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Court of Final Appeal rules that a director who signs a tax return for a corporation is an act "of the corporation" itself rather than "of an agent on behalf of the corporation". As such, the director concerned would not be personally liable for penalties under section 82A(1)(a) of the IRO in respect of a corporation filing an incorrect tax return without reasonable excuse¹.

Background facts

The Applicants, Mr. Koo, and Mr. Murakami, were directors of Nam Tai Trading Company Limited, formerly called Nam Tai Electronics & Electrical Products Limited (Nam Tai). In its profits tax returns for the years of assessment from 1996/97 to 1999/2000, Nam Tai claimed that it had incurred certain expenses, particularly management fees paid to its parent company incorporated in the British Virgin Islands and deducted them in arriving at the assessable profits. Profits tax assessments were made based on the returns filed and taxes demanded were paid.

After a tax audit in 2002, the Inland Revenue Department (IRD) decided to disallow the expenses and raised additional assessments accordingly. Nam Tai appealed to the Board of Review (the Board) against the additional assessments. The Board dismissed the appeal. However, Nam Tai did not pay the taxes demanded under the additional assessments, resulting in Nam Tai being eventually wound up by the court on the petition of the Commissioner of Inland Revenue (CIR) on 4 June 2012.

Apparently, frustrated by not being able to recover the taxes demanded under the additional assessments on Nam Tai through the winding-up process, the CIR levied administrative penalties on Mr. Koo and Mr. Murakami personally in the form of additional taxes under section 82A(1)(a) of the Inland Revenue Ordinance (IRO)².

The amounts of above penalties levied on Mr. Koo and Mr. Murakami of HK\$6.4 plus HK\$5.4 million and HK\$6.2 million respectively were close to the amount of taxes demanded under the additional assessments on Nam Tai (presumably in default) for the three years in question.

The penal additional taxes levied personally on the Applicants under section 82A(1)(a) of the IRO was made on the basis that the Applicants had filed incorrect tax returns "as agent on behalf of Nam Tai", by understating Nam Tai's assessable profits for the three years concerned.

The Applicants' appeal against the penal additional taxes levied on them personally under section 82A(1)(a) of the IRO to the Board backfired, the Board increasing the amounts payable by Mr. Koo and Mr. Murakami to HK\$21.8 million and HK\$6.7 million respectively.

Nonetheless, the Applicants successfully appealed to the Court of First Instance (CFI) against the decision of the Board on the penal additional taxes levied on them personally under section 82A(1)(a) of the IRO. The CFI's judgement was upheld by the Court of Appeal. The CIR then appealed to the Court of Final Appeal (CFA).

1. CIR v Koo Ming Kown and Murakami Tadao [FACV 1/2022]

2. The profits tax return for the year of assessment 1998/99 was signed by another director of Nam Tai who was not assessed to additional tax.

The provision of section 82A(1)(a) for the imposition of penal additional taxes

Section 82A falls under Part 14 of the IRO, which deals with penalties and offences for non-compliance with the IRO, including the making of incorrect returns. At the material time, section 82A(1)(a) of the IRO provided that:

"any person who without reasonable excuse 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 ... shall... be liable to be assessed under this section to additional tax of an amount not exceeding treble the undercharged amount." (Our emphasis)

As such, the question of law before the CFA was whether the Applicants, as directors of Nam Tai, were "required" by any provisions under the IRO to "make" the tax returns on behalf of Nam Tai. If they were not so required by the IRO, they would not be liable to the penal additional taxes levied on them personally under section 82A(1)(a) of the IRO.

Decision of the CFA

The CFA unanimously dismissed the CIR's appeal and upheld the judgment of the lower courts that the Applicants were not "required" to "make" or furnish the profits tax returns on behalf of Nam Tai, and so could not be made liable to the penal additional taxes imposed under section 82A(1)(a) of the IRO.

The CFA considered the following issues in arriving at its decision:

01 Whether the Applicants, as directors of Nam Tai, were "required" by any provisions of the IRO to make the returns on behalf of Nam Tai

The statutory obligations to make a return was contained in section 51(1) of the IRO, which at the relevant time, provided that a person was required to make a tax return in accordance with an assessor's written notice. Failure to comply with the requirement under the IRO to make a tax return without reasonable excuse would face penal actions under Part 14 of the IRO.

In the present appeal, in each of the relevant notices, the requirement was addressed to the corporation, Nam Tai, and made no reference to Mr. Koo, or Mr. Murakami. As such, the CFA considered that on the proper construction of section 51(1) of the IRO, the Applicants were not "required" to "make" the returns, their signing the returns was an act "of the corporation" itself.

