Case No. D32/16

Penalty tax – incorrect tax return - third parties charged for additional tax of the taxpayer (in liquidation) – whether third parties has any reasonable excuse – amendments to add additional ground – whether section 70 applicable to third parties – sections 70 and 82A of the Inland Revenue Ordinance

Panel: Albert T da Rosa, Jr. (chairman), Maurice Joseph Chan and Ha Suk Ling Shirley.

Dates of hearing: 26-30 January and 6 March 2015.
Date of decision: 6 January 2017.

The Appellants were directors of the Taxpayer, Company D (a company incorporated in Hong Kong with the name D1 at the relevant time and subsequently changed to D2).

The 1st Appellant signed the profits tax returns for the year of assessment 1996/1997 and 1999/2000 and the 2nd Appellant signed the profits tax returns for the year of assessment 1997/1998 of Company D.

In 2003, Company D ceased its trading business and disposed its entire interest to a fellow subsidiary.

In 2008, a differently constituted Board of Review upheld the determination by the Deputy Commissioner that Company D had understated its assessable profits in the years of assessment 1996/1997, 1997/1998 and over-claimed its losses in 1999/2000.

Company D lodged no further appeal after failing its appeal by way of case stated, failure to obtain leave to apply for judicial review, and appeal dismissed by the Court of Appeal in 2009.

Despite repeated demands and enforcement actions, Company D failed to pay any of the tax payable to the Revenue.

In or around June 2011, the Commissioner petitioned for the winding-up of Company D.

On 4 June 2012, the Court ordered Company D to be wound up.

On 26 April 2013, assessments were issued to the Appellants for Additional Tax under section 82A, for making incorrect profits tax returns on behalf of Company D.

Held:

1. Section 70 applies to any party who has not been a party to prior proceedings between the underlying taxpayer and the Revenue, so long as the other requirements of the section are applicable.

2. The Appellants signed the returns for and on behalf of Company D. They are required to furnish correct information and come under the terms of Section 84A as someone required to furnish accurate information to the Revenue.

3. The Appellants have furnished incorrect returns to the Revenue.

4. Both the Appellants fail to adduce evidence and prove that they had reasonable grounds to believe and did believe in the correctness of the returns when they signed them.

5. On a *de novo* basis, the Base Portion of Additional Tax is 140% for the 1st Appellant, and 90% for the 2nd Appellant:

    5.1 The starting off point 100% for both Appellants is appropriate.

    5.2 An additional 50% for the 1st Appellant for setting up of the arrangement and transactions carried out for the sole or dominant purpose of enabling Company D to obtain a tax benefit.

    5.3 10% deduction for both Appellants:

    - 5% for the accounting records maintained which enabled identification of the issue.

    - 5% for the disclosure of the transactions with non-residents in the profits tax returns and tax computations filed.

6. To both Appellants, there shall be added commercial interest compounded monthly on 100% of the tax undercharged for the relevant years of tax assessment from the respective dates when the tax would have been due if the original return filed were correct to the date of the actual demand note subject to the jurisdictional limit, under Section 82A (1), of 300% of the tax undercharged.

Appeal dismissed.

Cases referred to:

Associated Leisure Ltd (Phonographic Equipment Co Ltd) v Associated Newspapers Ltd [1970] 2 QB 450, 455

GL Baker Ltd v Medway Building and Supplies Ltd [1958] 1 WLR 1216, 1235-1236

Tildesley v Harper (1876) 10 ChD 393

Chu Ru Ying v Commissioner of Inland Revenue [2010] 2 HKLRD 1052

R (Revenue and Customs Commissioners) v Machell [2006] 1 WLR 609

Caffoor (Trustees of the Abdul Gaffoor Trust) v Commissioner of Income Tax, Colombo [1961] AC 584 (Privy Council, Ceylon)

MacNiven v Westmoreland Investments Ltd [2003] 1 AC 311

King v Walden (HM Inspector of Taxes) (No 2) (2001) 74 TC 45

Salmon v General Commissioners for Havering and Commissioners of Inland Revenue (1968) 45 TC 77

D17/08, (2008-09) IRBRD, vol 23, 301

Tesco Supermarkets Ltd v Nattrass [1972] AC 153

Lean v Brady (1937) 58 CLR 328

ING Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue [2008] 1 HKLRD 412

D24/84, IRBRD, vol 2, 136

D118/02, IRBRD, vol 18, 90

D69/03, IRBRD, vol 18, 699

D53/93, IRBRD, vol 8, 383

Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224

Shui On Credit Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 392

Commissioner of Inland Revenue v Board of Review ex parte Herald International Limited [1964] HKLR 224

D36/13, (2014-15) IRBRD, vol 29, 161

D53/88, IRBRD, vol 4, 10

D34/88, IRBRD, vol 3, 336

D23/88, IRBRD, vol 3, 283

Russell Coleman, Senior Counsel and Julian Lam, Counsel; instructed by Messrs Baker & McKenzie, for the Appellant.

Stewart K M Wong, Senior Counsel and Elizabeth Cheung, Counsel; instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

A. Introduction

1. All references to sections and subsections are, unless otherwise stated, to those of the Inland Revenue Ordinance, Chapter 112 (the 'Ordinance').

2. Mr A (the '1st Appellant') put his signatures to the profits tax returns of Company D (a company incorporated in Hong Kong with the name D1 at the relevant time and subsequently changed to D2), for the respective years of assessment of

2.1. 1996/1997 dated 27 July 1997; and

2.2. 1999/2000 dated 26 July 2000.

3. Mr F (the '2nd Appellant') put his signature to the profits tax return of Company D for the year of assessment 1997/1998 dated 30 July 1998.

4. The 1st Appellant and the 2nd Appellant are collectively called the Appellants.

5. Company D's profits tax liability for the relevant years was determined by the decision (the 'Previous BoR Decision') of a differently constituted Board of Review.

6. If the result of the Previous BoR Decision is accepted, then the following amounts being the discrepancies between the profits or loss as stated in the tax returns of Company D for the following years and the assessable profits of Company D for each relevant year of assessment as determined by the Previous BoR Decision would constitute the amounts that Company D understated as its assessable profit in the relevant years of assessment:

6.1. HK$36,742,830 for the year 1996/1997 (to which profits tax return the 1st Appellant put his signature);

6.2. HK$34,790,641 for the year 1997/1998 (to which profits tax return the 2nd Appellant put his signature);

6.3. HK$40,497,812 (comprising HK$36,694,629 as profits understated and HK$3,803,183 as loss over-claimed) for the year 1999/2000 (to which profits tax return the 1st Appellant put his signature).

7. On 4 June 2012, Company D was put into liquidation pursuant to a petition filed by the Respondent in HCCW XXX/XXXX, and so far, none of the amount

outstanding has been recovered by the Respondent. The Respondent is of the view that it is unlikely that such amount will be recovered.

8. By Notices of Assessment dated 26 April 2013 (the 'Notices of Assessment'), the Commissioner of Inland Revenue (the 'CIR') subjected:

8.1. the 1st Appellant to additional tax under Section 82A in respect of the years of assessment 1996/1997 and 1999/2000; and

8.2. the 2nd Appellant to additional tax in respect of the year of assessment 1997/1998.

(the 'Additional Tax Assessments')

9. By Notice of Appeal dated 24 May 2013, the Appellants appealed the Additional Tax Assessments to the Board of Review (the 'Board') under Section 82B.

10. Their appeals were heard together by this Board.

11. The parties agreed to the facts set out in the Statement of Agreed Facts dated 15 December 2014 exhibited as Annexure I hereto.

B. Section 82A

12. Material parts of Section 82A of the Inland Revenue Ordinance (Chapter 112) provides:

> *'(1) **Any 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**; **or** (Amended 1 of 2010 s. 8)*
>
> *(b) makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; **or***
>
> *(c) **gives any incorrect information** in relation to any matter or thing **affecting** his own liability (or **the liability of any other person**) **to tax**; **or** (Amended 1 of 2010 s. 8)*
>
> *(d) fails to comply with the requirements of a notice given to him under section 51(1) or (2A); **or***
>
> *(e) fails to comply with section 51(2),*

> *shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts,* ***be liable to*** *be assessed under this section to* ***additional tax*** *of an amount* ***not exceeding treble the amount of tax*** *which-*
>
> *(i) has been* ***undercharged*** *in consequence of such incorrect return, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct; or*
>
> *(ii) has been undercharged in consequence of the failure to comply with a notice under section 51(1) or (2A) or a failure to comply with section 51(2), or which would have been undercharged if such failure had not been detected.'* [Emphasis added.]

C. Procedural Issues

(1) Question of Time Bar Withdrawn

13. Initially the Appellants contended that the Additional Tax Assessments were time barred. However, the objection was withdrawn.

(2) Amendments to Add Additional Ground

14. By a letter dated 2 December 2014, the Appellants purported to clarify a point made in their appeal and, 'in case of need', sought leave to amend the Notice of Appeal to include an additional ground of appeal. The matter was dealt with on the first day of hearing when the Appellants definitely elected to apply for leave to amend the Notice of Appeal to include an additional ground of appeal as follows:

> '[Mr A] and [Mr F] should not be liable to additional tax so assessed since the profits of [Company D] for the years 1996 to 2000 were offshore in nature and not taxable.'

15. Associated with the question of whether the amendment should be allowed is the question of whether under Section 70, the Appellants are entitled to re-open the question of whether Company D has understated its assessable profits for the relevant years as found by the Previous BoR Decision.

16. The application was opposed by the Respondent. However, as counsel for the Respondent confirmed that even if he had to deal with the evidence and argument as if the amendment were allowed by us, he expected that the matter could still be dealt with within the 5 days originally allocated; whereas if we were to deal with the Section 70

question as a preliminary issue, the case might have to be adjourned. Hence, we proceeded with the case and allowed all evidence to be admitted on *de bene esse* basis, pending our decision regarding the amendment.

