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HONG KONG COURT OF FINAL APPEAL CONFIRMS THAT DIRECTORS ARE NOT LIABLE FOR PENALTY TAX FOR SIGNING INCORRECT COMPANY TAX RETURN

To Our Clients and Friends:

The Court of Final Appeal (the “CFA”) has recently confirmed that a director is not liable to penalty, by way of additional tax, arising from an incorrect tax return filed by the company which he/she has signed and declared to be correct, on the basis that he/she should not be regarded having made the company’s incorrect tax return.[1]

The CFA’s judgment provides clarity on the meaning and effect of s 82A(1)(a) of the Inland Revenue Ordinance (Cap. 112) (the “IRO”), which empowers the Commissioner of Inland Revenue (the “Commissioner”) to impose additional tax, commonly referred to as penalty tax, on any person who without reasonable excuse “makes” an incorrect tax return.

It should, however, be noted that the relevant provision has also recently been amended to cover a person who “causes or allows to be made on the person’s behalf, an incorrect return”, and it remains to be seen how this amendment will affect a director’s liability in relation to any company’s incorrect returns signed and declared to be correct by him/her.

1. Background and Procedural History

The CFA judgment was on the appeal by the Commissioner against a decision of the Court of Appeal (“CA”) in October 2019, in which the CA dismissed the Commissioner’s appeal against a decision of the Court of First Instance (the “CFI”) made in November 2018. The CFI ruled in favour of Mr Koo Ming Kown (“Mr Koo”) and Mr Murakami Tadao (“Mr Murakami”), who appealed against two earlier decisions of the Board of Review (the “Board”) upholding certain penalty tax assessed against them.[2]

Mr Koo and Mr Murakami were directors of Nam Tai Electronic & Electrical Products Limited (the “Company”) at the material times when the Company’s returns for the years 1996/97, 1997/98 and 1999/2000 were filed. Mr Koo and Mr Murakami respectively signed and declared to be correct the first and third, and the second, of these returns. Mr Murakami and Mr Koo ceased to be directors of the Company in 2002 and 2006 respectively.

Following a tax audit in 2002, the Inland Revenue Department (the “IRD”) disallowed claims for deductions made in the returns, and assessed the Company to undercharged tax under s 60 of the IRO, which the Company challenged unsuccessfully. The Company did not pay the amounts assessed and was eventually wound up in June 2012 by the court on the petition of the Commissioner.

In 2013, Mr Koo and Mr Murakami were assessed to additional tax under s 82A(1)(a) of the IRO in the amount of HK\$12,600,000 and HK\$5,400,000 respectively, on the basis that the Company's returns were incorrect. They appealed to the Board, which found against them. The Board found the returns to have been incorrect and increased the overall amounts payable by Mr Koo and Mr Murakami.

Mr Koo and Mr Murakami appealed to the CFI, which accepted their primary argument that they did not fall within s 82A(1)(a) of the IRO. The CFI ordered the annulment of the additional tax assessments against Mr Koo and Mr Murakami. The Commissioner appealed to the CA, which upheld the CFI's decision that Mr Koo and Mr Murakami were not required by the IRO to make the returns on behalf of the Company, and therefore could not be made liable to additional tax under s 82A(1)(a).

The Commissioner appealed to the CFA but Mr Koo and Mr Murakami informed the CFA that they did not intend to oppose the Commissioner's appeal and would not attend the hearing in person or instruct lawyers to do so. The CFA appointed Mr Eugene Fung SC and Mr John Leung as amici curiae, who filed submissions addressing the questions before the CFA that supported the CA and CFI decisions.

2. The CFA's Decision

Whether Mr Koo and Mr Murakami should be liable for the Company's incorrect returns signed by them depends on whether they fall within the description, in the s 82A(1)(a) prevailing at the material times, of a "*person who without reasonable excuse – (a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person...*"[3]

The Commissioner contended that the individuals specified under s 57(1),[4] which included Mr Koo and Mr Murakami as directors of the Company, were "answerable" for doing all such acts as were required to be done by the Company under the IRO, and accordingly they were required to make the Company's returns; and further that, by physically signing and declaring to be correct the relevant Company's returns, they did make the Company's return on behalf of the Company as a corporate taxpayer. On the case for the Commissioner, the individuals identified under s 57(1) to be "answerable" (for doing all such acts as required to be done by a corporate taxpayer) are required (secondarily) to do such acts which the corporate taxpayer is (primarily) required to do under the IRO.

Upon examining the legislative history and context, the CFA disagreed with the Commissioner's construction of the relevant provisions in the IRO. The CFA confirmed the decisions of the CFI and the CA and concluded that the Company (being the entity to which the notice for making a return was issued under s 51(1)), rather than the individual who signed the return, was the "person" legally required to make, and did make, the return. There is a distinction between answerability under s 57(1), which means that the individuals specified under s 57(1) are responsible for seeing or ensuring the corporate taxpayer does the act in question, and an obligation or requirement to do such act on behalf of the company.

Accordingly, the CFA dismissed the Commissioner's appeal.

3. Conclusion

The CFA judgment helpfully clarifies that a director of a company (or any other relevant individual specified under s 57(1)) is not required to “make” the tax return of the company, and does not make such tax return by reason that he/she has signed, and declared his/her belief in the correctness of the information in, the returns filed by the company. Therefore, such director or individual specified under s 57(1) does not incur liability under s 82A(1)(a) of the IRO.

However, as from 11 June 2021, s 82A(1)(a) has been amended to provide that “[a]ny person who without reasonable excuse—(a) makes, **or causes or allows to be made on the person’s behalf**, an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person...” (emphasis added to show the amendments).^[5]

It remains to be seen whether, notwithstanding that a company’s director signing (or approving the filing of) the company’s tax return is not one who “makes” the tax return, he/she might be caught by the current s 82A(1)(a) as a person who has “caused” or “allowed” the tax return to be made on the company’s behalf, and hence may be exposed to liability should the company’s tax return be found to be incorrect.

[1] *Koo Ming Kown & Murakami Tadao v Commissioner of Inland Revenue* [2022] HKCFA 18. A copy of the judgment of the Court of Final Appeal is available [here](#). The judgment in the Court of Appeal ([2021] HKCA 1037) is available [here](#). The judgment in the Court of First Instance ([2018] HKCFI 2593) is available [here](#).

[2] Board of Review, Cases D32/16 (available [here](#)) and D33/16 (available [here](#)).

[3] The current s 82A(1)(a) provides that “[a]ny person who without reasonable excuse—(a) makes, **or causes or allows to be made on the person’s behalf**, an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person...” (emphasis added to show the amendments).

[4] The then-prevailing s 57(1) provided that “[t]he secretary, manager, any director or the liquidator of a corporation and the principal officer of a body of persons shall be answerable for doing all such acts, matters or things as are required to be done under the provisions of this Ordinance by such corporation or body of persons”; whilst the current s 57(1) provides that “[t]he following person is answerable for doing all the acts, matters or things that are required to be done under the provisions of this Ordinance by a corporation or body of persons—(b) for any other corporation [that is not an open-ended fund company], the secretary, manager, any director or the provisional liquidator or liquidator of the corporation...”

[5] See the Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021, Ord. No. 18 of 2021, Gazette published on 11 June 2021, No. 23 Vol. 25 – Legal Supplement No. 1, available [here](#).

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