

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D96/00**

**Penalty tax** – late filing of tax return – reasonable excuse – mitigating factor – section 82A of the Inland Revenue Ordinance (‘IRO’).

Panel: Ronny Wong Fook Hum SC (chairman), Kenneth Leung Kai Cheong and Anthony So Chun Kung.

Date of hearing: 21 July 2000.

Date of decision: 21 November 2000.

The taxpayer, a company incorporated in Hong Kong, carried on a ‘foundation contracting’ business. The taxpayer did not submit its return for the year of assessment 1997/98 until 11 September 1998 and there was a delay of one month and eleven days from the extended date for the taxpayer to submit its return. The taxpayer had a poor record in the submission of its returns.

The Commissioner informed the taxpayer that tax in the sum of \$303,328 had been undercharged. After considering representations of the taxpayer, the Commissioner imposed additional tax on the taxpayer in the sum of \$20,000.

The taxpayer contended, inter alia, that

1. when the auditor commenced the audit, they found that the date provided by the accounting system of the taxpayer was unable to satisfy the disclosure requirements of SSAP 2.123 relating to construction contracts and data had to be re-input;
2. the quality of information disclosed in the audited accounts in connection with the construction contracts were greatly improved and it could certainly assist the working of the Inland Revenue Department;
3. the taxpayer had incurred loss in the year of assessment 1998/99 and was under financial difficulty.

**Held:**

1. No evidence was placed before the Board to show that the time required for fresh input of data exceeded the time reserved for the audit of its account constituted a

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reasonable excuse. Given the taxpayer's past record, one would expect greater urgency in the preparation of its accounts for the year of assessment 1997/98. There was no indication of any advanced planning.

2. The Board placed no weight on the current financial position of the taxpayer.
3. It is the primary obligation of every taxpayer to ensure that an accurate return be submitted within the allotted time. The Board did not consider a breach of the duty could be mitigated by the fact that the delay arose out of a belated attempt to update its affairs.

### **Appeal dismissed.**

Chan Chor Ming for the Commissioner of Inland Revenue.

Shea Chi Ngai, Alan of Messrs Berfield (Executive) Consultants Limited for the taxpayer.

### **Decision:**

### **Background**

1. The Taxpayer is a company incorporated in Hong Kong on 10 February 1987. It carried and still carries on a 'foundation contracting' business.
2. The Taxpayer has a poor record in the submission of its returns.

<b>Year of assessment</b>	<b>Date when return issued</b>	<b>Extended date for submission</b>	<b>Actual date of submission</b>	<b>Delay</b>	<b>Tax undercharged \$</b>
1994/95	3-4-1995	31-7-1995	17-11-1995	3 months and 17 days	275,674
1996/97	1-4-1997	31-7-1997	16-8-1997	16 days	12,416

By notice dated 22 September 1997, the Commissioner imposed a penalty of \$3,000 on the Taxpayer in respect of its delay in submitting its return for the year of assessment 1996/97.

3. We are concerned with the return of the Taxpayer for the year of assessment 1997/98. 31 July 1998 was the extended date for the Taxpayer to submit this return. The Taxpayer failed to do so. The Taxpayer did not submit its return for the year of assessment 1997/98 until 11 September 1998. There was a delay of one month and eleven days.

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4. By a notice of assessment dated 13 August 1998, the Taxpayer was assessed on the basis of \$130,000 being its assessable profits for the year of assessment 1997/98. After receipt of its return on 11 September 1998, the Revenue revised the Taxpayer's assessment by notice dated 12 July 1999.

5. By notice dated 22 November 1999, the Commissioner informed the Taxpayer that she was of the view that the Taxpayer had, without reasonable excuse, failed to furnish its return for the year of assessment 1997/98 within the time allowed and, in consequence thereof, tax in the sum of \$303,328 had been undercharged. The Taxpayer was invited to submit representations as to why the Commissioner should not impose additional tax under section 82A of the IRO (Chapter 112).