(a) Appellants' Position

17. The Appellants submitted that Section 66(3) provides that the Board may give its consent for an appellant to rely on grounds of appeal other than those contained in the statement of grounds of appeal. By reason of Section 82B(3), Section 66(3) applies to appeals against assessments to additional tax. The Appellants referred to the principles from the following cases that amendments ought to be allowed if necessary, to do justice between the parties after having balanced the respective prejudices to them in the circumstances:

17.1. Associated Leisure Ltd (Phonographic Equipment Co Ltd) v Associated Newspapers Ltd [1970] 2 QB 450, 455 per Lord Denning MR:

'*an amendment ought to be allowed, even if it comes late, if it is necessary to do justice between the parties, so long as any hardship done thereby can be compensated in money. That principle applies here. I think that justice requires that the matters alleged in this amendment should be investigated in a court of law.*'

17.2. GL Baker Ltd v Medway Building and Supplies Ltd [1958] 1 WLR 1216, 1235-1236 per Jenkins LJ:

'*It appears, therefore, that in the present case the judge ought in the exercise of his discretion to have granted this amendment if it appeared that this would involve no loss or detriment to the plaintiffs which could not be made good to them by an appropriate order as to costs.*'

And at page 1235, where Jenkins LJ also referred to Tildesley v Harper (1876) 10 ChD 393, where Bramwell LJ said:

'*My practice has always been to give leave to amend unless I have been satisfied that the party applying was acting mala fide, or that, by his blunder, he had done some injury to his opponent which could not be compensated by costs or otherwise.*'

(b) Respondent's Position

18. The Respondent referred us to the rules for amendment of pleadings in High Court Proceedings after the Civil Justice Reform ('CJR') and urged us not to grant the application for amendment.

19. The prejudice, the Respondent says, is being put into a position of having to decide whether

19.1. to ask for an adjournment for further time to prepare and to do further investigation and collection of evidence, and lose the hearing date; or

19.2. to keep the hearing date and prepare for the new ground with short notice, with inadequate preparation, with no real opportunity for further investigation and collection of evidence.

(c) Discussions and Findings

20. Proceedings before the Board cover simple appeals by an individual over his salaries tax as well as complicated appeals like the present one. At the time when the Appellants' cases were heard, proposed legislation to give a presiding chairman of a case heard by the Board the power to determine procedural issues has not yet been passed.

21. Elaborated rules and pre-trial conferences (whereby issues are identified) and elaborated pleading rules are in place for proceedings before the High Court. These are absent for proceedings before the Board. Legislation that buttresses the CJR and the technical rules that are promulgated thereunder in the form of the Rules of the High Court are technically not applicable to proceedings before the Board.

22. However, the spirit for justice is applicable.

23. As submitted by the Appellants, it is important that matters are properly brought before us and argued.

24. The fact that both sides represented by Senior Counsel have been able to put forward pages of argument before this Board shows that the Section 70 point is arguable.

25. Given Section 68 (9), the question of costs is of less significance for Board of Review cases in the balancing exercise. The prejudice of having to make the election to adjourn or not to adjourn does not outweigh the importance of having matters properly brought before us and argued. Since the Respondent counsel has indicated (see paragraph 16 herein) that he could deal with the additional issue within the period scheduled for hearing, we allow the amendment.

26. With the amendment, a number of issues are engaged in the grounds of appeal:

26.1. Whether on a fair interpretation of Section 70, the Appellants are barred from challenging the correctness of the assessments on Company D as found by the Previous BoR Decisions;

26.2. Whether in respect of Section 82A(1)(a)

(a) any of the Appellants 'made' any tax return by putting their respective signature on the respective tax returns in question;

(b) any of the Appellants was 'required' to make the respective tax returns which bore their respective signatures;

26.3. Whether in respect of Section 82A(1)(c), any of the Appellants 'gave' any 'incorrect information' in relation to any matter or thing 'affecting … the liability of any other person … to tax';

26.4. Whether any of the two Appellants has reasonable excuse; and

26.5. Whether the additional tax was excessive for each of the two Appellants.

D. Section 70 Binding Effect

(1) Basis of Challenge

27. Section 70 provides as follows:

'*Where no valid objection or appeal has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable income or profits or net assessable value assessed thereby, or where an appeal against an assessment has been withdrawn under section 68(1A)(a) or dismissed under subsection (2B) of that section, or where the amount of the assessable income or profits or net assessable value has been agreed to under section 64(3), or where the amount of such assessable income or profits or net assessable value has been determined on objection or appeal,* ***the assessment*** *as made or agreed to or determined on objection or appeal, as the case may be,* ***shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income or profits*** *or net assessable value:*

Provided that nothing in this Part shall prevent an assessor from making an assessment or additional assessment for any year of assessment which

> *does not involve re-opening any matter which has been determined on objection or appeal for the year.*' [Emphasis added.]

28. Section 82B(3) provides as follows:

> '*Sections … and 70 shall, so far as they are applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax.*'

29. On the face of the language, Section 70 is applicable with respect to additional tax cases.

30. Chu Ru Ying v Commissioner of Inland Revenue [2010] 2 HKLRD 1052 is binding on this Board regarding the effect of Section 70 as between the Commissioner and the same taxpayer in an additional tax appeal situation. The question remains whether the same could be said for the effect of Section 70 on a third party in an additional tax appeal situation.

(2) Whether Section 70 Applies to Third Parties

31. In the application of Section 70 to this case before us

> 31.1. an appeal has been dismissed under Section 68, and
>
> 31.2. the amount of such assessable income or profits or net assessable value has been determined on objection or appeal.

32. On the plain language reading, Section 70 is applicable for all purposes without distinguishing between direct taxpayers and third party situations.

33. The Appellants say that it is unfair to have the findings in a previous Board decision between Company D and the Respondent binding on the Appellants who were not parties to those proceedings.

34. The Appellants are not challenging the constitutionality of Section 70. They are challenging the position only as a matter of construction, and posed the following propositions on such construction:

> 34.1. the phrase 'final and conclusive for all purposes of this Ordinance' means that the assessment cannot be reopened by either the Revenue or the taxpayer on the issue of the particular taxpayer's tax liability for the year of assessment for all purposes of the Ordinance, and goes no further than that;

34.2. such construction of the phrase 'final and conclusive for all purposes of this Ordinance' is consistent with the purpose of the provision, which is to prevent either the Revenue or taxpayer from reopening the particular taxpayer's tax liability.

35. The Appellants submitted that the Respondent's broader construction of Section 70 is not required by the wording of the legislation. It goes too far and could not have been intended by the legislature.

(a) Case Law

36. The Appellants cited passages in various cases in support of their narrower interpretation.

36.1. R (Revenue and Customs Commissioners) v Machell [2006] 1 WLR 609 ('Machell Case'):

(a) The Appellants referred to the passage at paragraph 24, where Stanley Burnton J interpreted the words 'final and conclusive', saying: '*A decision is "final" if there is no appeal from it… "Conclusive" means no more than that the decision as made is binding as between the parties…*'.

(b) The Appellants submitted that the words 'for all purposes of this Ordinance' do not add anything, and they just mean that an assessment was final (in the sense of no appeal) and binding (as between the parties), for all purposes of the Ordinance.

(c) The Respondent submitted that Machell Case is not a tax case but a case on judicial review. We agree with the Respondent's contention the question there arises is whether these words 'final and conclusive' meaning that the decision cannot be judicially reviewed.

(d) In any event, the relevant provision in question in Machell Case , the crucial words 'for all purposes of the Ordinance' or similar words do not appear. We do not find the case particularly helpful for our purposes.

36.2. Caffoor (Trustees of the Abdul Gaffoor Trust) v Commissioner of Income Tax, Colombo [1961] AC 584 (Privy Council, Ceylon) and MacNiven v Westmoreland Investments Ltd [2003] 1 AC 311:

(a) The Appellants contend that these cases demonstrate that assessments by one board do not bind a subsequent board dealing with similar issues.

(b) As contended by the Respondent, those cases concern the temporal effect only of an assessment in that assessment, for Year 1 only applies to Year 1, and it does not apply to Year 2 in the sense that even if in Year 2, exactly the same thing happens, the parties are free to re-argue and adopt a different position. There is no issue of res judicata in such situation because tax is an annual matter.

36.3. King v Walden (HM Inspector of Taxes) (No 2) (2001) 74 TC 45 and Salmon v General Commissioners for Havering and Commissioners of Inland Revenue (1968) 45 TC 77:

(a) The Appellants said that the dicta in these cases support their contention that in similar penalty tax situations, the English Courts have suggested that the Board can go behind the Previous BoR Decision.

(b) However the Respondent contends as follows:

(i) The relevant statutes with a different scheme in terms of finality of assessments vis-à-vis additional tax, Section 46(2) of the Taxes Management Act 1970 ('TMA'), provides that '*the determination of the General Commissioners or the Special Commissioners in any proceedings under the Taxes Acts shall be final and conclusive*'. It relates to the effect of the determinations of the General or Special Commissioners as a decision of a tribunal (similar to Section 69(1) of the Ordinance), and so were the words of the decisions referred to by Jacob J in King v Walden (HM Inspector of Taxes) (No 2) (2001) 74 TC 45 at paragraphs 18 and 19 (and cited by the Appellants at paragraph 96(1) and (2) of their Submissions). It was not drafted in the wide and sweeping terms of our Section 70, which gives finality and conclusiveness to the assessment for all purposes of this Ordinance as regards the amount of such assessable income or profits. A judgment dealing with differently worded provisions of much more limited scope in another piece of tax legislation does not assist us at all.

(ii) Further, for the purposes of additional tax, the effect of Section 70 is expressly applied to the additional tax context by Section 82B(3). On the other hand, this is not the case in the United Kingdom. Section 101 of the TMA (which concerns penalty appeals) uses a different phrase, instead of applying or cross-referencing Section 46(2) of the TMA (like Sections 70 and 82B(3) here). TMA simply states that the assessment, which can no longer be varied, shall be 'sufficient evidence' that the income or chargeable gains (in respect of which tax is charged in the assessment) arose or were received as stated therein. Thus, it is only a piece of evidence, sufficient to prove the Revenue's case in the absence of evidence to the contrary. Finality and conclusiveness of the original assessment is clearly not intended in the context of the penalty appeal. This is totally different from the legislative scheme in Hong Kong.

