

Hong Kong Tax Alert

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The Highest Court clarified company directors are not liable for additional taxes under section 82A for incorrect profits tax returns filed

Summary



The Court of Final Appeal (CFA) recently held in a case that a corporation, instead of its directors, is required to furnish a profits tax return issued to it under the Inland Revenue Ordinance (IRO). Accordingly, the directors of a company are not liable for the additional taxes assessed under section 82A of the IRO for the incorrect tax returns filed by the company.

In this tax alert, we summarise the CFA's judgement and discuss our observations from the case.

The CFA handed down its judgement in *Commissioner of Inland Revenue v Koo Ming Kown and Another*¹ on 5 August 2022. The CFA unanimously dismissed the Commissioner of Inland Revenue (CIR)'s appeal and upheld the lower courts' judgements that when a company's return filed with the Inland Revenue Department (IRD) is found to be incorrect, the company directors who signed on the return filed are not liable for the administrative penalties charged by the IRD for the incorrect return filed.

Background

The case concerned whether the two directors of Nam Tai Electronic & Electrical Products Limited (Nam Tai), who signed the profits tax returns of Nam Tai filed with the IRD, were liable for the additional taxes assessed (as administrative penalties) under section 82A of the IRO for the incorrect returns filed.

The IRD found Nam Tai's profits tax returns to be incorrect² following a tax audit and raised additional tax assessments to Nam Tai under section 60 of the IRO. However, the company did not pay the amounts assessed and was wound up by the court upon petition of the CIR. Subsequently, the two directors were assessed to additional tax under section 82A(1)(a)³ of the IRO for the incorrect tax returns filed.

The directors successfully appealed to the Court of First Instance, and then the Court of Appeal (COA), against the additional tax assessments issued to them. The CIR then appealed to the CFA.

¹ The CFA judgement can be accessed via this link: https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=146294&currpage=T

² The returns were regarded as incorrect on the basis that certain management and service fees paid by Nam Tai to other group companies were artificial and non-arm's length and therefore not tax deductible.

³ At the relevant times, section 82A(1)(a) of the IRO stated that a person who, without reasonable excuse, makes an incorrect tax return by omitting or understating anything in respect of which he is required to make a return either on his behalf or on behalf of another person or a partnership shall be liable to additional tax.

The CFA's judgement and analysis

Below is a summary of the CFA's judgement and analysis:

- the requirement to make a return results from a written notice given under section 51(1) of the IRO. The notice is given to the person who is required to furnish a tax return under that section. In the present case, the tax returns (i.e. the notices) were addressed to Nam Tai without any reference made to the two directors;
- the form of the return (including the declaration) was created by the CIR and the signing of the declaration by the directors is only part of the process facilitating Nam Tai to fulfil the requirement for it to furnish the returns. By signing the declaration in the returns, the two directors simply declared their belief in the correctness of the information in the returns and did not assume the capacity of the makers of the returns; and
- the fact that the two directors were required to be “answerable” under section 57(1) of the IRO for doing all acts which were required to be done by Nam Tai under the IRO does not create a secondary requirement on them to make the returns on behalf of Nam Tai or cause them to be liable for the additional taxes assessed for the incorrect returns filed because:
 - the obligation under section 57(1) falls on all the members of the class to which the section refers to— the section does not single out the signers of the tax returns (i.e. the two directors) as subject to the requirement to make Nam Tai's returns on its behalf;
 - the purpose of section 57(1) is to facilitate the exercise of the IRD's functions in relation to corporations- the language of “answerability” in the section does not, in terms, impose any legal obligations on the corporate officers identified in the section to do anything; and
 - there are other provisions in the IRO which expressly impose a requirement on certain persons to do certain acts (including making of tax returns) on behalf of others⁴ but section 57(1) does not expressly impose a requirement for the corporate officers to make a return on behalf of a company.

Based on the above analysis, the CFA unanimously held that the tax returns in question (1) were required to be made, and were made, by Nam Tai, (2) were not required to be made, and were not made, by the two directors on behalf of Nam Tai and (3) the two directors were not liable to the additional taxes charged under section 82A(1) for the incorrect returns filed.

KPMG observations

The CFA judgement in this case has highlighted two important points:

- there is a distinction between “responsibility to ensure a company makes a tax return” and “an obligation to make a tax return on a company's behalf”, and that section 57(1) of the IRO falls into the former and does not impose an obligation for the corporate officers to file a tax return on behalf of the company; and
- the application of the “separate legal entity” principle to corporate officers in the tax filing context and that the corporate veil should not be lifted easily except as expressly provided for in the relevant legislation.

While company directors and other corporate officers would welcome this judgment, they need to be mindful that under Hong Kong law (including the Companies Ordinance), they could be held personally liable for a company's action and exposed to potential personal liabilities in certain circumstances such as those involving breach of duties, misrepresentation and criminal offences.

Another interesting observation from this case comes from what the judges termed as “procedural twist” in the judgement – shortly before the scheduled date of hearing of the case, the two directors (as respondents of the case) wrote to inform the CFA that they did not intend to oppose the CIR's appeal and wished to withdraw their case filed, and that they did not intend to instruct lawyers to attend the hearing or to attend the hearing in person. However, since the issues in question for the appeal were determined by the COA to be of great general or public importance, the CFA decided to proceed with the hearing of the appeal in the absence of the two directors and appointed two independent advisers as *amici curiae* to provide expertise assistance to the Court during the hearing. The final outcome of the appeal turned out to be in favor of the respondents despite their absence in the hearing.

⁴ These sections include: section 20A(3) on furnishing a return for sale of any goods in Hong Kong on behalf of a non-resident, section 22 on furnishing a return on behalf of a partnership and section 53 on requiring an agent of a non-resident to do the acts that are required to be done by the non-resident under the IRO.

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