

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D61/90

Penalty tax – failure to file profits tax return in time – quantum of penalty – whether token penalty should be increased – section 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Glen C Docherty and John Haggarty.

Date of hearing: 9 January 1991.

Date of decision: 28 January 1991.

The taxpayer failed to file its profits tax return within the time stipulated as extended. An estimated assessment was issued following which a tax return was filed and an objection was made but no audited accounts were delivered. The assessor allowed an extension of time for filing the audited accounts to validate the objection. Subsequently a penalty of \$15,000 was imposed upon the taxpayer for failing to file the tax return within the time stipulated. The taxpayer appealed.

Held:

The penalty was a token penalty imposed because the taxpayer had failed to file its tax return within the time stipulated as extended. The extension of time granted to the taxpayer to validate its objection was not relevant. The Board considered the penalty to be too small but did not increase it because the Commissioner's representative did not request an increase.

Appeal dismissed.

Case referred to:

D2/88, IRBRD, vol 3, 125

Woo Sai Hong for the Commissioner of Inland Revenue.
Ernest Cheung Hon Kuen of P Cheung Wong & Co for the taxpayer.

Decision:

1. THE SUBJECT MATTER OF THE APPEAL

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The Taxpayer appealed against the imposition, pursuant to section 82A of the Inland Revenue Ordinance ('the Ordinance') of an assessment to additional tax in the sum of \$15,000 in respect of its failure to comply with a notice under section 51(1) of the Ordinance for the year of assessment 1988/89.

2. THE FACTS

The following facts were not in dispute:

- 2.1 The Taxpayer commenced business in Hong Kong as an importer and exporter of textiles, garments and general merchandise in 1981.
- 2.2 The notice requiring the Taxpayer to file a profits tax return for the year of assessment 1988/89 ('the return') was issued on 3 April 1989 but had not been returned to the Revenue completed as of 22 November 1989.
- 2.3 In the absence of the completed return, on 22 November 1989, pursuant to section 59(3) of the Ordinance, the assessor raised on the Taxpayer an assessment for the year of assessment 1988/89, based on estimated assessable profits of \$3,180,000.
- 2.4 On 20 December 1989 the Taxpayer's tax representative, a firm of certified public accountants, lodged an objection to this assessment on the ground that the estimated profit was excessive. However, the return had not been filed to support, this objection.
- 2.5 By letter in writing dated 11 January 1990, the assessor advised the tax representative, inter alia, that the objection could not be accepted as a valid objection in the absence of the return and advising that if the return was received by 22 January 1990 the objection would be considered.
- 2.6 On 1 February 1990 the Taxpayer submitted the return, showing assessable profits of \$4,958,499.73.
- 2.7 On 15 February 1990 the assessor raised an additional assessment to profits tax for the year of assessment 1988/89 in respect of profits of \$1,778,499, namely the difference between the assessable profits of \$4,958,499.73, as shown in the return, and the estimated profits of \$3,180,000 in the assessment of 22 November 1989.
- 2.8 On 4 June 1990 the Commissioner gave notice to the Taxpayer in terms of section 82A(4) of the Ordinance, namely that he was of the opinion that the Taxpayer had without reasonable excuse failed to comply with a notice issued under section 51(1) of the Ordinance for the year of assessment 1988/89 and

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advising that he proposed to assess the Taxpayer to additional tax by way of penalty. The notice invited representations with respect thereto.

2.9 By letter dated 19 June 1990, the Taxpayer's tax representatives submitted reasons to the Commissioner why additional tax should not be assessed on the Taxpayer.

2.10 On 17 August 1990 the Commissioner issued a notice of assessment to additional tax with respect to the year of assessment 1988/89 in the sum of \$15,000.