(c) Again, we do not find the two cases particularly helpful for our purposes.

(b) Interpretation

37. None of the cases is binding on this Board on the issue in question. At the end of the day, it is a question of interpretation with the purposes of the legislation in mind.

38. This Board is conscious of the importance of natural justice principles and the presumption that legislature would not impair a person's rights in relation to legal proceedings and due process.

39. The Appellant submitted that the following policies referred to by the Respondent cannot be supported:

39.1. The 'finality' policy: This is the point that the policy of the IRO requires finality of assessments, and that the question of the true and correct tax liability must not remain unresolved. The Appellant submitted that whether or not the third party could argue that the tax return was correct in penalty proceedings does not at all affect the amount of profits tax the taxpayer must pay.

39.2. The 'compliance' policy: This is to encourage the correctness of tax returns filed. The Respondent submitted that in a penalty hearing, that tax return would have had to be correct in the first place. In other words, even if the director signing the return could argue in the

penalty appeal that the return was correct, he/she would still of course try to get the return right.

39.3. The 'efficient penalisation' policy: This is the policy (said to be dubious by the Appellant) that the legislature intended penalisation proceedings to be as efficient as possible, notwithstanding the abrogation of the defendant's rights of due process. The Appellants accepted that the only real justification given is the 'efficient penalisation' policy. However, the Respondent has not pointed to any basis as to why Section 70 should be interpreted purposively to support this specific policy.

40. We are with the Appellants on the first two policies.

41. However, on the third policy, while the Appellants say that Section 82B(3) by the express application of Section 70, can still have an effect because it can still apply in a late return case to fix the quantum of the tax being undercharged so as to fix the penalty or the maximum amount, we do not accept that finding one possible application should necessarily exclude the application of the sweeping general wordings to penalty tax situation.

(3) Hong Kong's Simple Tax Regime

42. It is useful to take note of the background regarding Hong Kong's simple tax regime as referred to in D17/08 and the discussions therein.

43. Where additional tax is levied on a taxpayer who has had his day in previous Board or in court over the same period of assessment and lost, there is no reason to reopen such fact finding exercise.

44. The Appellants, however, contend that a person who is not himself the taxpayer concerned, should not be bound by the results of previous decisions in which the taxpayer is not a party, as he would not have absolute control over such previous proceeding.

(4) Discussions and Findings

45. Even where the assessment is presumed under Section 70, there is nothing to prevent such a third party charged for additional tax to adduce evidence and prove that he had reasonable grounds to believe and did believe in the correctness of the return when he signed it. Such evidence will constitute 'reasonable excuse'. It is clear that a taxpayer will not have to be subject to additional tax if he can justify with reasonable excuse.

46. Section 70 fulfils the policy to keep our tax system simple relying on the system of self-disclosure by the taxpayer and those in the taxpayer's organisation involved in the process. In particular,

46.1. if a person knows he/she can have another go, then it would make the system far less efficient, and dilute the way such person discharges the duty to ensure that the return is correct; and

46.2. one can prove one's case on one's own by just focusing on what oneself has done when one signed the return.

47. If a conscientious third party who filled in the form had reasons to believe that the taxpayer was not liable, he can show that he had reasonable grounds for his belief, even without the ability to challenge and establish that in fact, the taxpayer was not liable.

48. There is no policy justification to permit repeated challenges just to ensure that a callous and reckless third party who simply signs without any belief in the truth of the matter, might nevertheless, by reopening the arguments before another panel, be able to avoid responsibility by the off chance that another panel might find the taxpayer not liable. The correct policy surely is geared towards requiring such persons to act responsibly, and cannot justify a revision of the previous findings.

49. In any Section 82A case as the present one, the third party can always adduce evidence of his own belief at the relevant time as reasonable excuse, even though Section 70 prevents him from challenging the binding effect of the determination in prior proceedings.

50. We are satisfied that Section 70 applies to any party who has not been a party to prior proceedings between the underlying taxpayer and the Revenue, so long as the other requirements of the section are applicable.

E. Effect Of What The Appellants Signed

(1) What the Appellants Signed

51. There are two returns signed by the 1st Appellant:

51.1. Part H of the return for the year 1996/97 where the 1st Appellant put his signature read:

> 'I, [Mr A] (full name), being [Position G] of [Company D] (state full name of the Corporation) declare that to the best of my knowledge and belief all the statements contained in this return are true, correct and complete and I have disclosed the whole of the Assessable Profits (or Adjusted Loss) of the Corporation arising during the basis

period for the year of assessment ended 31 March as stated in the formal notice in page 1.

Signature [signature of the 1st Appellant]

(Heavy penalties may be incurred for failing to keep sufficient business records, making an incorrect return or committing other offences --- See Notes 8 and 9.)

Date 27 July 97

* Delete whichever is inapplicable'

51.2. Part 14 of the return for the year 1999/2000 where the 1st Appellant put his signature read:

'I, [Mr A] (full name), being [Position G] of [Company D] (state the full name of the Corporation) declare that

- to the best of my knowledge and belief all the statements contained in this return are true, correct and complete

- the whole of the Assessable Profits (or Adjusted Loss) arising during the basis period for the year of assessment ended 31 March as stated in the formal notice in page 1 have been disclosed; and

- the Supporting Documents referred to in the formal notice on Page 1 have been prepared and this return completed in accordance with the Supporting Documents.

Date 26 July 2000 Signature [signature of the 1st Appellant]

(Heavy penalties may be incurred for failing to keep sufficient business records, making an incorrect return or committing other offences --- See Notes 15 and 16.)

* Delete whichever is inapplicable'

52. The 2nd Appellant signed on the return for the year 1997/98 which is the same as set out in paragraph 51.1 with corresponding changes in references to the 2nd Appellant instead of the 1st Appellant, the relevant date and references to the paragraph of notes at the end to read '… See Notes 9 and 10' instead of referring to notes 8 and 9.

(2) Section 82A(1)(a)

53. The Appellants submitted that the Appellants did not 'make' the returns but Company D did.

(a) Section 51 Point: Whether the Appellants 'Made' the Returns?

54. The Appellants so submitted because Section 51(1) requires any person to furnish an assessor with the returns, and Section 51AA specify three (exclusive) methods by which a return may be furnished; and therefore only the person so required by Section 51(1) can make the return.

55. We note that what Section 51 requires is for a person to whom a notice thereunder is to 'furnish' the return. However, Section 82A bites any person who 'makes' the return. Given the difference in the two words, there is no inherent constraints that Section 82A could only bite someone who furnishes the return under Section 51.

56. Section 82A(1)(a) expressly says if a person makes an incorrect return on behalf of another person, he can be liable. Section 82 contains no such express stipulation. To read Sections 51, 82 and 82A together, we are satisfied that the statutory scheme is that for Section 82A purposes, the return can be 'made' by someone other than the person to whom a Section 51 notice is addressed, but on his behalf.

(b) Tesco Point

57. The Appellants also submitted that if the corporate taxpayer relies on a natural person to act, it is not necessarily the case that that natural person is acting on the company's behalf. Instead, the natural person can be acting as the embodiment of the company itself, and referred to Tesco Supermarkets Ltd v Nattrass [1972] AC 153.[1] At 170E-G, Lord Reid, when '*considering the nature of the personality which by a fiction the law attributes to a corporation*' in the context of the criminal liability of a company, said:

> *'A living person has a mind which can have knowledge or intention or be negligent and he has hands to carry out his intentions. A corporation has none of these: it must act through living persons, though not always one or the same person. Then the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts is the mind of the company. There is no question of the company being vicariously liable. He is not acting as a servant, representative, agent or delegate. He is an embodiment of the company*

[1] cf. the direct execution of documents with the corporate seal.

> *or, one could say, he hears and speaks through the persona of the company, within his appropriate sphere, and his mind is the mind of the company. If it is a guilty mind then that guilt is the guilt of the company. It must be a question of law whether, once the facts have been ascertained, a person in doing particular things is to be regarded as the company or merely as the company's servant or agent. In that case any liability of the company can only be a statutory or vicarious liability.*' [Emphasis added.]

58. Section 82A itself envisages a return by A on behalf of B. Indeed, a person can act as the company, or merely as the company's servant or agent (see e.g. Lord Reid at 170E-G). It is a question to be decided according to the facts of each case. Thus, the person can act in his own capacity but for and on behalf of the corporation, so that both assume liability under Section 82A for the incorrect return according to its plain wording.

59. There is nothing magical about the word 'making'. 'Making' simply means completing and signing on a return form, which the 1st Appellant and the 2nd Appellant did on their respective forms. Each made the necessary declaration. Each signed the relevant form. Each thereby made the relevant return.

60. We are satisfied that the Appellants signed on the relevant returns for and on behalf of Company D, and therefore made the respective returns.

(3) Were they Required to Make the Return?

61. Section 57(1) provides:

> '*The 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.*'

62. The Appellant contends that Section 57(1) does not provide that the secretary, manager, any director or the liquidator 'shall be required to do all such acts, matters, or things as are required to be done' by a company – 'answerable' does not mean 'required'.

62.1. The words 'answerable' and 'required' are both used, and the presumption is that two different words were used because they mean different things. It is unlikely that the legislature would have used different words to impose the same obligation on different people.

62.2. The distinction between the words used is borne out in the Chinese text of section 57(1).

(a) That provides:

'*任何法團的秘書、經理、任何董事或清盤人及任何團體的主要職員，須負責作出根據本條例的條文須由該法團或該團體作出的所有作為、事宜或事情。*' [Emphasis added.]

(b) Like the English text, the Chinese text does not merely provide that:

'*任何法團的秘書、經理、任何董事或清盤人...須作出根據本條例的條文須由該法團或該團體作出的所有作為、事宜或事情。*'

63. The Appellants submitted that the wording of Section 57(1) itself recognises that the secretary, manager, director or liquidator are not required to do the acts in question, because it distinguishes between the obligations of the officers of the company and the company itself. At the end of the day, it is still the corporation which is 'required' to do the act; Section 57(1) only provides that the officers are the persons who are 'answerable' or responsible for ensuring that the company does the act in question.

