: Robert Wei Wen Nam QC (chairman), Michael Choy Wah Ying and Rowdget W Young.

Date of hearing: 13 October 1993.

Date of decision: 24 January 1994.

The taxpayer was late in filing its profits tax return because of the incompetence of its accounting manager. The taxpayer also blamed his/her auditor for the delay but this allegation was not accepted by the Board. The taxpayer argued that in the circumstances of the penalty was excessive.

Held:

The quantum of penalty equal to 13.83% of the tax undercharged was not excessive. The Board reviewed a number of decided cases in reaching its decision that a penalty of 13.83% of the tax undercharged was not excessive.

Appeal dismissed.

Cases referred to:

D53/88, IRBRD, vol 4, 10

D11/93, IRBRD, vol 8, 143

Woo Sai Hong for the Commissioner of Inland Revenue.

Taxpayer represented by Taxpayer's Accounting Manager.

Decision:

1. In this appeal a holding company of a group of companies (the Taxpayer) is appealing against a section 82A penalty in the sum of \$100,000 for failing to file a profits tax return for the year of assessment 1991/92 within the time allowed for the purpose, that is, one month from 1 April 1992, the date when the profits tax return was issued to the Taxpayer.

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2. The Taxpayer closed its accounts on 30 September 1991 for the year of assessment 1991/92.
3. Taxpayers who closed their accounts between 1 April 1991 and 30 November 1991 must lodge their returns within the one month period specified in the returns; no extension of time was permitted by the Commissioner of Inland Revenue.
4. The Taxpayer having failed to lodge its profits tax return for the year of assessment 1991/92 on or before 1 May 1992, the assessor on 24 June 1992 raised an estimated assessment for that year in the sum of \$3,770,000 on the Taxpayer under section 59(3) of the Inland Revenue Ordinance.
5. No objection was lodged in respect of that assessment.
6. On 24 July 1992 the then tax representative of the Taxpayer lodged a profits tax return for the year of assessment 1991/92 showing assessable profits of \$4,250,430.
7. On 30 September 1992 the assessor raised an additional assessment on the Taxpayer in the sum of \$480,430, being the difference between the returned profits and the profits previously estimated.
8. On 14 December 1992 the assessor raised another additional assessment on the Taxpayer in the sum of \$129,100 which resulted from the adding back of a bad debt which was capital in nature.
9. On 21 May 1993 the Commissioner of Inland Revenue gave notice to the Taxpayer under section 82A(4) of the Ordinance that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the year of assessment 1991/92 in respect of the Taxpayer's failure to furnish a profits tax return for the year of assessment 1991/92 within the time allowed, that the amount of tax undercharged or which would have been undercharged in consequence of such failure was \$722,621 and that it had the right to submit written representations with regard to the proposed assessment.
10. By a letter dated 24 May 1993 and signed by its managing director on its behalf, the Taxpayer submitted its representations to the Commissioner of Inland Revenue, stating in effect: (1) that the delay in filing the return was caused by its former tax representative and former accounting manager; (2) that they were entrusted to co-ordinate the handling of all its accounting and tax matters; (3) that it was unaware of any default in filing any return until the accounting manager's sudden resignation. In June 1992; (4) that it had not ignored the section 51(1) notice requiring it to furnish a return within one month, that it had been chasing its former auditor (who was also its tax representative) for the auditor's report for the year of assessment 1991/92 before the tax return filing deadline expired, that it continued chasing the auditor for the auditor's report after it had discovered the default in filing the return following the accounting manager's resignation; (5) that there was no tax undercharged; (6) that it had not tried to evade or avoid payment of tax; (7) that it had put in extra efforts to meet the year of assessment 1992/93 reporting deadline by

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taking on additional staff and appointing a more responsible and efficient auditor/tax representative, and that its 1992/93 profits tax return was filed on time.

11. On 25 June 1993 the Commissioner of Inland Revenue issued a section 82A notice of assessment of additional tax for the year of assessment 1991/92 in the sum of \$100,000.

12. On 23 July 1993 the Taxpayer lodged an appeal to the Board of Review against the additional tax assessment. The notice of appeal contained the following grounds of appeal:

- (1) The assessment is excessive.
- (2) The Taxpayer has taken reasonable steps to ensure that the submission of the tax return form was not delayed. The facts are summarised in its letter to the Commissioner of Inland Revenue dated 24 May 1993.

13. At the hearing the present accounting manager of the Taxpayer conducted the appeal on its behalf. He raised a new allegation that the former auditor/tax representative misled the Taxpayer's management into believing that an extension of time had been obtained for the filing of the 1991/92 return, while no such extension had in fact been obtained. The managing director of the Taxpayer gave evidence in support of that allegation, which will be dealt with later.

