Case No. D65/90

Penalty tax – shortage of staff and difficulty in recruiting staff – reasonable excuse – quantum of penalty – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Eleanor Wong and Yu Yui Chiu.

Date of hearing: 27 September 1990.
Date of decision: 4 February 1991.

The taxpayer was a limited company which failed to file its tax return in time. An estimated assessment was issued following which the taxpayer filed its tax return disclosing profits in excess of the estimated assessment. The Commissioner imposed a penalty of $30,000 upon the taxpayer for being late in filing its tax return. The taxpayer appealed and argued that it had a reasonable excuse or alternatively that the penalty was excessive because the taxpayer had difficulty in recruiting staff.

Held:

This was a borderline case and taking into account all of the facts the penalty should be reduced from $30,000 to $ 20,000.

Appeal allowed in part.

Chan Kam Tat for the Commissioner of Inland Revenue.
Tony Ng Kwok Tung of Tony Kwok Tung Ng & Co for the taxpayer.

Decision:

This is an appeal by a limited company against an additional assessment to tax imposed upon it under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer was incorporated in 1971 and commenced business in 1972.

2. The Taxpayer closes its accounts on 31 March each year.

3. On 3 April 1989 a profits tax return for the year of assessment 1988/89 was issued to the Taxpayer. The extended expiry date for the submission of the return was 31 October 1989.

4. In the absence of the profits tax returns, an estimated assessment was issued to the Taxpayer on 22 December 1989 in the sum of $800,000. No objection was lodged against the estimated assessment.

5. On 15 February 1990 an additional assessment for 1988/89 was issued to the Taxpayer in the sum of $1,000,000. By letter dated 21 February 1990 the tax representative for the Taxpayer lodged an objection against this additional assessment and in support of the objection filed a properly completed profits tax return for 1988/89 showing assessable profits of $1,567,520. The return was undated but the auditor's report on the financial statements in support was dated 23 January 1990.

6. The objection was settled on 22 March 1990 with a revised additional assessment for the year 1988/89 issued on 28 March 1990 showing the revised additional assessable profits of $777,720.

7. On 6 April 1990 the Commissioner gave notice to the Taxpayer that he proposed to assess additional tax by way of penalty under section 82A of the Inland Revenue Ordinance in respect of the Taxpayer's failure to file the profits tax return for the year 1988/89 by the due date.

8. On 1 May 1990 the tax representative for the Taxpayer submitted representations to the Commissioner. On 23 May 1990 the Commissioner after having considered and taken into account the representations issued notice of assessment for additional tax under section 82A in the amount $30,000.

9. On 22 June 1990 the tax representative of the Taxpayer gave notice to appeal to the Board of Review.

At the hearing of the appeal the tax representative appeared on behalf of the Taxpayer. The representative submitted that the Taxpayer had a reasonable excuse for the delay in the submission of the return and was not liable to any additional tax. Alternatively the representative said that the amount of the additional tax was excessive in the circumstances.

The representative submitted that the accountant for the Taxpayer had left the Taxpayer since the end of May 1988 and the replacement did not start work until 6 October 1988 during which period the records and accounting books of the Taxpayer fell behind. The representative went on to say that the principal staff who took part in the management and control of the day to day operation of the Taxpayer was away during January and February 1990 and as a result there was a delay in his firm obtaining certain information and

documents for the completion of the audit. Finally he said because of shortage of accounting staff in Hong Kong and the high turnover of staff, it took longer to complete the accounts than was expected.

Having submitted that the foregoing constituted a reasonable excuse within the terms of the Inland Revenue Ordinance the representative went on to submit that even if this was not a reasonable excuse the tax imposed was excessive in the circumstances. He pointed out that an estimated assessment had been issued at the same time as a tax assessment would have been issued in the ordinary course of events if a taxpayer duly filed its tax return on time. He said that this should be taken into account and that if the amounts of the estimated assessments were taken into account the amount of the additional tax would be nil. He said in fact the tax payable under the two estimated assessments exceeded the total tax ultimately payable.

He went on to submit that from his experience it had been the practice of the Inland Revenue Department in the past to impose a small administrative penalty upon taxpayers who were late in filing their returns and that if it was the intention of the Commissioner to impose substantial penalties he should first issue a warning. He drew to our attention a circular letter from the Hong Kong Society of Accountants which referred to the practical problems in Hong Kong in filing tax returns on time and saying that the Commissioner would grant extensions of time to enable taxpayers to validate objections where estimated assessments had been issued in default of the filing of tax returns.