64. We note, however, the Chinese version of Section 57(1) reads '*任何法團的秘書、經理、任何董事或清盤人及任何團體的主要職員，**須負責**"**作出**"根據本條例的條文**須由該法團或該團體"作出"的所有作為、事宜或事情**。' [Emphasis added.]

65. Had the Chinese version been relevant to determine the meaning of Section 57(1), then on proper interpretation of Section 57(1), such persons are responsible (負責) to effect or do (作出) what is required to be effected or done (作出) by the corporation. In other words, they are required to do what is required to be done by the corporation.

66. However, Section 57(1) (save for immaterial changes) was already in existence prior to 1987. In that old version, the formula 'answerable for doing all such acts' was already in our statute. Until 1987, Official Languages Ordinance (Chapter 5) had only provided for our statute law to be enacted in the English language. Thus the Chinese version of such an old ordinance is not relevant for determining the legislative intent.

67. The Respondent submitted that to be answerable for something means to be liable or responsible for it. That must mean legal consequences or liabilities for the thing required to be done by the corporation. Further, the Respondent submitted that

prosecution under Sections 80(2) or 82(1) is not the answer: if a director has no liability under Section 82A(1), then equally he has no liability under Section 80(2) which refers to the same defaults, while Section 82(1) only deals with wilful evasion of tax. In effect, the Ordinance requires the directors to file a correct, timely return on behalf of the corporation. It is simply ridiculous to say that someone is answerable for something as a legal obligation, without being required by the law to make sure that the thing is done.

68. In Lean v Brady (1937) 58 CLR 328, the relevant provision in a tax statute stated that a 'public officer' of a company shall be liable for doing all such things as are required to be done by or on behalf of the company under the legislation, and in the case of default, the public officer shall be liable for all penalties imposed for the breach. It was held that, while this provision did not make the public officer liable for the non-payment of tax, it did cast upon the public officer duties such as

68.1. '*making returns, giving information and so forth*' for which he could be sanctioned in case of default (as the company could be) (at 332 per Strake J), or

68.2. '*the discharge of the various responsibilities placed upon the taxpayers in relation to the administration of income tax law of which, perhaps, the best example, because the most common place, is making annual returns of income … "things required to be done" do not refer to payment of tax but to the active responsibility falling on taxpayers in connection with returns, assessments and ancillary matters*' (at 336-337 per Dixon J).

69. There is no absurdity in such construction because in all the absurd cases suggested by the Appellants, the 'reasonable excuse' provision would save the day.

70. We are satisfied that once the Appellants signed the returns, they have chosen to file them, and are required to furnish correct information and come under the terms of Section 84A as someone required to furnish accurate information to the Revenue.

(4) Section 82A(1)(c)

71. Did the Appellants give the information in the Form?

72. The Appellants submitted that whilst Sections 82A(1)(b) and (1)(c) do not expressly refer to any particular provisions, they are 'referable' to specific requirements under the IRO to furnish correct information:

72.1. The claims 'for any deduction or allowance under the Ordinance' referred to in Section 82A(1)(b), are claims for deductions or allowances under Parts IVA and V of the IRO. Sections 26B(2) and 27(2), respectively, specify that a person claiming a deduction or

allowance must make the claim in the specified form and provide such particulars and proof as required by the CIR.

72.2. The 'incorrect information' referred to in Section 82A(1)(c) is referable to the various instances in the IRO where a person may be required to provide 'information', namely pursuant to Section 51(4) and 52.

73. We agree that Section 82A(1)(b) is only referable to claims of deductions by persons making the claims under Sections 26B(2) and 27(2), and would not cover the Appellants.

74. However, while Section 82A(1)(c) is 'referable' to the various instances in the IRO where a person may be required to provide 'information', namely pursuant to Section 51(4) and Section 52, we are satisfied that it is also referable to other situations so long as incorrect information has been furnished to the Respondent.

75. We find that the Appellants have in the respective returns signed by them furnished the information to the Respondent. Given our decision regarding the effect of Section 70, they have furnished incorrect information to the Respondent.

F. Reasonable Excuse

76. The Appellants are under personal legal duty to take all reasonable necessary steps in the circumstances. The focus is why each of them made an incorrect return? What was the excuse?

77. The burden is on the person making incorrect return in the additional tax appeal to show that full instructions have been provided to the delegate, the professional adviser or internal accounting manager, and to show that the incorrect view taken is reasonable in all the circumstances, and that there was a genuine reliance on a correct view.

78. The approach is to find out first, what the excuse is, and then whether the excuse is reasonable, rather than asking what a reasonable person would have done in discharging his tax affairs, or whether such person would ask professional advice etc.

79. That is the burden that they have to discharge.

(1) Witnesses

80. The 2nd Appellant gave witness statement but could not attend the hearing.

81. The following witnesses were called:

81.1. Mr H;

81.2. Ms J; and

81.3. the 1st Appellant himself.

82. In assessing their evidence, we are conscious of the length of time that has elapsed. We have been reminded by the Appellants of the various principles of evidence, and in particular, that the absence of first-hand or primary evidence does not mean that there is no evidence to prove facts, and we should take note of circumstantial evidence and the presumption of regularity.

(2) Mr H

83. According to Mr H, currently employed within the K Group as the Chairman of Company L's Audit Committee, after the financial statements had been finalised, the external auditors would transfer them to their own tax department to review and prepare the tax returns, and the tax department would contact the local in-house accountants of Company D for assistance.

84. We agree with the Respondent's following observations:

84.1. It should be remembered that although Mr H had been employed by different entities within the K Group from time to time, namely by Company M from 1990 to 1995 (first as its Position N then as Position P) and then later in 1998 to 1999 as the Position Q of Company L, an important limitation of his evidence is that for the years of assessment relevant to the present appeal, namely 1996/97, 1997/98 and 1999/2000, he was not working for any entities within the K Group. He told the Board that from 1995 to 1998, he worked at Company R in City S, and from 1999 to 2003, he worked first at a public company in City S then at a medium sized accounting firm.

84.2. Importantly, Mr H confirmed in cross-examination that as a result of his professional movements at the relevant time, he had no personal knowledge of the K Group or of Company D for any of the relevant years in question. Mr H could thus only have been speculating when he said that 'they would have followed the same system' for the years where he had no involvement within the K Group.

85. Even if one were to take Mr H as describing in a loose sense, the system that had been in place during the time he was in office, and expecting that system to continue during the time he was not in office, his evidence did not address the specific matter of how information pertaining to tax computation would, as a matter of system, be

identified and passed on to which qualified in-house personnel and then to which external review.

86. There is no evidence at all from Mr H as to what instructions or information or documents the tax department was given in preparing the tax computations and returns. Nor is there evidence that at any time Mr H took any steps to check, confirm or ensure that the tax department had all the necessary instructions, information or documents to form a view as to the true nature of the management fees and the legal and professional fees.

(3) Ms J

87. Her evidence dealt with the operation side of the group of companies but not on how tax was computed. She has no information pertaining to anything related to the reasonable excuses (if any) of the Appellants.

(4) 1st Appellant

88. Most of the 1st Appellant's evidence is on the operational side in the attempt to show that Company D should not be liable to tax as assessed.

89. Despite the lapse of time, he is capable of giving very firm and clear answers of matters he personally dealt with and does not refrain from giving his views. Unfortunately, he gives evidence on his misguided conviction of the correctness of the Group's perspective, i.e., the source of business of a taxpayer cannot be considered in isolation from the activities of the group of companies to which it belongs.

90. It is legally wrong to consider it in that way, as Lord Millett NPJ warned at ING Baring Securities (Hong Kong) Limited v CIR [2008] 1 HKLRD 412 at paragraph 134:

> '*Before the recent decision of this Court in Kim Eng Securities (Hong Kong) Ltd v. Commissioner of Inland Revenue [2007] 2 HKLRD 117 ("Kim Eng"), where the same test was applied, the cases were concerned with taxpayers which were independent companies and not part of a group.* ***But I cannot accept the proposition that, in the case of a group of companies, "commercial reality" dictates that the source of the profits of one member of the group can be ascribed to the activities of another.*** *The profits in question must be the profits of a business carried on in Hong Kong. No doubt a group may for some purposes be properly regarded as a single commercial entity.* ***But for tax purposes in this jurisdiction a business which is carried on in Hong Kong is the business of the company which carries it on and not of the group of which it is a member;*** *the profits which are potentially chargeable to tax are the profits of the business of the company which carries it on; and the source of those*

> *profits must be attributed to the operations of the company which produced them and not to the operations of other members of the group.*' [Emphasis added.]

91. What is more important is that his evidence shows that he had a misguided belief that in signing the tax returns, he could simply rely on the fact that in a big corporation, there are other professionals employed internally and externally, but without articulating how such professionals are allocated at a high level with the clear lines of instruction pertaining to accuracy of tax information. That to us is reckless disregard of his duty.

92. There is no evidence at all from the 1st Appellant as to what instructions or information or documents the tax department was given in preparing the tax computations and returns. The 1st Appellant has confirmed that he did not know what information and instructions had been given. Nor is there evidence that at any time the 1st Appellant took any steps to check, confirm or ensure that the tax department had all the necessary instructions, information or documents to form a view as to the true nature of the management fees and the legal and professional fees.

(5) So-Called Professional Advisers

93. The evidence of the witnesses for the Appellants tends to suggest that a very strict and proper review and audit system was adopted by the Group under the relevant accounting standards in the preparation of the audited accounts of the Group. However, this Board is not concerned about preparing the audited accounts, but the tax computations.

