

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D64/94

Penalty tax – management accounts filed in lieu of audited accounts and then followed by return with audited accounts – penalty of 6% - whether excessive – section 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), William E Mocatta and Kenneth Ting Woo Shou.

Date of hearing: 29 July 1994.

Date of decision: 13 January 1995.

The taxpayer failed to file its tax return within the time stipulated but did file its management accounts together with a tax computation. About two weeks later the taxpayer filed its tax return together with its audited accounts. A penalty of 6% of the tax involved was imposed upon the taxpayer. The taxpayer appealed to the Board of Review and submitted that the penalty was excessive.

Held:

Bearing in mind that a 5% surcharge is made on taxpayers who are late in paying duly assessed tax, a penalty of 6% is not excessive where a taxpayer has filed its tax return outside of the specified extended period.

Appeal dismissed.

Cases referred to:

D2/90, IRBRD, vol 5, 77

D105/89, IRBRD, vol 6, 384

D53/88, IRBRD, vol 4, 10

Lai Chi Lai Ming for the Commissioner of Inland Revenue.

T O Yip of Messrs Leung, Kong, Yip & Tai for the taxpayer.

Decision:

1. THE SUBJECT MATTER OF THE APPEAL

The Taxpayer appealed against an assessment to additional tax imposed under section 82A of the Inland Revenue Ordinance ('the IRO') as a result of its failure to file a

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profits tax return for the year of assessment 1992/93 ('the relevant year') within the prescribed period.

2. THE FACTS

The facts, which were not in dispute, were:

- 2.1 The Taxpayer was incorporated in Hong Kong in December 1976 and at all material times was principally engaged as a wholesaler and retailer.
- 2.2 At all material times the Taxpayer prepared its annual accounts to 31 March. These accounts were prepared by a firm of certified public accountants, identified, and which firm was also its tax representatives.
- 2.3 On 1 April 1993 a profits tax return, form BIR 51, ('the return') for the relevant year was issued to the Taxpayer for completion under section 51(1) of the IRO. By operation of the 'block extension' the last date for lodgement of the return by or on behalf of the Taxpayer was 15 November 1993.
- 2.4 By a letter dated 15 November 1993 the Taxpayer notified the Commissioner that its then tax representatives, the firm referred to in sub-paragraph 2.2 above, would not be filing the return before the expiration of the 'block extension' and enclosed a copy of the Taxpayer's management accounts for its year ended 31 March 1993 together with a tax computation for the relevant year.
- 2.5 On 26 November 1993 a notice containing an estimated assessment was issued to the Taxpayer under section 59(3) of the IRO showing assessable profits \$1,620,000.
- 2.6 On 3 December 1993 a notice of objection was lodged against that estimated assessment.
- 2.7 The return, disclosing assessable profits of \$4,367,758, together with the audited accounts was lodged on 6 December 1993.
- 2.8 The estimated assessment was revised pursuant to section 64(3) of the IRO and a revised assessment was issued on 19 January 1994 showing revised assessable profits increased to \$4,367,758.
- 2.9 On 7 February 1994 the Commissioner issued a notice under section 82A(4) of the IRO in which the Taxpayer was notified that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the relevant year.
- 2.10 On 22 February 1994 the Taxpayer, through new tax representatives, made representations to the Commissioner pursuant to section 82A(4)(a) of the IRO.
- 2.11 On 25 April 1994 the Commissioner, having considered and taken into account the representations made on behalf of the Taxpayer issued a notice of

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assessment for additional tax in respect of the relevant year in the sum of \$50,000.

3. THE CASE FOR THE TAXPAYER

The Taxpayer was represented at the hearing by the new tax representatives. No evidence was adduced and the submission on behalf of the Taxpayer was to the following effect:

- 3.1 The return was submitted together with the management accounts on the last day of the 'block extension', namely 15 November 1993.
- 3.2 The Taxpayer had been pressing its then auditors to complete the audit but they were unable to do so.
- 3.3 The Taxpayer did its best to comply by submitting what information it was able to submit. Before it did so the management accounts were checked with the then auditors and were advised there was no substantial difference between the management accounts and the 'audited accounts' in their then state. As it transpired the only difference was accounted for by the then auditors' remuneration.
- 3.4 The failure was without the control of the Taxpayer.
- 3.5 On receipt of the estimated assessment an objection was lodged in which the Taxpayer stated that the estimated assessment understated the taxable profits. On the next day the audited accounts and the return were lodged.
- 3.6 The Commissioner has no reasonable excuse for assessing the Taxpayer to a penalty.

