

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D55/94

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

Panel: William Turnbull (chairman), Cheung Wai Hing and Peter Raymond Griffiths.

Date of hearing: 16 September 1994.

Date of decision: 28 November 1994.

The taxpayer was late in filing its tax return in respect of the year of assessment 1991/92. A penalty of 10% was imposed upon the taxpayer. The taxpayer was again late in filing its tax return in the subsequent year of assessment 1992/93. The Commissioner was of the opinion that the second failure to file the tax return merited a more substantial penalty than the first occasion and imposed a penalty of 50% of the tax undercharged or involved in respect of the second year. The taxpayer appealed to the Board of Review and submitted that the second penalty was excessive and should have been based on the same percentage as the first penalty.

Held:

At the hearing of the appeal the representative for the Commissioner submitted that the higher penalty for the second year was merited because the first penalty had already been imposed upon the taxpayer and this should have acted as a warning to the taxpayer. However the Board considered the second penalty excessive because the taxpayer was not aware of the first penalty until after it had filed its tax return in respect of the second year of assessment. Appeal allowed and penalty reduced to 10% of the tax which would have been undercharged.

Appeal partly allowed.

Ngai See Wah for the Commissioner of Inland Revenue.

Taxpayer represented by his director.

Decision:

This is an appeal by a private limited company (the Taxpayer) against additional tax imposed by way of penalty under section 82A of the Inland Revenue Ordinance (the IRO) for the year of assessment 1992/93. The facts are as follows:

1. The Taxpayer was incorporated in Hong Kong in March 1990.

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2. A profits tax return for the year of assessment 1992/93 was issued to the Taxpayer on 1 April 1993 with a return date of one month later.
3. On 26 November 1993 an estimated assessment for 1992/93 with estimated assessable profits in amount of \$2,180,000 was issued to the Taxpayer in the absence of a return.
4. The 1992/93 profits tax return was filed by the Taxpayer on 12 January 1994 showing assessable profits of \$2,279,473 together with supporting accounts for the year of assessment 1992/93.
5. On 14 February 1994 the assessor raised an additional assessment on the Taxpayer in the sum of \$99,473 additional profits in respect to the year of assessment 1992/93. Particulars of the additional assessment are as follows:

	\$
Profits Per Return	2,279,473
Less: Already assessed	<u>2,180,000</u>
Additional Assessable Profits	<u>\$99,473</u>

6. On 22 April 1994 the Commissioner gave notice to the Taxpayer that he proposed to assess the Taxpayer to additional tax by way of penalty in respect to the year of assessment 1992/93.
7. By a letter dated 5 May 1994 the tax representative for the Taxpayer made submissions to the Commissioner. On 23 May 1994 the Commissioner having taken the representations into account issued a notice of assessment for additional tax in respect of the year of assessment 1992/93 in the sum of \$60,000.
8. By letter dated 9 June 1994 the tax representative gave notice of appeal to the Board of Review on behalf of the Taxpayer against the assessment to additional tax by way of penalty.

At the hearing of the appeal the Taxpayer was represented by its director who explained the reason for the delay. She said that the Taxpayer was a family business incorporated in March 1990. There were three partners two of whom were frequently absent on business trips. She said that she was the person responsible and that from the very beginning the Taxpayer had been short of personnel. She said that she was not experienced in accounting and when the business increased more staff were employed but they did not stay with the Taxpayer for very long. She said that in August 1993 the accounts of the Taxpayer had been computerised. She said that the Taxpayer had also experienced problems with its auditors which they had changed.

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The representative for the Commissioner submitted that the penalty was reasonable in the circumstances. He pointed out that the penalty of \$60,000 was only 15% of the amount of tax undercharged or involved. He said that this was not the first occasion on which the Taxpayer had been late in filing its tax return and pointed out that a warning letter had previously been issued to the Taxpayer. He also pointed out that a penalty of \$30,000 being 10% of the tax involved in respect of that year had been imposed upon the Taxpayer in respect of the year of assessment 1991/92.

