

# PERSONAL LIABILITY OF COMPANY DIRECTORS ON PENALTY TAX FOR INCORRECT PROFITS TAX RETURNS FILED

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## Introduction

### Should company directors be personally liable for penalty tax for incorrect profits tax returns filed?

This is an appeal case<sup>1</sup> concerning whether an individual is liable for additional penalty tax for signing an incorrect profits tax return for a company in which he/she holds a directorship.

The case was heard by the Court of Appeal (“CA”) on 11 October 2019, with the written reasons for judgement being handed down by the CA’s judges on 20 July 2021.

In this article, we will provide a brief background of the case as well as the ruling of the CA, followed by our comments regarding some areas that individual directors should be aware of when signing profits tax returns for their companies.

## Background

Mr. Koo and Mr. Murakami (“the Applicants”), both directors of Nam Tai Trading Company Ltd (“the Company”), signed the Company’s profits tax returns for the years of assessment 1996/97 to 1999/2000 in which the Company claimed deductions of management fees and professional fees paid to the Company’s parent company.

In December 2002, the Inland Revenue Department (“IRD”) commenced an audit of Company’s profits tax returns and accounts lodged with those returns. At the conclusion of the tax audit, the IRD disallowed the deduction of management fees and professional fees and issued to the Company additional tax assessments for the relevant years of assessment, against which the Company lodged an appeal with the Board of Review (“BOR”). The appeal was dismissed by the BOR. The Company did not pay the additional tax imposed by the IRD and was eventually wound up by the court on the petition of the Commissioner of the Inland Revenue (“CIR”). Thereafter, the CIR issued additional notices of tax assessments to the Applicants under S.82A(1)(a)<sup>2</sup> of the Inland Revenue Ordinance (“IRO”), alleging that the Applicants had made incorrect statements in the Company’s profits tax returns which led to the understatement of the Company’s assessable profits. The IRD again imposed additional tax on the Applicants on the grounds that, having signed the tax

returns for the Company in the capacity of directors, the Applicants had made incorrect tax returns within the meaning of S.82A(1)(a).

The Applicants appealed against the additional tax assessments to the BOR but the appeals were dismissed. They then appealed to the Court of First Instance (“CFI”), which ruled in the Applicants’ favour and ordered that the additional tax assessments be annulled. However, the IRD was not satisfied with the CFI’s judgment and lodged an appeal with the CA against the CFI’s decision.

## Judgement of CA

The CA upheld the CFI’s decision and ruled in favour of the Applicants that S.82A(1)(a) does not permit the CIR to make a penalty assessment against an agent of a corporate taxpayer who assists the taxpayer to make a return on the grounds that (i) the return was not made by the directors in their personal capacity as agents for the Company, but by the Company alone acting through the physical agency of the directors; (ii) the directors were not required by the IRO to make the returns on behalf of the Company. In particular, the CA viewed that the notices issued by the IRD were addressed to the Company and it was the Company that was required to make or furnish the returns, and therefore the directors who signed the returns should not be liable for additional tax under S.82A(1)(a) even if the contents of the returns were incorrect.

According to the CA’s judgement, although the directors were not required to make or furnish returns, they should be made answerable for doing so under S.57(1) of the IRO. In the CA’s view, to be answerable for doing acts required to be done by a company could best be understood as being under a duty to ensure that the act in question was done by the company — this is different to being under an obligation or requirement to do the act on behalf of the company.

This tax case has still not been finalized. The CIR has filed an application for leave to appeal against the decision of CA to the Court of Final Appeal.

## PKF’s Comments

In general, the judgement of the CA is in favor of the signing persons of corporations only. In other situations, the signing persons may be personally

required to make the returns according to relevant laws. Moreover, it is worth noting that the signing persons should be made “answerable” and should be fully conversant with the matters stated in the returns, and they should declare their belief as to the correctness of the returns when signing such returns. It is an offense if an answerable person fails to provide information with regard to the tax liabilities of a company without reasonable excuse. Accordingly, we recommend that the directors of a company should still exercise the greatest prudence and due diligence in performing their duties and reviewing the information contained in the returns.

#### Notes:

<sup>1</sup> The full context of the court judgement can be found at the following link: [https://legalref.judiciary.hk/doc/judg/word/vetted/other/en/2018/CACV000602\\_2018.docx](https://legalref.judiciary.hk/doc/judg/word/vetted/other/en/2018/CACV000602_2018.docx).

<sup>2</sup> Under Section 82A(1)(a) of the IRO, additional penalty tax can be imposed on a person who, without reasonable excuse, makes an incorrect return by omitting or understating anything in respect of which he is required by the Inland Revenue Ordinance to make a return, either on his behalf or on behalf of another person.

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