14. Our deliberations have led us to the conclusion that this appeal should be dismissed, and for these reasons.

15. The Taxpayer's case is that it had taken such steps as would be expected of it to avoid any delay in the filing of the return, but that despite such steps, delay was caused by the former accounting manager and the former auditor/tax representative. The onus is on the Taxpayer to prove its case.

15.1 The documentary evidence put in by the Taxpayer consisted of the following tax messages and letters:

- (1) On 13 April 1992 the managing director faxed to the auditor as follows:

‘I trust you had received all required documents from [the accounting manager].

Please let me know when I can expect your audited report so that I can arrange our shareholder meeting.’

- (2) On 14 April 1992 the auditor faxed to the managing director a long list of missing computer ledger accounts which were required for audit purposes.

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- (3) On 7 May 1992 the managing director faxed to the auditor as follows:

‘I refer to my conversation with you yesterday.

I believe [the accounting manager] will give you all documents you required latest tomorrow. And I do hope you can help me to finalise the audit report before end of this month.

In case, just in case, you still cannot get all documents, please do not hesitate to contact me.

...’

- (4) On 6 July 1992 the Taxpayer wrote to the Assistant Commissioner of Inland Revenue Unit 2, stating:

‘Re: Employer’s return of remuneration and pensions for the year ended 31 March 1992

...

I am writing here to explain the delay in submitting the above mentioned return. The returns had all been completed on 22 May and signed by our accounting manager ... to whom authorisation was delegated. However, all the returns were not sent out but only locked in [the accounting manager’s] office. This was undiscovered until [the accounting manager’s] resignation without notice [in June 1992]. Afterwards, as you may have noted, all the returns have been sent out by registered post on 10 June 1992.

...’

- (5) On 7 July 1992 the managing director received a fax message from the auditor which was not produced before us. The managing director faxed a reply:

‘I refer to your fax today. I do not understand what is the problem. Please inform me the up to date situation of auditor’s report for the following companies:

1 [the Taxpayer].

...’

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- (6) On 17 July 1992 under a covering letter the auditor sent five copies of the financial statements of the Taxpayer for the year ended 30 September 1991 duly signed by the auditor to the directors of the Taxpayer.
- (7) On 4 August 1992 the Taxpayer wrote to the accounting manager as follows:

‘I am very sorry that our company are now keeping on receiving ‘penalty notices’ from the Inland Revenue Department. This is due to your wrong handling and non-responsibility during your working period in our company. Also I am informed by your assistants ... that it is very difficult to follow up the accounts handled by yourself because:

- (1) The records done by you were not complete and not clear.
- (2) You left our company suddenly.

...’

- (8) On 22 December 1992 the auditor sent a bill for taxation services to the Taxpayer containing the following item:

‘Obtaining extensions on a number of occasions for filing your profits tax return for the year of assessment 1991/92.’

15.2 The managing director gave evidence in support of the Taxpayer’s case. In summary, it is to the following effect:

‘I kept asking the auditor why the auditor’s report was not ready, as we had to submit tax return by end of April 1992. I knew that. I kept asking him, normally by telephone. He would say that there were still some documents missing. I asked for details to pass on to the accounting manager. So on 14 April he sent me a fax listing out the details of the missing documents. I at once passed it on to the accounting manager and asked him to get all the documents to the auditor and give the auditor a reply by fax. I did not know what the accounting manager did. On 30 April I telephoned the auditor when he told me that he had got an extension of time like last year. I believed him.’

15.3 On the evidence we find that because of the incompetence of the accounting manager, the Taxpayer was unable to supply the auditor with all the documents required for audit purposes until well after 1 May 1992, the deadline for the filing of the return. On 7 May 1992 the managing director was telling the auditor that he believed that all the documents requested would be furnished the following day. There is no evidence that the documents were furnished the following day: the accounting manager was supposed to reply to the auditor by fax, but no such fax was produced. Our finding is that no documents

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were furnished to the auditor the following day. In June 1992 the accounting manager suddenly resigned. On 7 July 1992, the auditor sent a fax message to the Taxpayer. We do not know what the fax said, but we are inclined to think that it had to do with some missing information relevant to the audit, and so we find. The managing director faxed a reply on the same day, stating that he did not understand what the problem was. There is no evidence as to when the last bit of information was supplied to the auditor, but we would consider it likely that it occurred sometime between 7 July and 17 July 1992 when the auditor's report was completed, and so we find.

