

Tax

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Hong Kong Tax Analysis

Court of Final Appeal affirmed directors not liable to additional tax for signing incorrect returns

In a judgment¹ released on 5 August 2022, Hong Kong's Court of Final Appeal (CFA) ruled that directors were not liable to administrative penalty, described as additional tax, under Section 82A of the Inland Revenue Ordinance (IRO) for signing incorrect tax returns of a company.

Pursuant to Section 82A(1)(a) of the IRO, additional tax would be imposed on a person who makes an incorrect return by omitting or understating anything in respect of which he is required by the IRO to make a return, either on his behalf or on behalf of another person. In most cases, it is imposed on the taxpayer itself. However, in *Koo Ming Kown & Murakami Tadao v. The Commissioner of Inland Revenue [2022 HKCFA 18]*, the Inland Revenue Department (IRD) imposed the additional tax on the signers of the tax returns (i.e. the company's directors) after the company was wound up. The technical argument was whether Section 82A(1)(a) permitted the IRD to assess additional tax on the person (a secretary, manager, director or liquidator) who physically signed an incorrect tax return of a corporate taxpayer. The lower courts and the CFA consistently considered that the tax returns were required to be made by the corporate taxpayer, not the person who signed the returns, and hence the directors could not be liable for additional tax under Section 82A(1)(a).

In this article, we highlight the facts of the case and analyse the reasoning behind the judgment.

Background

Mr. Koo and Mr. Murakami were directors of Nam Tai Trading Company Limited (the Company). They signed the tax returns of the Company for the years of assessment 1996/1997, 1997/98 and 1999/2000 in which the Company claimed deductions of management fees paid to its parent company. Upon a tax audit, the Commissioner of Inland Revenue (CIR) disallowed the deductions claims and issued additional assessments to the Company. On appeal, the Board of Review

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¹ *Koo Ming Kown & Murakami Tadao v. The Commissioner of Inland Revenue [2022 HKCFA 18]*

(BoR) upheld the assessments. The Company failed to pay the tax and was wound up. The CIR then assessed the directors, Mr. Koo and Mr. Murakami, who signed the Company's tax returns to additional tax under Section 82A of the IRO which amounted to HKD18 million in total, representing 105% of the Company's tax undercharged.

History of the dispute

The two directors appealed against the assessments to the BoR which dismissed their appeals and substituted a higher penalty than those imposed by the CIR.

Both directors appealed to the Court of First Instance (CFI) which ruled in favour of the directors. The CIR then appealed to the Court of Appeal (CA) and the CFA. Both courts ruled that Section 82A(1)(a) did not permit a penalty assessment to be made on the directors of the Company.

Decision of the CFA

The technical discussion of this case mainly concerned whether the directors were "required" to make the returns and hence fell within Section 82A(1)(a). In addition, whether the director who signed the return was "making" the return in his personal capacity on behalf of the taxpayer.

The CFA, as well as the CFI and CA, ruled in favour of the directors, concluding that the returns were not required to be made, and were not made, by the directors on behalf of the Company and thus the directors were not liable to additional tax under Section 82A(1)(a). The reasons for the judgement were as follows:

- A requirement to make a return results from a written notice (i.e. a blank profits tax return form with a requirement to make a return printed on that form) given by the CIR. In this case, the returns were addressed to the Company and no reference was made to the directors. Accordingly, it should be the Company (instead of the directors) which was required to make the returns.
- The CIR argued that pursuant to Section 57(1) of the IRO, directors should be answerable for doing the act required to be done by the Company and hence they were interpreted to be required to make the tax returns on behalf of the Company. The courts considered "answerable" means having a duty to ensure that the act in question was done by the Company. It is different to having an obligation or requirement to do the act on behalf of the Company. For example, the directors would not be liable if no return was made. As such, it remained the Company which was required to make the returns. The directors were not required to make the returns. The answerability requirement did not extend to personal liability for tax due by the Company, i.e. additional tax under Section 82A of the IRO in this case.
- The CFA further commented that the signing of the declaration by the directors was part of the process by which the Company acted to fulfil the requirement of making the returns. Despite the directors signed the declaration in the returns, they did not make the returns.

Our observation

This is probably the first Hong Kong court case to investigate the directors' liability for additional tax by reason of signing incorrect returns of a company. We welcome the CFA's decision which clarified that the person who signed an incorrect tax return was not personally liable to additional tax under Section 82A(1)(a) of the IRO. Nevertheless, an officer of a corporation could be liable for penalties arising out of the administration of the IRO under certain circumstances, e.g. providing false information wilfully with intent to assist a company to evade tax. Please also note that certain persons (e.g. precedent partner of a partnership, a trustee of an incapacitated person and a local agent of a non-resident person) are expressly required to make a return on behalf of other persons under the IRO and hence may have exposure to additional tax under Section 82A(1)(a) of the IRO for the incorrect tax returns furnished by them.

On the other hand, a new penal provision was introduced in 2021 against "service providers" for certain acts without reasonable excuse, including failure to furnish returns and furnishing incorrect tax returns. A service provider means a person engaged to carry out a taxpayer's obligation to furnish returns (i.e. the one signing the return). As such, a service provider signing on an incorrect tax return may have exposure to the new penalty provision which amounts to HKD10,000.

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