94. As the Board said in D24/84, IRBRD, vol 2, 136 at 138:

> '*Likewise it is no excuse to say that qualified accountants were employed and that this exonerated the Appellant. Qualified accountants can do no more than act on the information provided to them and in accordance with the instructions given to them. The client and not the accountant must take full legal responsibility for what the client signs.*'

95. As the Respondent rightly submitted: The audited accounts record the receipts and outgoings and other financial information regarding Company D, and the fact that they include certain receipts and expenses is not the point. The audited accounts only record, for example, the fact that certain items of expenditure had been incurred but not the tax consequence (i.e. deductibility) thereof. The point is whether any of such receipts have to be taken out as they are not assessable to tax (such as dividend income), or whether any of such expenses have to be added back as they are not deductible under the provisions of the Ordinance. Thus, it is the preparation of the tax computations that matters, and if the Appellants can establish reasonable excuse because of reliance on the professionals, such professionals can only be those who prepared the tax computations.

96. The Respondent submitted that this Board needs to know that the in-house tax departments knew about the true transactions; for example:

96.1. The true 'management reasons' for Company D receiving management fees from the PRC subsidiaries and paying management fees to Company L, as stated in the letter dated 8 March 2013 from Company T.

96.2. The intention of the Group, including Company D, that the payment terms of the service agreements would not be strictly adhered to, and management fees thereunder were intended to be charged only when the gross profit margin was insufficient to pay Company L. Thus, management fees income would always be less than the management fees payments under the 'back-to-back' contracts, and thus, overall, would reduce the assessable profits of Company D.

97. These matters point to the conclusion that the management fees were not deductible, and are certainly matters that ought to have been disclosed to the tax department, or the internal or external auditors, for them to assess properly whether the management fees were deductible or otherwise (whether in the tax computations or the quarterly reports).

98. If the director cannot do those things in the proper discharge of his duty for whatever reason, he should not sign the return. Someone else who knows should do it. But if a director is doing it and making the declaration, then he must personally ensure the correct return is done.

99. If one looks at the form of the return, there are only four types of persons who can sign it - secretary, manager, director or liquidator; and all these people fall within Section 57(1).

100. The Respondent also reminded us that the 1st Appellant told the Board that when he signed the tax return, he did not know for sure what information, instructions or documents had been provided to the tax department of the external auditors. Similarly, when Mr H was asked in cross-examination as to what instructions, information and documents had been provided to the tax departments of Company U or Company R to enable them to make a judgment on the appropriate tax treatment of management fees, he was unable to assist. He said very vaguely that Company U or Company R would be given 'all the information they would need', but when asked for specifics as to whether he actually knew what information was given, he said that he did not know the specifics, that 'I don't have a list.'; 'I can't give you the specifics'. Neither of these witnesses has offered assistance to the Board in this respect. Nor is there evidence that the Appellants took any steps to ensure that the tax department was provided with all the necessary information and instructions for it to prepare the tax computations properly. The 1st

Appellant simply asserted that he had done his best without giving evidence of what he had done properly to ensure full instructions were given. He also said he simply relied on his staff regarding the provision of instructions on the legal and professional fees. However, one simply cannot blame someone else and says this is a reasonable excuse.

101. Indeed, we find that there is no evidence that in-house professionals have been required to report to the directors of Company D or the Appellants on points of discretions or assessment on whether it is definitively so; strongly reasonably or merely arguably so; or just a chanced non-discovery. A director is expected to ask for all these. The directors are not expected to re-do what the in-house staff has done. However, in his evidence the 1st Appellant gave us nothing.

102. In so far as the outside consultants are concerned, there is no evidence of their basis of engagement. Tax advice is an 'agreed upon procedure'; it is not an audit although an audit at group consolidated level may generically cover the impact of tax. Again, the directors are not expected to re-do what the external professional tax advisers have done. However, they must at least have to be satisfied that the external professional tax advisers have been supplied with the information in paragraphs 96 and 97 herein.

103. The only 'consultation' the 1st Appellant could relate to us that he personally did was the conversations with Mr V for informal advice. In paragraph 64 of his witness statement the 1st Appellant said 'After the service agreement arrangement was conceived but before they were entered into in 1995, I had **informally** discussed it with [Mr V], a former tax partner at [Company U] in Hong Kong. Since this took place some 20 years ago, I could not recall the exact details of the contents of that discussion, but my understanding after that discussion was that the arrangement was proper and appropriate.' [Emphasis added.]

104. Although the 1st Appellant tried to suggest to the Board at some point that he had told Mr V 'the whole structure' pursuant to which the management fees were paid, he cannot get away from the fact that he had said earlier in his statement that given the 20 years gap, he could not recall the details of the contents of the discussion with Mr V. Moreover, this was confirmed when pressed in cross-examination about details of what had been told to Mr V, the 1st Appellant conceded that he could not remember the details. Certainly, there was no evidence from the 1st Appellant or Mr H that any of the matters referred to in the preceding paragraph was explained to Mr V (or anybody else involved in the preparation of the tax returns and computations). Mr H also confirmed he did not know the details about what the external auditors were given about the intercompany charges.

105. The 1st Appellant might well have believed or deluded himself into believing, from his informal discussion with Mr V, that the conceptual framework of his tax structure works. But without ensuring that for those working for him in the implementation and in the preparation of the tax computation, as well as for those external advisers involved in the tax return preparation, they all knew what actually took place and

agreed that the structure as implemented actually works, there is no reasonable excuse to make the returns in question in the way they were made. We are satisfied that, despite the lapse of time, had these matters been in the mind of the 1st Appellant at the relevant time, he would have no difficulties in articulating to us his concepts on taxation from the Group's perspective, just as well as he did for the Group's operations.

106. We are not satisfied that the 1st Appellant has done enough to say that he has a reasonable excuse. If anything, the evidence confirmed that he was at least reckless in masterminding what he perceived as a valid tax avoidance scheme, and signing the tax returns as such, and we so find. We are not saying that merely having obtained the kind of assurance referred to in paragraph 105 herein would necessarily qualify as reasonable excuse. That would have to be considered on a case by case basis.

107. The fact that he came up with the scheme, and asked Mr V informally on its workability after Company U had already rendered a view expressing their reservation of its validity, and then have Company D to implement the scheme, shows not only that he was the original instigator of the tax avoidance scheme which failed, but that he was the ultimate person actively responsible for maintaining its dubious and reckless contentions. Indeed, according to the 1st Appellant himself, his professional advisers at Company U did initially express reservation about his scheme in a 6-page letter dated 26 June 1997, but he had subsequently gone so far as to mistrust them and seek out Mr V, the most senior tax partner, with a view to talk him into seeing things his way, and eventually got things done his way. This was said to have been achieved notwithstanding that the letter pin-pointed the crux of the problem as follows:

> 'I would add that, given the size of the management fees, the IRD may question whether some or all of them were charged in connection with services provided by [Company L] in Hong Kong, and whether [Company L] is liable to Hong Kong Profits Tax as a result of carrying on business in Hong Kong. Should any such queries be raised, the position will obviously depend on the facts. However, in practice, the IRD may be persuaded to accept that [Company L] was not carrying on business in Hong Kong if it could be shown that it was paying tax in other jurisdictions on the fees received in return for the services provided to the Company. However, as [Company L] is not I understand paying any taxes in any location on the management fees which it receives, the IRD are likely to raise detailed questions concerning [Company L's] activities. Furthermore, unless clear evidence and documentation is available to show that the services provided by [Company L] are performed outside Hong Kong, the IRD are likely to contend that [Company L] is carrying on business in Hong Kong.'

(6) Mr F

108. Mr F, the 2nd Appellant, gave a scant statement and was not available for cross examination. In particular we note the 2nd Appellant admitted to the following in his statement:

> 108.1. paragraph 16: 'I do not have any professional knowledge in tax or accounting. I was not personally involved in the preparation of the accounts and profits tax returns or its supervision. There were other people at both the management and staff level who were responsible **and I left matters to them**. As I said, I was involved in the manufacturing and marketing side of the business. [Company L's] Board of Directors ensured that reputable and reliable external auditors were engaged to audit, prepare and review the accounts, statutory filings and tax returns of the Group (including those of [Company D]). [Company L's] board deliberated on the appointment of independent auditors each year. **I relied on both internal and external professional accountants and auditors to prepare the accounts and tax returns for the Group including [Company D]**.' [Emphasis added.]
>
> 108.2. paragraph 17: 'Since the accounting and tax affairs of [Company D] were taken care of by professionals and other competent staff who were directly responsible for these matters, I honestly and in good faith believed that [Company D's] tax returns were truthful and correct and continue to hold that belief today.'
>
> 108.3. paragraph 18: '[Company D] did not have any board resolutions or protocol specifying which officer was responsible for signing the tax returns, nor was this required in [Company D's] memorandum or articles of association. Generally**, I would sign off on [Company D's] tax returns if I happened to be the most senior officer in Hong Kong at the time** when [Company D's] tax returns were due to be submitted. [Company D's] staff would request me to sign off as a mark of respect. If [Mr A] was in Hong Kong at that time, the staff would request him to sign as he is the more senior officer. If neither [Mr A] or myself were in Hong Kong, other officers of [Company D] could sign the tax returns. For instance, for the year of assessment 1998/99, [Mr W], the then [Position N] of [Company D], signed the tax returns.' [Emphasis added.]

109. There is no evidence that the Appellants ensured proper disclosure to the so called 'internal and external professional accountants' or external auditors.

110. He could fare no better in justifying reasonable excuse than the 1st Appellant.

111. Like the 1st Appellant, we find him to be reckless in his purported discharge of his duties.

(7) Findings on Liability

112. We are not satisfied that there is reasonable excuse for the Appellants or either of them.

G. Quantum

113. In this case, the following percentages of the tax undercharged are levied as additional tax:

Year of assessment	Tax undercharged	Additional tax	Percentage
1996/97	$6,062,567	$6,400,000	105.57%
1997/98	$5,166,411	$5,400,000	104.52%
1999/2000	$5,871,140	$6,200,000	105.60%

(1) Evidence of Ms X

114. In her witness statement, Ms X referred to the Inland Revenue Department Penalty Policy (the 'Penalty Policy').

115. She produced the Penalty Policy (attached hereto as Annexure II).

116. The following matters regarding the Penalty Policy are noted:

116.1. Section D of the Penalty Policy is headed 'Section 82A Penalty Policy for cases involving Field Audit & Investigation'. The section applies to cases where a field audit or investigation has been conducted. It is stated that the most common offences for the type of cases are (a) '*Omission or understatement of income or profit;*' (b) '***Making incorrect statement in connection with a claim for any deduction or allowance****;'* (c) '*Failure to notify chargeability to tax*'.[2] [Emphasis added.]