4. THE CASE FOR THE REVENUE

The case for the Revenue may be summarised as follows:

- 4.1 The appeal was against a penalty assessment imposed under section 82A of the IRO on the grounds that it is not liable to penalty. It was the submission of the Revenue that the Taxpayer had, without reasonable excuse, failed to file the return for the relevant year within the specified time limit and was therefore liable to a penalty under section 82A. By failing to file the return within the specified time limit, the Taxpayer caused an undercharge of tax in the sum of \$764,357, that is, 17.5% on its declared assessable profit of \$4,367,758. Under section 82A of the IRO, the Taxpayer was liable to additional tax not exceeding 300% of the tax undercharged. It has, however, only been assessed to additional tax of \$50,000 which is some 6.5% of the tax undercharged or 2.2% of the maximum additional tax permitted by the IRO.

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4.2 The Taxpayer had commenced business on 1 April 1977 and carried on the business of wholesaling and retailing. The Revenue issued a profits tax return for the relevant year on 1 April 1993. The return was subsequently received by the Revenue on 6 December 1993 which was after the expiration of the 'block extension' namely 15 November 1993.

4.3 In making the assessment to additional tax the Commissioner had personally examined the case and taken into account the representations made by the Taxpayer and other factors including the time of filing of the return and the gravity of the tax undercharged. In the absence of a reasonable excuse for the failure to file the return for the year of assessment 1992/93 within the specified time limit the Taxpayer was liable to additional tax under section 82A of the IRO and that the additional tax assessed was not excessive.

4.4 As to the specific grounds of appeal:

4.4.1 Ground 1

That the Taxpayer had no wilful intention to cause the return to be lodged beyond the filing deadline and that the late submission was wholly due to the unexpected slow progress of the Taxpayer's former auditors in finalizing the audited financial statements for the year ended 31 March 1993.

4.4.1.1 This was an acknowledgment by the Taxpayer that the return was submitted after the stipulated time. It was not the Revenue's case that the late filing was a deliberate act to evade or postpone the payment of tax. The Commissioner was of the opinion that the Taxpayer, without reasonable excuse, had failed to file the return in time and, accordingly, was liable to additional tax under section 82A.

4.4.1.2 The delay in filing the return cannot be excused by the slow progress and late finalization of the audited accounts by the then auditors. The Taxpayer, as principal, must be held responsible for acts done by its agent. Even if the unexpected slow progress and the faults and problems of the then auditors were the causes of the late filing, none of these excuses in itself constitutes a reasonable excuse. They are not grounds for arguing that the Taxpayer is not liable to a penalty. It was the duty of the Taxpayer to ensure that the return was lodged within the time limit specified in the IRO. The Board was referred to case D2/90, IRBRD, vol 5, 77 at page 81:

'However, in dismissing the appeal, we have some concern because of the frank and open manner in which the partner of the certified public accountants representing the Taxpayer addressed the Board. As stated, we have considerable sympathy for him and his firm. However, it has been held in many previous Board of Review cases that the penalties are imposed upon the Taxpayer and not upon the agents of the Taxpayer. It is totally inappropriate for us to take into account that the certified public accountants have acknowledged their liability because the IRO

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imposes the obligation on the Taxpayer and the Taxpayer alone. Furthermore, even if one takes into account the problems of the tax representative, it has been held in many previous cases that an approximate penalty in such cases as the present would be in the order of 10% to 20% of the amount of the tax included. In this case, the Commissioner had already been lenient by imposing penalties of only approximately 10% of the tax involved.'

4.4.2 Ground 2:

That the Taxpayer had tried its very best to keep the Revenue informed on the actual assessable profits at the earliest instant. Having known that the return could not be submitted before the deadline, the Taxpayer had submitted management accounts and tax computation to the Revenue on 15 November 1993. After the issue of estimated assessment on 26 November 1993 the Taxpayer informed the Revenue in its letter dated 7 December 1993 that the actual profit was greater than the estimated profit.

The Taxpayer's subsequent acts to remedy the situation do not constitute a reasonable excuse for the late filing. They are merely mitigating factors. All these relevant facts had been noted and taken into consideration by the Commissioner in determining the quantum of the penalty. The Commissioner, by imposing a minimal penalty of 6.5% of the tax undercharged, has been lenient enough. The Commissioner must not be tempted to condone tardiness otherwise the floodgates will be opened. If the Commissioner were to condone the lodgement of management accounts in substitution for a duly completed and timely filed return, the Revenue would be piercing holes in its block extension scheme and disrupting its assessment programme. This was simply unacceptable.

4.5 The representative commented that the Taxpayer's submission that the Commissioner had no reasonable excuse to impose the penalty was not what section 82A required.