2.11 On 12 September 1990 the Taxpayer's tax representative gave notice of appeal to the Board against the said assessment to additional tax. The grounds contained in this notice are as follows:

- ‘1. We have disclosed all the facts and reasonable excuses in our representations dated 19 June 1990. It appears that the Commissioner of Inland Revenue has not taken into account the most important factor, namely our client has no intention to evade tax.. The penalty imposed is heavy in comparison with the fine \$2,000 for the compound offer for late submission of supporting accounts.
2. It is seldom in the past for the Commissioner of Inland Revenue to raise additional assessment of tax which may be treble of the amount of tax in connection with late submission of profits tax return and the supporting accounts. The former practice is that should be estimated assessment be lesser than the actual one, additional assessment will be issued to charge the balance. Since it is a completely new measure and its implement has never been informed before hand, it is unfair to the taxpayers who rely on previous practice especially in 1989, the year of serious labour shortage.
3. Our client acts in good faith. What in its mind was that the later it submitted the accounts, that later the payment of tax. Nevertheless, it submitted that audited accounts as soon as it could, notably the short duration between the expiry date and the date of submission (notwithstanding the Chinese New Year holidays).’

3. CASE FOR THE TAXPAYER

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- 3.1 At the hearing the Taxpayer was represented by a tax manager employed by its tax representative, who was also its auditor.
- 3.2 In a brief address the representative stated that:
- 3.2.1 The Taxpayer was only eight days late in submitting the return.
- 3.2.2 The Taxpayer had no intention to delay the filing of the return but was delayed because it was near to the Chinese New Year holiday and the Taxpayer being in the garment business and secures its merchandise from factories in the People's Republic of China ('PRC'), its director had to visit suppliers in the PRC.
- 3.2.3 The labour shortage in 1989 had made it a bad year for certified public accountants generally and both the Taxpayer and the representative's own firm had been affected. There had been a high staff turnover.
- 3.2.4 The Commissioner had made concessions for the filing of profits tax returns. As the estimated assessment was near to the actual anticipated profit the representative's firm had dealt with more urgent cases.
- 3.2.5 Although the Commissioner was empowered to make additional assessments he had not done so in previous years. This was the first occasion the representative's firm had encountered and additional assessment in these circumstances.
- 3.2.6. The taxpayer had done its best but had missed the final date by eight days.

4. SUBMISSION OF THE REVENUE

In a written submission, supplemented by additional comments, the representative for the Revenue stated:

- 4.1 The assessment based on estimated profits had been issued because the Taxpayer had not filed the return within the time stipulated. In reply to a question from the Board the representative stated that the expression 'time stipulated' did not mean the one month stated in the return but meant 31 October 1989, that is six months subsequent to the Taxpayer's financial year end, that is the 'block extension' afforded to all taxpayers with tax representatives.
- 4.2 The estimated assessment was raised under section 59(3) of the Ordinance which expressly provides that such an assessment shall not affect the liability of the taxpayer, and in the words used in the section, 'to a penalty by reason of his failure or neglect to deliver a return'.

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- 4.3 When the Taxpayer's tax representative lodged the objection to this assessment it did not file the return. Accordingly, by the letter dated 11 January 1990, the assessor notified the tax representative that the objection could not be entertained unless the return was received by the assessor by 22 January 1990.
- 4.4 The return was received by the Revenue on 1 February 1990. It was accepted by the assessor as correct and the additional assessment was raised.
- 4.5 Thereafter the Commissioner gave notice under section 82A(4) of the Ordinance and the Taxpayer's tax representative submitted its representations.
- 4.6 In its representations the tax representative stated that the Taxpayer's books and records had been sent to them on 17 October 1989, that is just fifteen days before the expiry of the 'block extension', refer paragraph 4.1 above. It was unreasonable for the Taxpayer to expect an audit to be completed in only fifteen days.
- 4.7 The Taxpayer had offered the labour shortage as an excuse. This was not something which only affected the Taxpayer. In any event, the Taxpayer had an obligation under the law to submit the return on time.
- 4.8 The additional tax under section 82A was imposed because of the Taxpayer's failure to comply with the section 51(1) notice. It was not imposed to punish the Taxpayer for making an incorrect return or for endeavouring to avoid tax whereby excuses to the effect that voluntary disclosure had been made and that there had been no intention to evade tax were irrelevant and did not constitute a reasonable excuse.
- 4.9 The Commissioner was empowered to impose a penalty equivalent to three times the tax which would have been undercharged had the failure not been detected, which in the instant appeal could have resulted in a penalty of \$2,528,832, namely \$842,944 x 3. As it was, the Commissioner had imposed a considerably smaller penalty, namely \$15,000.
- 4.10 The Board was referred to Case No D2/88, IRBRD, vol 3, 125, and passages at pages 130, 131 and 132, the latter two references being with respect to the quantum of penalties under section 82A. The representative added that he had no instructions to request the Board to increase the penalty.
- 4.11 It was submitted that no reasonable excuse had been offered with respect to the Taxpayer's failure to comply with the notice under section 51(1), whereby the appeal should be dismissed.
- 4.12 In answer to a question from the Board as to the circumstances under which a taxpayer was offered a fine of \$2,000 to compound the offence of late