In other words, making or furnishing a return is a legal act capable of being said to have been done directly by a company albeit through physical steps undertaken by human beings.

The CFA added that it does not follow from the fact that one director signed a declaration that the information in the return was true that such director made the return.

02 Whether being "answerable" for doing all acts required to be done by a corporation under the IRO made the directors sign the returns as agent on behalf of Nam Tai

While accepting that Nam Tai was the person primarily required to make the return, Counsel for the CIR contended that the Applicants, as its directors and had physically signed the returns on behalf of Nam Tai, were liable secondarily.

In support of his contention, Counsel relied on section 57(1) of the IRO, which at the relevant time, 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". (Our emphasis)

The CFA however considered that section 57(1) does not, in terms, impose a legal obligation on the officers whom it identifies, either collectively or individually, primarily, or secondarily, to do anything. Section 57(1) only makes them "answerable" for doing acts required to be done by a corporation to facilitate the exercise by the revenue authorities of their functions in relation to a corporation and confers authority on certain individuals to bind the corporation for the purposes of the IRO.

The CFA then concluded that section 57(1) does not have the consequences contended for by Counsel.

03 Whether the directors signed the returns as agent on behalf of Nam Tai by virtue of section 51(5)

Section 51(5) of the IRO, relied on by Counsel as supporting his contention, has the effect that, if a return is made by one person on behalf of another, then the former is deemed to have authority to make the return. It also facilitates proof that someone who signs a return knows what it is.

The CFA however considered that section 51(5) did not assist Counsel's contention as the terms of section 51(5) does not actually address the issue of whether the directors were "required" to "make" the returns as agent on behalf of Nam Tai.

The judgement of the lower courts nonetheless indicates that section 51(5) would have relevance to certain other situations, e.g., where a Hong Kong payer of royalties to a non-resident is required under the IRO to file a tax return on behalf of the non-resident; or a precedent partner is required under the IRO to make a tax return on behalf of the partnership.

Commentary

It seems to be the IRD's long established practice and also the understanding of practitioners that penal additional taxes under section 82A(1)(a) for a corporation filing an incorrect tax return without reasonable excuse would only be levied on the corporation itself but not the officer who signed the declaration on such a return.

This case may be special given that the IRD apparently cannot recover the taxes demanded under the additional assessments on Nam Tai through the winding-up process.

Transfer of business

It is however unclear whether there was any transfer of the former business of Nam Tai before it was wound up by the court on the petition of the CIR.

Taxpayers should note that, under the Transfer of Businesses (Protection of Creditors) Ordinance, where there is a transfer of business, the transferor and the transferee must publish a Notice of Transfer of Business in the Government Gazette not more than four months and not less than one month before the transfer takes effect. The Notice shall become complete upon the expiration of one month after its publication.

However, if no such publication is made for the transfer of business, the transferee will potentially be liable for all the debts and obligations including liability for tax charged or chargeable under the IRO arising out of the carrying on of the business by the transferor.

Legislative intent for the scope of section 82A(1)(a)

It is interesting to note that in arriving at its decision, the CFA rejected Counsel's argument that, given the purpose of the IRO is to raise revenue, the legislature intended to cast the net of liability of section 82A(1)(a) of the IRO as wide as possible.

In this regard, the CFA noted that section 82A(1)(a) does not impose liability on those directors who did not sign the return even if they voted in favor of a resolution to adopt the accounts reflected in the return.

As such, if the intention of the legislature was to cast the net of liability of section 82A(1)(a) as wide as possible as contended for by Counsel, it would be difficult to explain why the legislature would only fasten upon the element of physicality of signing a tax return stressed by Counsel.

Furthermore, as between people referred to in section 57(1), the identity of the individual who signs a corporation return may only be a matter of happenstance.

Taxpayers should however note that there are other provisions in the IRO which would hold company officers personally liable for company's offences, e.g., sections 80(4) and 82 of the IRO impose liability on those who aid, abet, or incite a company to commit certain offences including assisting a company to evade tax with wilful intent.

Company officers could also be liable under section 101E of the Criminal Procedure Ordinance for an offence under any Ordinance committed by a company if it is proved that the offence was committed with the consent or connivance of the officers concerned.

Filing a tax return for a company is a responsible act requiring due diligence and care. Clients who need any assistance should contact their tax executives.

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