6. By letter dated 17 December 1999, the Taxpayer's Representative Berfield (Executive) Consultants Limited [ ' Berfield ' ] explained that the delay ' was because that when the auditors of our client commenced the audit, they found that the data provided by accounting system of our client was unable to satisfy the disclosure requirements of SSAP 2.123 relating to construction contracts. In order to rectify this, our client had to re-input that data in connection with costing of construction contracts.' SSAP 2.123 was published by the Hong Kong Society of Accountants in May 1998. Its principal objective is to ensure fair spread of the income and expenditure of a construction contract over the full duration of the construction which might straddle over different accounting periods. Clause 45 of SSAP 2.123 provides that the standards set out therein should be regarded as the relevant benchmarks for accounts prepared after 1 January 1998. Business enterprises should adopt these standards as soon as possible but there is no mandatory requirement for compliance.

7. After considering these representations of the Taxpayer, the Commissioner by notice dated 18 January 2000 imposed additional tax on the Taxpayer in the sum of \$20,000. This is the Taxpayer's appeal against that assessment.

### **The hearing before us**

8. Mr Alan Shea and Miss Amy Chan of Berfield appeared for the Taxpayer. They explained that the Taxpayer's auditor commenced auditing its account for the year of assessment 1997/98 on 7 July 1998. Given the fact that they had about a month before the scheduled date for submission of the return, the auditor reckoned they had sufficient time to complete the audit. The auditor however discovered that four heads of information were missing and those heads of information were essential for compliance with SSAP 2.123. The four heads of information were:

- (a) Progress billings;
- (b) Contract costs for individual jobs;

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- (c) Retention money; and
- (d) The percentage completion of each job.

They admitted that the auditors of the Taxpayer made various qualifications in relation to the final accounts of the Taxpayer for the year ended 31 December 1997. One such qualification relates to non-compliance with SSAP 2.123. They submitted that the work carried out this year was essential for full compliance in subsequent years.

Berfield further submitted on behalf of the Taxpayer that they had over-paid profits tax in the sum of \$40,623. They asserted that the Revenue had erroneously included \$253,894 being retention money receivable in computing the assessable profits for the year of assessment 1997/98.

It was also urged upon us that the Taxpayer 'had incurred loss in 1998/99 and is now under financial difficulty'.

9. Miss A gave evidence before us. She was the in-house accountant of the Taxpayer in the relevant year. She told us that the Taxpayer had about seven jobs in 1997/98. She gave instructions to the Taxpayer's auditor in May 1998. She became aware of the requirements of SSAP 2.123 in the course of the audit for 1997/98. Her principal difficulty was in calculating the amount of retention money. Her problems were compounded by the change of the Taxpayer's computer system.

### **Our decision**

10. In essence, the Taxpayer's case is that the delay arose as a result of their anticipated compliance with SSAP 2.123. The time required for fresh input of data exceeded the time reserved for the audit of its account. In order for this to constitute a reasonable excuse, the Taxpayer has to adduce evidence before us to demonstrate that, given its size and its business, it was reasonable for audit to commence on 7 July 1998 with a 31 July 1998 deadline. No such evidence was placed before us. Given its past record, one would expect greater urgency in the preparation of its accounts for 1997/98. There was no indication of any advanced planning. They started late and quickly ran out of time.

11. Our attention has been drawn to the additional tax imposed in the following cases:

<b>Case no</b>	<b>Period of delay</b>	<b>Tax undercharged \$</b>	<b>Additional tax \$</b>	<b>Relationship between additional tax and tax undercharged</b>
D100/97	38 days	183,161	18,000	9.83%

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D43/95	2 weeks	1,470,751	70,000	4.76%
D55/94	About 2 months	398,907	39,000	10%
The instant case	1 month and 11 days	303,238	20,000	6.60%

12. We place no weight on the current financial position of the Taxpayer. The revised assessment on the Taxpayer on 12 July 1999 was pursuant to agreement between the parties. We fail to see how the Taxpayer can maintain an overpayment of tax in these circumstances.

13. Berfield further submitted that ‘... the quality of information disclosed in the audited accounts in connection with the construction contracts were greatly improved and ... this can certainly assist the working of the Inland Revenue Department.’ We have considered whether this constitutes a good mitigating factor. We think not. It is the primary obligation of every taxpayer to ensure that an accurate return be submitted within the allotted time. SSAP 2.123 is merely a new benchmark to ensure accuracy. In order to discharge its primary duty, a taxpayer should make timely start to observe this new benchmark. We find it difficult to see how a breach of that duty could be mitigated by the fact that the delay arose out of a belated attempt to update its affairs.

14. For these reasons, we see no ground to interfere with the assessment. We dismiss the Taxpayer’s appeal.