116.2. As per Note 1 to paragraph 2 of Section D of the Penalty Policy, the Penalty Policy classifies under each of the four types of cases

[2] Paragraph 1 of Section D of the Penalty Policy.

(namely: (1) Full Voluntary Disclosure, (2) Disclosure with full information promptly on challenge, (3) Incomplete or belated disclosure and (4) Disclosure denied) into three broad groups as follows:

'Group (a) –cases where the taxpayers show intentional disregard to the law and adopt deliberate cover-up tactics involving the preparation of a false set of books, padded wage rolls and fictitious entries or multiple omissions over a long period of time.

Group (b) –cases with slightly less serious acts of omissions resulting from **recklessness** including the 'hand in the till' type of evasion, failure to bring to account sales of scrap, and sheer gross negligence. [Emphasis added.]

Group (c) –cases where the taxpayers fail to exercise reasonable care and omit profits/income such as lease premium, one-off commission, etc.'

116.3. Paragraph 3 of Section D of the Penalty Policy states: 'To conclude that a taxpayer has intentionally disregarded the provisions of the IRO requires a finding that the taxpayer consciously decided to disregard clear obligations imposed on him. Such a finding may be based on direct evidence on the taxpayer's intention (such as an admission) or may be inferred from the taxpayer's behaviour. **Recklessness is gross carelessness. A taxpayer will be found to have behaved recklessly if his conduct clearly showed disregard of, or indifference to, consequences that are foreseeable by a reasonable person as being a likely result of his actions. It is not necessary for a finding of recklessness that the taxpayer should have been acting dishonestly, nor that the taxpayer intended to bring about the consequences that his actions caused.** The reasonable care test requires a taxpayer to take the care that a reasonable, ordinary person would take in all the circumstances of the taxpayer to fulfil the taxpayer's tax obligations.' [Emphasis added.]

116.4. Paragraph 2 of Section D sets out a penalty loading table. The relevant loading (expressed as a percentage of the tax undercharged for Group (b) cases under 4 types in the following 4 columns) are as follows:

Full Voluntary Disclosure		Disclosure with FULL Information Promptly on Challenge		Incomplete Belated Disclosure		Disclosure Denied	
Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.
10	45	50	75	110	150	150	200

116.5. The term 'C.R.' in the table above refers to commercial restitution.

116.6. Note 3 to paragraph 2 of the Penalty Policy, which also forms part of her evidence, states that 'for cases completed after 30 November 2003, the CR (commercial restitution) is at 7% per annum monthly compounded for periods up to and including 30 November 2003 and at the best lending rate compound for periods after 30 November 2003.'

117. According to Ms X, the rates for commercial restitution (at the best lending rate) monthly compounded are as follows:

30 November 2003 and before	7%
December 2003	7%
January 2004 to October 2004	5%
November 2004 to December 2004	5.125%
January 2005 to April 2005	5%
May 2005 to June 2005	5.25%
July 2005 to August 2005	5.75%
September 2005	6.5%
October 2005	6.75%
November 2005 to December 2005	7%
January 2006	7.5%
February 2006 to April 2006	7.75%
May 2006	8%

118. Ms X classified the Appellants' cases into the category of Group (b) of the third type under 'Incomplete or Belated Disclosure' for the purposes of the Penalty Policy, and applied a maximum loading of 150%, including commercial restitution (at 7% per annum monthly compounded up to and including 30 November 2003, and at the best lending rate compounded monthly thereafter).

119. In Appendix A of her witness statement she sets out a chronology of events.

120. The 1st Appellant contend that he could not remember whether those acts were authorised by him or whether they took place during the time when he ceased to be director of Company D.

121. We are not bound by the views of Ms X or the CIR on the Penalty Policy but have to render our own assessment. See paragraphs 128 to 129 herein on *De Novo* Determination.

(2) D118/02

122. Both parties referred to the leading case on quantum of additional tax D118/02, IRBRD, vol 18, 90 (chaired by the then Chairman of the Board sitting together with two Deputy Chairmen), where the Board said:

'***The 100% starting point***

> *46. This Board has in numerous cases referred to 100% of the tax involved as the starting point for imposition of additional tax. Such references are not intended to substitute the proper approach which is to consider whether the amount of additional tax is excessive by reference to the amount of tax undercharged.*
>
> *47. The cases decided by this Board are not at one as to the circumstances whereby assessment at 100% is applicable.*
>
> *48. One of the earliest statements in relation to assessment at 100% of the tax involved is to be found in D53/88, IRBRD, vol 4, 10. The Board there pointed out that penalty at 100% of the amount of tax undercharged is appropriate to those cases:*
>
> *(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or*[3]
>
> *(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or*
>
> *(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.*
>
> *49. Similar sentiments were expressed by this Board in D34/88, IRBRD, vol 3, 336:*

[3] It is now accepted that this should mean 'and' so that the three conditions are conjunctive: D12/08, IRBRD, vol 23, 205 at footnote 5 on page 223.

"As previous Boards have stated in cases of this nature, the starting point for assessing an appropriate penalty would appear to be approximately 100% of the tax underpaid. In effect, this means that, for completely ignoring one's tax obligations, one can assume that one is likely to have to pay about double the tax which other citizens who handle their tax affairs properly are required to pay."(emphasis added).

50. *These statements are at variance with the position adopted by the Board in D62/90, IRBRD, vol 5, 451 and D52/93, IRBRD, vol 8, 372 where the Board stated that:*

> *"100% of the tax undercharged should be taken as the norm, that is, the measure for a case where there are neither aggravating nor mitigating circumstances".*

This statement seems to indicate that 100% of the tax undercharged is intended to apply to the run of the mill type of cases. It is inconsistent with the broad categories outlined in D53/88 and D34/88. ***We prefer the statements in D53/88 and D34/88.*** [Emphasis added.] *Given the fact that 97.5% represents the level of additional fine imposed by the Court for more serious cases, it would be wrong for the Board to adopt 100% as the starting point for a case with no aggravating or mitigating circumstances. The circumstances of each particular case must be examined bearing in mind that the maximum penalty is 300%. Depending on the circumstances of each individual case, the Board has approved additional tax at 200% of the tax involved in D22/90, IRBRD, vol 5, 167 and in D53/92, IRBRD, vol 7, 446 and at 210% of the tax involved plus 7% compound interest per annum in D43/01, IRBRD, vol 16, 391.*

Is there a different starting point for late return cases under section 82A(1)(d)?

51. *Section 82A makes no distinction between the five categories of transgressions. The exposure to treble the amount of tax undercharged is applicable to each.*

52. *We are of the view that the principles established in D53/88 and D34/88 are equally applicable to late return cases. However, as most of the late return cases do not fall into the categories established by D53/88 and D34/88, the level of penalty for those cases is much lower.*

53. *In D53/93, IRBRD, vol 8, 383, the Board pointed out that*

" *... a substantially lower penalty was appropriate if the delay or default related to one year of assessment only and if the return was accepted by the Revenue without requiring an investigation*".

54. ***The approach of this Board is to consider the overall circumstances of each case.*** *Factors that affect the level of penalty include:* [Emphasis added.]

(a) The length and nature of the delay

D2/90, IRBRD, vol 5, 77 and D85/01, IRBRD, vol 16, 696

(b) The amount of tax involved

D2/90 (above cited)

(c) The absence of an intention to evade

D53/93 (above cited)

(d) Whether there is any loss of revenue

D59/96, IRBRD, vol 12, 8, D63/96, IRBRD, vol 11, 641 and D65/00, IRBRD, vol 15, 610

(e) The track record of the taxpayer

D59/96 (above cited) and D63/96 (above cited).

(f) The acceptance of the tax return eventually submitted without further investigation by the assessor

D53/88 (above cited)

(g) The lack of education on the part of the taxpayer

D58/87, IRBRD, vol 3, 11

(h) The steps taken to put the taxpayer's house in order

D53/93 (above cited) contrasted with D65/00 (above cited)

(i) The provision of management account

D64/94, IRBRD, vol 9, 361

(j) Conduct of the taxpayer before this Board

D59/96 (above cited)

55. ***Depending on the circumstances of each individual case****, the Board has approved additional tax at 100% of the tax involved in D65/00 to 0.2% of the tax involved in D24/94, IRBRD, vol 9, 226 for late submission of return without reasonable excuse.*' [Emphasis added.]

123. The Respondent submitted that the principles in D118/02 are applicable to incorrect return cases, and cited D69/03, IRBRD, vol 18, 699, where the board at paragraph 41 cited paragraphs 48 to 50 of the decision in D118/02, and quoted verbatim in paragraph 122 herein, then said at paragraph 42, '*We are of the view that the observations outlined in paragraph 41 above are applicable to cases involving incorrect returns.*'

124. The Respondent and the Appellants are however in disagreement over the applicability of the principles in D118/02 and various issues on quantum.

(3) De Novo Determination

125. The Appellants submitted that they do not accept that the Respondent is entitled to resile from his former stance and advocate an entirely different approach.

125.1. None of the authorities referred to by the Respondent support the suggestion that the Respondent can advocate an entirely different approach on a Section 82B appeal (or an ordinary appeal under Section 68).

125.2. Notwithstanding CIR v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224 (relied on by the Respondent), the Respondent and the Board are under a duty to proceed fairly, so that the Appellants are not taken by surprise: Shui On Credit Co Ltd v CIR (2009) 12 HKCFAR 392 paragraph 31 per Lord Walker NPJ.