The representative for the Commissioner pointed out that the Taxpayer had been granted a period of almost seven months from 31 March 1989 within which to complete its audited accounts and file its tax return. He said that there was sufficient time for the Taxpayer to comply with its obligations under the Ordinance. He pointed out that according to the Taxpayer's submission the accounting records had only been sent to its auditors for audit at the end of the period of seven months and that the Taxpayer was responsible for this. He pointed out that the excuse given with regard to the staff who left the employment of the Taxpayer during 1988 is irrelevant because the tax return in question was issued to the Taxpayer many months after the replacement accountant had taken up his duty.

He pointed out that the amount of penalty imposed by the Commissioner is only approximately 11% of the amount of tax which would have been undercharged and is less than 4% of the maximum penalty.

With regard to the submission made by the representative for the Taxpayer that a warning should have been given, the representative for the Commissioner pointed out that there had been a number of published Board of Review decisions relating to cases where taxpayers had been late in filing returns and section 82A penalties had been imposed. He also drew our attention to a circular letter from the Commissioner of Inland Revenue dated 24 February 1989 granting block extensions of time for filing tax returns. This circular letter stated that further extensions of time would only be granted in very exceptional

circumstances and drew attention to the provisions of section 82A and quoted a number of Board of Review decisions relating to section 82A penalties being imposed for late filing of returns.

In reaching its decision in this case the Board of Review has given careful thought to all of the facts and submissions made before it. It is not an easy case because there are both good and bad points so far as the Taxpayer is concerned. It is a fact of life in Hong Kong that in recent years there have been many changes of staff in all organisations. However notwithstanding the problems and difficulties most taxpayers are able to fulfil their obligations under the Inland Revenue Ordinance. No doubt there may be exceptional circumstances which affect a taxpayer in fulfilling its obligation under the Ordinance. However the mere fact that it is difficult to recruit staff and that staff change frequently is not in itself an excuse for failing to file a tax return on time and is only of marginal value when considering the quantum. It must be assumed that all taxpayers use their best endeavours to comply with their obligations under the Inland Revenue Ordinance and that they take the necessary steps to ensure that they have adequate staff and resources even in difficult times. Indeed if a taxpayer were not to take all reasonable steps to ensure that they have adequate staff, this would be in itself a ground for a substantially higher penalty.

Likewise the submission by the tax representative relating to the previous imposition of small 'administrative' penalties is of doubtful assistance. On the one hand the Inland Revenue Department should act in a consistent manner and that applies to the Commissioner and his Deputy when deciding whether or not to impose section 82A penalties. On the other hand it is a somewhat specious argument to say that because I have been fortunate in only receiving a minor penalty in previous cases therefore I do not need to use my best efforts to ensure that the obligations imposed upon taxpayers by the Inland Revenue Ordinance are fulfilled. Such an attitude might justify a higher penalty rather than a lower penalty. However, in this case it is hardly material because the tax representative clearly had due notice from the Commissioner that substantial penalties might be imposed in such cases when he received the circular letter dated 24 February 1989 from the Commissioner. Furthermore the circular letter from the Hong Kong Society of Accountants to the tax representative had indicated that where tax returns were not filed in time a substantial penalty might be imposed. The circular letter from the Hong Kong Society of Accountants related not to the due filing of tax returns themselves but a concession granted by the Commissioner where tax returns had not been duly filed and estimated assessments had been raised. In such circumstances the Commissioner would allow a delay in filing audited accounts to validate objections to the estimated assessments and clearly referred to administrative penalties being imposed only in those cases where previous tax returns had been promptly and correctly filed and the full tax return was received not later than 31 December 1989. The tax representative can hardly be heard to complain that an administrative penalty was not imposed but the section 82A provisions were invoked in a case where he failed to file the tax return by 31 December 1989 being the deadline which his own professional society had warned would apply and in fact filed the audited accounts and the tax return on 21 February 1990.

However notwithstanding the foregoing we feel on all of the facts and submissions before us that the Commissioner has been a little heavy handed in the penalty which he has imposed. In our opinion on all of the facts and taking into account all of the submissions we feel that an appropriate penalty would be $20,000 and not the $30,000 imposed by the Commissioner. Thus we find that the penalty imposed is excessive. It is difficult for a Board of Review to set out all of the facts and considerations which they have in mind when reaching a decision and we would not wish this case to be considered to be a precedent for other cases having what might appear to be similar facts. Each case must be decided on its own merits by the members of the individual Board who hear it.

In all of the circumstances the Board orders that the section 82A penalty tax assessment appealed against be reduced from the sum of $30,000 to the sum of $20,000.