The representative for the Commissioner challenged the Taxpayer with regard to its auditors. He confirmed that the Taxpayer had changed its auditors three times but said that there are hundreds of certified public accountants practising in Hong Kong and it is not difficult to find a responsible auditor so that a tax return can be filed in time.

At this stage, the Board found it difficult to understand the submissions made on behalf of the Taxpayer and the Commissioner. On the one hand the representative for the Taxpayer was explaining that the Taxpayer did not fully understand the law in Hong Kong and the substantial penalty which can be imposed upon taxpayers who are late in filing returns. On the other hand the representative for the Commissioner was submitting that this was not the first time that the Taxpayer had failed to file its tax return on time and was therefore aware of its responsibility. Furthermore the representative for the Commissioner pointed out that a penalty had been imposed upon the Taxpayer in respect of a previous year.

Enquiries of the representative for the Taxpayer revealed additional facts which were confirmed by the representative for the Commissioner and which clarified the situation. In respect of the year of assessment 1991/92 the Taxpayer should have filed its tax return before the due day in 1992 which was 15 November 1992. However it was not until 14 October 1993 that the Taxpayer eventually filed its tax return for the year of assessment 1991/92. The representative for the Taxpayer explained that in respect of the year of assessment 1991/92 she was the person who made the simple entries in the accounts of the Taxpayer. She employed the current accountant for the Taxpayer in March 1992 and it took the new accountant sometime before she could set up a system and complete the accounts for the year ended March 1992. She completed these accounts in early 1993 and they were submitted to the auditor in May 1993. In August the Taxpayer received the auditor's report and the accounts were approved by the Taxpayer but for some reason not known by the representative for the Taxpayer the auditors did not file the audited accounts for the year of assessment 1991/92 until 14 October 1993.

The accounts for the following year of assessment 1992/93 had been completed in August 1993 and were then audited and submitted to the Revenue with the tax return at the beginning of January 1994. This was a great improvement on the preceding year.

The Commissioner gave notice of his intention to impose a penalty in respect of the year of assessment 1991/92 by letter received on or dated 21 December 1993. The Taxpayer replied on 18 January 1994 and a notice of assessment to penalty tax in the sum of \$30,000 was received by the Taxpayer dated 4 February 1994.

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This additional chronology of events for the two years, 1991/92 and 1992/93 explained the difference in the points of view of the Taxpayer and the Commissioner. It is true that a penalty had been imposed in respect of an earlier year but that penalty was not imposed until after the Taxpayer was in default in respect of the subsequent year. It seems to this Board that there is no logical reason for the Commissioner to impose a higher percentage penalty on the Taxpayer in respect of the year of assessment 1992/93 than he did in respect of the previous year. In reality the two years of assessment are one and the same thing. The Taxpayer failed in its obligation to maintain its accounts in respect of the year 1991/92 but by March 1992 had taken positive steps to overcome its problems. The accounts for the year of assessment 1992/93 could not be completed until the preceding year had been completed. Apparently the accounts for 1991/92 were completed in May but for some reason there was a delay in the same being audited and submitted to the Revenue. Simultaneously the Taxpayer was falling into default in respect of the following year 1992/93 and for the same reasons. However the Taxpayer was actively tackling the problem which included changing its auditors.

Whilst none of the foregoing excuses the Taxpayer for having failed to file its tax returns on time, it does act as mitigation. In the circumstances we do not feel that the default of the Taxpayer in respect of the year of assessment 1992/93 merits a higher percentage penalty than for the preceding year. We feel that on the facts before us both years should be seen together in the same light. Accordingly we consider that an appropriate penalty for the year of assessment of 1992/93 would be an amount equal to approximately 10% of the tax which would have been undercharged.

Based on the foregoing we direct that the amount of the penalty assessed under section 82A of the IRO for the year of assessment 1992/93 should be reduced from \$60,000 to \$39,000.