125.3. Part of this duty to proceed fairly must be to not take a different stance which had hitherto been adopted. This is consistent with the Respondent's public law duties to act fairly and rationally. It is trite that this involves acting consistently and not departing from his previous decisions without cogent reasons – see e.g., the examples in Fordham, Judicial Review Handbook (6th ed., 2012),

(a) paragraph 55.1.13(A):

'55.1.13 **Interests of consistency/previous decisions as a relevancy.**

(A) PRIOR ACTION IN SAME CASE. R (Watson) v Dartford Magistrates Court [2005] EWHC 905 (Admin) (magistrates only entitled to revoke earlier order refusing adjournment where "change of circumstances"); R (Chisnell) v Richmond Upon Thames London Borough Council [2005] EWHC 134 (Admin) at [19]-[20] (previous planning decisions in respect of same site relevant considerations; need to recognise importance of consistency and give reasons for departure); R v Secretary of State for the Home Department, ex p Golam Mowla [1992] 1 WLR 70 (unreasonable to disregard "the facts as to the passport holder's previous leaves to enter and remain in the United Kingdom, and his or her conduct and history while in the United Kingdom"); R (Saunders) v Tendring District Council [2003] EWHC 2977 (Admin) at [62] (officer's report seriously misleading because did not present members with proper opportunity to consider whether still adhered to earlier objections, and if not why not); R v Birmingham City Council, ex p Sheptonhurst Ltd [1990] 1 All ER 1026, 1035j ("when considering an application for renewal the local authority has to give due weight to the fact that a licence was granted in the previous year and indeed for however many years before that"); Secretary of State for the Home Department v AF [2008] EWCA Civ 117 (previous findings in control order proceedings not binding in later hearing).' and

(b) the general principle stated at paragraph 55.1:

'55.1 **Equal treatment, non-arbitrariness and certainty**.[29] Consistency is a principle of good administration. Judicial review can be granted where treatment of the present matter: (1) is unjustifiedly unfavourable compared with treatment of relevantly similar matters, or even with prior treatment of the present matter; or (2) unjustifiedly fails to distinguish other dissimilar matters. Public law consistency is a value which manifests itself in other ways, such as: within the duties of fairness and reasonableness; in the protection from arbitrariness; and in the duty to provide adequate certainty of approach.

[29] Dinah Rose [2006] JR 19.'.

125.4. The Respondent filed Ms X's evidence explaining in detail the Respondent's approach to quantum. There was no indication until the Respondent's Closing that the Respondent would resile from it and adopt a different approach.

126. The Appellants submitted that this precludes the Respondent from arguing anything which is inconsistent with what Ms X said in her witness statement or in her evidence in cross-examination. On this basis, the following paragraphs of the Respondent's Closing should be ignored:

126.1. paragraph 112(1)(c) (persistent underreporting of Company D);

126.2. paragraph 112(6) (profits tax had not been recovered from Company D);

126.3. paragraph 112(7) (tax avoidance scheme).

127. At the very least, the Appellants submitted that the Respondent should not be permitted to withdraw the mitigating percentages previously given at Ms X's witness statement paragraph 37, adding up to a total of 30%.

128. This Board deals with the matter on a *de novo* basis. In a Section 82B appeal, which applies Section 68, the Respondent is not bound by the method or reason by which he comes to the quantum of additional tax. Herald[4], and cases in a similar vein, had been applied by the Board in Section 82B appeals. For example, in D36/13, (2014-15) IRBRD, vol 29, 161 at paragraphs 26-29, the Board laid down the following useful guidelines about its function in a tax appeal:

'*The Board's function in a tax appeal*

26. …

27. *Section 82B confers on a taxpayer the right to appeal to the Board. Once the taxpayer invokes the statutory right of appeal, he is subject to the appeal scheme provided by the Ordinance, including the provisions referred to above and below.*

28. …

[4] CIR v Board of Review ex parte Herald International Limited [1964] HKLR 224

> *29. On an appeal to the Board:*
>
> *(1) The Board, not the representative, is the fact finding body. The onus is on the Appellant through the representative to adduce intelligible evidence on how the late filing came about [section 68(4)].*
>
> *(2) The Board, not the Commissioner, is the decision maker. If there is any discretion in any matter, such discretion is to be exercised by the Board.'*

129. It is up to the Appellants to state their grounds and prove their case. In Board of Review cases under Section 82B or otherwise, the Respondent need not have a 'Case'. The Respondent is duty bound to make submissions to the Board on the basis of the net effect of the evidence presented and disclosed at the hearing.

130. The 'complaints' by the Appellants in paragraphs 125 to 127 herein do not matter.

(4) Starting Point of 100%

131. The Respondent contends that the starting point of 100% is applicable where the three conditions set out in paragraph 48 of the decision in D118/02 (approving D53/88) referred to in paragraph 122 herein are applicable. To repeat, they are:

> '*(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or*[5]
>
> *(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or*
>
> *(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.'*

132. The Appellants submitted that the starting point of 100% should not be adopted because the three cumulative factors set out in D118/02[6] at paragraph 48 therein (see paragraph 131 herein) are inapplicable.

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[5] It is now accepted that this should mean 'and' so that the three conditions are conjunctive: D12/08, IRBRD, vol 23, 205 at footnote 5 on page 223. See also D53/88 at page 13.

[6] At paragraph 48.

133. Thus the arguments of the parties as presented centred on whether and to what extent the 3 factors are present.

(a) First Factor: Total Failure

134. In relation to the first factor (i.e., the taxpayer has totally failed in his or its obligations under the IRO), the Appellants made 3 contentions:[7]

134.1. Firstly, the first factor is not relevant because the taxpayer's failures should not be visited on the Appellants. This board however notes the following:

(a) Given our simple tax system and the reliance on taxpayers to provide correct information, there is nothing inherently wrong with a taxpayer's failures being visited on someone who recklessly filled in the tax returns on behalf of the taxpayer.

(b) In any event, the guidance in D118/02 is not a technical rule binding on this board. It is a useful guidance from which this board can draw an analogy. In applying the guidance to novel situations, this board should distil the substratum underlying the analogous guidance.

(c) Where additional tax is levied on a third party signing the returns, the analogous 'total failure of the taxpayer' could be that of a taxpayer of the additional tax under consideration, and not that of the 'taxpayer' the tax position of which was reflected in the tax return.

134.2. Secondly, the first factor is not suitable in 'incorrect return' cases.

(a) The Appellants contend that:

(i) It is because necessarily the return would be incorrect, and hence, in every case there would be a 'total failure'. By contrast, D118/02 was a 'late return' case, so the Board could distinguish between late filing of the return and total failure to file the return. In those latter

[7] In response to the Respondent's position in the Respondent's written closing submissions (cf. Respondent's Closing paragraph 112(1)(a)).

circumstances, it would make more sense to talk of a 'total failure'.

(ii) In 'incorrect return' cases, this factor must therefore be modified to take into account the nature of the taxpayer's failure to comply with his/her obligations.

(iii) The most serious 'incorrect return' cases would be where the taxpayer fails to disclose profits entirely. That is where a field audit comes in, where the Respondent might need to, for example, search the taxpayer's offices or conduct forensic accounting on the taxpayer's records. It can also be seen from the descriptions of Groups (a) to (c) at Note 1 of the Penalty Policy that the purpose of the penalty for non-disclosure and putting the Respondent to a field audit, is to punish the non-disclosure of profits, which were only discovered after the Respondent's investigations.

(iv) That is entirely different from circumstances where the taxpayer (or in this case the Appellants) fully discloses its profits, claims a deduction on the basis of a view which the Board ultimately differs with, and fully discloses that deduction. That is not a situation where the Appellants had totally failed to comply with their obligations.

(b) The Respondent rightly drew our attention to

(i) paragraphs 51 and 52 of D118/02 where it is stated that:

(A) '51 *Section 82A makes no distinction between the five categories of transgressions. The exposure to treble the amount of tax undercharged is applicable to each*'; and

(B) '52 *We are of the view that the principles established in D53/88 and D34/88 are equally applicable to late return cases. However, as most of the late return cases do not fall into the categories established by D53/88 and D34/88, the level of penalty for those cases is much lower.*'

(ii) D69/03, IRBRD, vol 18, 699 at paragraph 42, where the principles in D118/02 are stated to be applicable to incorrect return cases.

(c) In any event, the period of delay in late return cases is not the only factor in determining total failure of all types of situations. In wrong return cases, the failure to disclose profit is one factor. (Given that one is considering whether to levy 100% of the tax unreported, it is the total failure in relation to the undercharged tax that matters for considering the worst case scenario - not whether it is the whole profit or part of it that is not reported.) The reckless claims of deduction would be another type of total failure of the deduction involved.

134.3. Thirdly, the Appellants contend that, any criticisms of Company D's conduct of the tax audit cannot be applied to the 2nd Appellant, who had by then retired. As for the 1st Appellant, although he was one of the persons in charge of the tax audit until he retired from Company D in around mid 2006, the person responsible for executing the matter was Mr Y, Financial Controller of Company D, and other professional staff. Given our view in paragraph 134.2(c) herein as regards the 1st Appellant, this third argument is not sustainable for the first factor. As regards the 2nd Appellant, it will be dealt with in the second factor.

(b) Second Factor: Difficulty in Assessing the Tax - Tax Audit

135. In relation to the second factor,[8] the Appellants contend as follows:

135.1. In the original penalty assessment the Respondent placed heavy reliance on the assertion that the Respondent only discovered the understatement after a field audit.[9]

135.2. The fact of the matter is that a field audit was not necessary for the Additional Profits Tax assessments to be raised. This is an undeniable matter of fact – the first Additional Profits Tax Assessment was made on 28 February 2003, only a few months after the tax audit began in December 2002.

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[8] cf. the Respondent's Closing paragraph 112(1)(b).

[9] The Appellants say the Respondent again places heavy reliance on this in Respondent's Closing at paragraph 112(1)(b).

135.3. The Respondent was able to do so because the Appellants had fully disclosed the matters they sought to deduct at the outset:

(a) It was made clear during Ms. X's cross-examination that Company D had disclosed the items which Company D deducted in each of Company D's returns.

(b) Ms X admitted that neither the 1st Appellant nor the 2nd Appellant had disclosed anything belatedly.