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submission of supporting accounts, something referred to in paragraph 1 of the grounds of appeal, the representative stated that this offer was only made to taxpayers who had returned a loss in the previous year and who were late in complying with a notice section 51(1) of the Ordinance.

5. REPLY ON BEHALF OF THE TAXPAYER

The representative declined the opportunity to reply.

6. REASONS FOR THE DECISION

- 6.1 It is for the Taxpayer to satisfy the Board that there was a reasonable excuse for its failure to comply with the notice issued under section 51(1) of the Ordinance.
- 6.2 When the tax representative made representations on behalf of the Taxpayer in its letter of 22 August 1990, it said that the Taxpayer had only sent its books and records to it on 17 October 1989, and refer paragraph 4.6 above. That the tax representative well knew that the 'block extension' expired some fifteen days later is apparent from the first sentence of its letter of 19 June 1990, but, apparently, it did not apply to the Revenue for an extension. Whether or not an extension would have been granted is unknown but the effects of the labour shortage, which were fully appreciated at that time, might have resulted in an extension which might have avoided the imposition of the penalty.
- 6.3 In his submission the Taxpayer's representative suggested that the profits tax return was only eight days late and that was partly attributable to the need for the director of the Taxpayer to visit factories in the PRC at or about the time of the Chinese New Year holidays. The former statement is misconceived and misleading. The date for the filing of the profits tax return expired on 31 October 1989 and the date 22 January 1990 was not the last day of an extension but was the date by which the profits tax return had to be filed if the objection to the assessment of 22 November 1989 was to be capable of being entertained. The proximity of 1990 Chinese New Year holidays merely compounded a situation which would not have arisen if the Taxpayer had acted responsibly in supplying its books and records to its auditor and tax representative.
- 6.4 The excuse that accounting staff were difficult to obtain in 1989 has been put to the Board on many occasions. The Board has consistently stated that it is the duty of a taxpayer to ensure that its accounting records are maintained up-to-date and that the returns required to be made by taxpayers under the Ordinance are made within the time limits specified in the Ordinance. Difficulties in recruiting staff do not excuse taxpayers from fulfilling their statutory obligations.

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6.5 The Board regards this case as a particularly bad case. First, the auditor was put in an impossible position by the failure of the Taxpayer to deliver its books and records in adequate time to enable an audit to be completed. Secondly, the Board notes the first two sentences in paragraph 3 of the grounds of appeal which read:

‘Our client acts in good faith. What in its mind was that the later it submitted the accounts, the later the payment of tax.’

The Board regards these two sentences as mutually contradictory. Further, the second sentence invites a severe penalty as, effectively, it constitutes an averment that the delay was intentional.

6.6 The Board regards the penalty imposed by the Commissioner as a token penalty and a penalty which, in the circumstances, the Taxpayer should have accepted gratefully. Were it not for the fact that the representative of the Revenue stated that he had no instructions to seek an increase in the penalty the Board would have considered making a substantial increase. However, there is one redeeming feature in this case, namely that the payment of the full amount of the tax which was due was not unduly delayed.

6.7 The Taxpayer has totally failed to establish that there was any reasonable excuse for its failure to complete the notice given under section 51(1) within the permitted time, namely on or before 31 October 1989.

7. DECISION

For the reasons given this appeal is dismissed.