15.4 We also find that the accounting manager's incompetence was responsible for the late filing of the return. The next question is whether the blame was shared by the auditor. At the hearing of this appeal, the Taxpayer's representative introduced the new allegation that the auditor had misled the Taxpayer into believing that an extension of time for the filing of the return had been obtained. That no extension was ever granted or applied for was confirmed by Mr WOO the Commissioner's representative. Thus, on 22 December 1992, by a bill for taxation services (see paragraph 15.1(8) above), the auditor made a misrepresentation about extensions having been obtained: a fact no doubt in favour of the managing director's allegation about a specific misrepresentation made by the auditor on 30 April 1992 (see paragraph 15.2 above). On the other hand, we note that the allegation was made for the first time at the hearing, while it should have been made in the Taxpayer's written representations dated 24 May 1993 and signed by the managing director (see paragraph 10 above) and in the notice of appeal dated 23 July 1993 (see paragraph 12 above). No explanation was offered as to why the Taxpayer waited until the hearing to make the allegation. Further, there is no evidence as to the duration of the alleged extension; nor is there any mention of the alleged extension in the correspondence (by fax or by letter) which is quite consistent with no misrepresentation about any extension having been made on 30 April 1992. We should like to point out that the auditor's bill for taxation services dated 22 December 1992, albeit in favour of the allegation about the 30 April 1992 misrepresentation, is not itself evidence that that specific misrepresentation was made. The managing director did not state or demonstrate in what way the alleged misrepresentation influenced the course of events leading to the delay in the filing of the return. All in all, there is so much doubt about the allegation that we find it unacceptable. We are not satisfied that the auditor made the alleged misrepresentation, or, alternatively, if he did, that it caused or contributed to the delay in the filing of the return. In our view, the Taxpayer has failed to prove that the auditor was responsible for the delay.

15.5 The Taxpayer's representative alleged that 'the modus operandi of our former auditor and tax representative was to delay the issuance of the audit report and claim that our accounting records were messy so that he could charge a higher fee again next year'. No witness was called to substantiate the allegation. The documentary evidence produced on that score was correspondence between a subsidiary of the Taxpayer and the auditor relating to requests for the auditor's report and counter-requests for documents and information; it did not prove the allegation.

15.6 That leaves the question of whether the Taxpayer has taken all reasonable steps to avoid the delay caused by the former accounting manager. Here again the evidence is

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scanty. The managing director received a list of missing ledger accounts from the auditor on 14 April 1992 and passed it on to the accounting manager with instructions to send all the missing documents to the auditor and give the auditor a reply by fax; the managing director did not know what the accounting manager did (see paragraphs 14.2(2) and 14.3). The only other bit of evidence is the fax dated 7 May 1992 (see paragraph 14.2(3)), from which we find that on 6 May 1992 the managing director had a conversation with the auditor and that the next day the managing director conveyed his belief to the auditor that the accounting manager would supply all the documents on 8 May 1992. The next thing we are told (which we accept) is that the accounting manager suddenly resigned in June 1992 (see paragraph 14.2(4)). The overall picture is to be found in the statement in the written representations (see paragraph 10(3)) that the Taxpayer was unaware of any default in the filing of any return until the accounting manager's sudden resignation in June 1992. There is no evidence of any steps, precautionary or remedial, taken by Taxpayer to monitor or supervise the work of the accounting manager, or to identify and remove the causes of the delay. We are not satisfied that the Taxpayer took all reasonable steps to avoid the delay.

16. The contention that there was no profits tax undercharged was misconceived. The amount of tax undercharged for the purposes of section 82A(1) is the full amount of tax payable on the assessable profits or income for the relevant year which crystallises as soon as the taxpayer makes a default in filing his tax return; it serves as a measure in the calculation of the penalty which is considered appropriate in the particular circumstances of each case. The amount of tax undercharged in this case crystallised on 1 May 1992.

17. The penalty of \$100,000 is equivalent to 13.83% of the tax undercharged. Is that excessive? We think not. 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. In the present case, the penalty, being 13.83% of the tax undercharged, is in our view not excessive. It was submitted that the Taxpayer never tried to evade or avoid the payment of profits tax. An intention or attempt to evade tax is always an aggravating factor, while the absence of such intention or attempt is not a mitigating factor, because a taxpayer is expected to behave honestly. It was further submitted that the Taxpayer has taken steps to put its house in order and was able to file its 1992/93 return within time. That again is irrelevant because (1) it related to a different year and (2) the punctual filing of a return is something every dutiful taxpayer is expected to do.

18. At the hearing we raised the question whether the amount of the tax undercharged should include the amount of the bad debt which was disallowed as a deduction. Having further considered the matter, we have come to the conclusion that it should, in accordance with the principle that the amount of the tax undercharged under section 82A is the full tax liability in respect of the relevant year of assessment.

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19. It follows that this appeal is dismissed, and that the additional tax assessment in question is hereby confirmed.