4.6 The submission concluded with a statement that there had been no reasonable excuse for the Taxpayer to submit the return late and it was liable to additional tax and that the amount of the additional tax was not excessive having regard to the circumstances. The Board was requested to dismiss the appeal.

5. **REPLY OF THE TAXPAYER**

The representative accepted that the return was filed some three weeks late but stated that the attempts of the Taxpayer to co-operate and ensure that a correct assessment was made ought to be considered. A penalty of \$50,000 did not appear to afford any recognition to what the Taxpayer had done.

6. **REASONS FOR THE DECISION**

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- 6.1 Sections 82A, 82B and 68(4) of the IRO.
- 6.1.1 In synopsis, pursuant to section 82A of the IRO any person, which includes a corporation, who, without reasonable excuse, fails to comply with a section 51(1) notice and who is not prosecuted is liable to be assessed to additional tax in an amount not exceeding three times the tax which has been undercharged in consequence of such failure, refer sub-sections (1)(d) and (e)(ii).
- 6.1.2 Under section 82B any person who is assessed to additional tax under section 82A may submit to the Board that the quantum of the additional tax '*is excessive having regard to the circumstances*', refer sub-section 82B(2)(c).
- 6.1.3 Section 68(4) of the IRO places the onus of proof in all appeals on the taxpayer.
- 6.2 It is now well established that the correct interpretation of the IRO with respect to the failure to comply with the section 51(1) notice is that such failure occurs on the stroke of midnight on the last day for compliance, in this appeal 15 November 1993, and that the tax which the person is liable to pay, notwithstanding the Revenue has no means to know the amount of tax due from that person when the failure occurred, is undercharged as of that moment in time, refer D105/89, IRBRD, vol 6, 384.
- 6.3 The Board accepts that it is the responsibility of each taxpayer to comply with the requirements of the IRO and that that responsibility is not excused if a taxpayer elects to place his tax affairs in the hands of a tax representative. Accordingly, the action or lack of action on the part of a taxpayer's tax representative is irrelevant to the disposal of appeals of this nature, refer D2/90, IRBRD, vol 5, 77.
- 6.4 It is an agreed fact that the Taxpayer failed to comply with the section 51(1) notice for the relevant year and the only questions for the Board to consider are:
- 6.4.1 Whether the explanation tendered to the Board, namely the inability of the then auditors to finalise the audit and the lodgement of management accounts and a tax computation based on those accounts, constitutes a reasonable excuse?
- 6.4.2 Whether, in the circumstances, the penalty assessed was excessive?
- 6.5 The excuse:
- As stated in sub-paragraph 6.3 above, the default of the then auditors is not an excuse; the Taxpayer is liable for the consequences of the auditor's defaults. The lodgement of management accounts and a tax computation based on those accounts is not compliance with a section 51(1) notice. Accordingly, the Taxpayer has failed to establish that there was a reasonable excuse for its default.
- 6.6 Whether or not the assessed penalty was, in the circumstances, excessive?

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6.6.1 The tax undercharged immediately following the expiration of the 'block extension' applicable to the Taxpayer was clarified upon the filing of the return and this amounted to \$764,357. Accordingly, the Taxpayer was at risk of a penalty amounting to three times that sum. The penalty assessed, \$50,000, amounts to some 6% of the tax undercharged or some 2% of the maximum penalty which could have been imposed.

6.6.2 D53/88, IRBRD, vol 4, 10 is authority for the following:

The general rule established in other appeals against additional assessments 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 Revenue 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.

6.6.3 In the present appeal, a substantially less penalty is appropriate because, first, the default related to one year only and, secondly, the fact that the return was accepted by the Revenue without requiring an investigation was also in the Taxpayer's favour.

6.6.4 The Board is unable to conclude that the quantum of the penalty is excessive. A penalty of 6% of the tax underpaid (or 2% of the maximum permitted) is not unreasonable given the shortness of the delay. This is particularly so in view of the fact that a surcharge of 5% is routinely imposed on taxpayers who fail to make payment on the tax due on the due date, even if the delay is one day only, and in cases where the unpaid assessment was made without there having been any default on the taxpayer's part.

6.6.5 Additionally, the Board considers that it would be wrong for it to interfere with the quantum of the additional tax assessed as this could be taken as an indication that the Board is prepared to countenance actions such as those of the Taxpayer as a quasi compliance with the section 51(1) notice when, in fact, such actions are no such thing. The Board considers it important that the time limit permitted to those who benefit from the 'block extension' is strictly enforced.

7. **Decision**

For those reasons given, the Taxpayer has failed to satisfy the Board that it had a reasonable excuse for failing to comply with the section 51(1) notice or that

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the penalty assessed was, in the circumstances, excessive. Accordingly, this appeal fails and is dismissed.