(c) The Additional Profits Tax Assessments were made because the Respondent took a different view as to the deductibility of expenses, and not because of anything which had not been disclosed.

(d) The only thing Company D failed to disclose was sufficient evidence to persuade the Respondent that the expenses were deductible.

135.4. The only thing the Respondent says it discovered before then was the 'arrangement of the group'. However, the Respondent knew about the basic structure from the tax computations. Further, there is absolutely no evidence that this was the cause of the first additional profits tax assessment (Ms X having given none), instead of an impending time-bar issue.

136. The second factor relates to the resources the Revenue had to put in to correct the wrong committed by the Appellants under the first factor.

137. As the Respondent rightly submitted, the Respondent had to resort to an audit to discover the understatement. In the cross-examination of Ms X, it was suggested that it was merely a difference of views between the Respondent and Company D in terms of whether expenses were deductible, and that somehow, this disagreement is less culpable than a deliberate understatement of income. However, that does not change the fact that the Respondent still had to resort to an audit to gather all relevant information and see whether there were justifications, before it could be determined that the expenses were in fact not deductible. If an audit was not conducted, the deductions would remain allowed when, *ex hypothesi*, they ought not be.

138. As far as this board is concerned, the gist of the second factor lies not in whether technically a tax audit was necessary to trigger an assessment. The gist lies in whether the wrong doing in the first factor contributed to any difficulty in assessing the tax in question in the proper exercise of the Respondent's duty, such that extra resources

had to be applied by the Respondent, in tax audit or otherwise, as a result of the non-cooperation of the taxpayer.

139. The Respondent could not be faulted to have taken a conscientious approach and asked for background information to ensure that when Company D's case came for hearing before a Board of Review, the Respondent should not be faced with a case or argument by Company D based on facts not yet uncovered.

140. Various documents, not available to the Revenue before, had to be requested in the audit, including the service agreement between Company D and Company L. See letter dated 21 December 2002 from the Respondent, which was only provided on 25 August 2003.

141. In considering whether to allow the deduction in question, the Respondent tried to ask for background information to properly understand the basis of the deduction. It was only during the interviews conducted under the audit that the arrangement of the K Group was explained to the Respondent, enabling it to form a view as to the deductibility of the management fees.

142. The fact that the 2nd Appellant has resigned may be a factor in mitigation but not a factor that could help him get away from the 100% starting off point to reflect the degree of severity of the consequence of what he triggered.

143. We find the second factor proven against each of the Appellants.

(c) Third Factor: Persistent Failure

144. In relation to the third factor, the Appellants submitted:

144.1. that they are not Company D, and any repetitive failure by Company D should not be construed as persistent failure of the Appellants;

144.2. that unlike late filing cases, in an 'incorrect return' case such as this, where the incorrectness stemmed from the very fact that the taxpayer honestly believed that its returns were correct, repeated incorrect returns should not be an aggravating factor. This is a fortiori when the returns had continued to be prepared in the same way by the taxpayer's tax advisers.

145. The Respondent submitted: The under-reporting by Company D had persisted for a number of years, at least for the four years of assessment from 1996/97 to 1999/2000. Both the Appellants were directors of Company D throughout those years. When the two most senior officers of the K Group (with 1st Appellant being the most senior) was each under a duty, by reason of Section 57(1), to ensure that Company D

discharged its obligations under the Ordinance to file a correct return, they failed to discharge that duty. While each of them can only be liable for additional tax for the incorrect return which he made, the Board is entitled to take into account the fact that the under-reporting has persisted for a number of years during which each Appellant was a director and each of them had failed to discharge his duty under Section 57(1) for all the relevant years in question.

146. The third factor is not an aggravating factor to add anything to the 100% starting off point.

147. We are in agreement with the Respondent.

(d) Other Appropriate Starting off Point

148. Even if one takes the Penalty Policy as a relevant point of comparison, the Appellants would be in Group (b) covering 'cases with slightly less serious acts of omissions resulting from **recklessness** including the "hand in the till" type of evasion, failure to bring to account sales of scrap, and sheer gross negligence.'

149. Since the Appellants cannot possibly come under the situations of 'Full Voluntary Disclosure' and not 'Disclosure with FULL Information Promptly on Challenge', they should be looking at 110% to 200% if the Penalty Policy is to be applied.

150. The Penalty Policy makes commercial restitution as part of the starting off point (see paragraphs 116.4 and 116.5 herein).

151. Here we must register our observation on the Penalty Policy that there is no reason why commercial restitution (being interest at commercial rate on the tax understated) should, as a matter of law, form part of the component of the starting off point for quantum assessment before consideration of the aggravating and mitigating factors as Ms X contends. We will give our more detailed reasons in paragraphs herein under the heading '(8) Commercial Restitution or Interest'.

(e) Board's Conclusion on 100% Starting Point

152. We repeat what we said in paragraph 134.1(a) herein that, given our simple tax system and the reliance on taxpayers to provide correct information, there is nothing inherently wrong with a taxpayer's failures being visited on someone who recklessly filled in the tax returns on behalf of the taxpayer.

153. We are satisfied that applying 100% as the starting off point for the Appellants' cases is correct.

154. It is true that on the evidence, we are not satisfied that the Appellants themselves have been so repetitive.

155. However, one must not forget that in D118/02 where the Board stated it preferred the statements in D53/88 and D34/88, it added its own emphasis in quoting D34/88, and stated 'Similar sentiments were expressed by this Board in D34/88, IRBRD, vol 3, 336 "*As previous Boards have stated* [… omitted …] *In effect, this means that, for* ***completely ignoring one's tax obligations****, one can assume that one is likely to have to* ***pay about double the tax*** *which other citizens who handle their tax affairs properly are required to pay*." *(emphasis added)*'

156. In D23/88, the Board further added after the above quoted statement '*This is not unreasonable when it is borne in mind that the tax rates in Hong Kong are comparatively low and that the system of taxation in Hong Kong relies upon individual taxpayers making full and frank disclosures of all of their taxable income on a voluntary basis. If this is taken as the starting point for cases of this type, the question then to be decided is whether on the particular facts of this case there are any extenuating circumstances which would merit a decrease in the amount of the penalties.*'

157. Thus, even if we were to find that the third factor is required to be proved in respect of the acts of the Appellants without attributing to them anything done or omitted by Company D as such, we would have found that it is still appropriate in the present case to apply 100% as a starting off point.

(5) Ms X's Aggravating and Mitigating Factors

158. In paragraph 37 of her statement, Ms X explained that she applied a net discount of 30% from her starting off point for the following 6 factors:

158.1. +15% for the '1st Aggravating Factor' set out in paragraph 161 herein;

158.2. +5% for the '2nd Aggravating Factor' set out in paragraph 169 herein;

158.3. -5% for the '1st Mitigating Factor' set out in paragraph 173 herein;

158.4. -5% for the '2nd Mitigating Factor' set out in paragraph 176 herein;

158.5. -30% for the '3rd Mitigating Factor' set out in paragraph 179 herein; and

158.6. -10% for the '4th Mitigating Factor' set out in paragraph 182 herein.

159. In applying the 100% starting point, we are not applying the Penalty Policy as such. If it were so, one would be applying '… a maximum loading of 150% …

including commercial restitution …' as Ms X did. We are therefore not applying the aggravating and mitigating factors as applied by Ms X.

160. However, since these factors have been urged upon us by the Appellants for a **net** 30% discount, we considered them.

(a) 1st Aggravating Factor

161. According to Ms X, the 1st Aggravating Factor was that '[Company D] and/or the Appellants kept on denying that there were incorrect Profits Tax Returns filed. Even after the BOR had upheld the Determination and all the assessments become final and conclusive, they still insisted that the returned profits (loss) for the audit years were correct. There was no acceptance of the adjustments after the IRD had identified the discrepancy'.

162. We find that proven. But whether that fact warrants a 15% increase is a question that needs further consideration.

163. In essence, this factor goes to the attitude of the Appellants, and whether it is so reprehensible as to warrant an increase from the 100% starting point, and if so by how much.

164. The Respondent in oral closing submission further referred to the following factors:

> 164.1. '[Company D], on the [1st Appellant's] instructions and the Appellants themselves commenced various court proceedings against the Commissioner (civil actions and applications for judicial review) on the basis that the assessments disallowing the deductions were incorrect, and to challenge the additional tax assessments, leading to further waste of time and financial resources to the Revenue. This obstructive, and non-remorseful, attitude of the Appellants is a relevant factor to be taken into account. See [Ms X's] Statement §§9-15 [R1(1)/3-6] and SAF §§28-29 and 32-33.'
>
> 164.2. 'Yet even when all avenues of appeal have been exhausted, the Appellants have, even up to now, refused to accept that incorrect returns had been made, and even attempted to re-open, at this hearing, the profits tax assessments and additional assessments. [Mr A] and [Mr F] might have genuinely believed that the returns were correct when they signed them, but that belief could not persist (and had indeed become irrelevant) once all avenues of appeal by [Company D] had ended. And this is notwithstanding [Mr A's] own acknowledgment on at least three occasions that they

are final and conclusive under section 70 (see §12 above). While the Appellants had a right to make representations under section 82A as to why additional tax should not be levied, to persist in arguing that there was no incorrect return while at the same time accepting the effect of section 70 is, with respect, taking an obstructive and non-remorseful attitude, and is wasteful of the Revenue's resources, which the Board is entitled to take into account.'

164.3. '[Mr A] and [Mr F] even threatened to call a press conference to exert undue pressure and to try to force the hand of the Commissioner during the audit process: see letter dated 23 April 2013 from [Company T]. On this see D66/05 (2005) 20 IRBRD 920 [AA2/55] at §40.'

165. The Appellants submitted that it is the taxpayer Company D and not the Appellants who are in charge of those conduct; and in particular for the 2nd Appellant, he retired at the relevant time.

166. Insofar as the actions of Company D are concerned, we are with the Appellants in that mere acts or omissions of Company D should not be automatically attributed to the Appellants at this stage of consideration on aggravating factor.

167. However for the 1st Appellant, we note the following:

167.1. In a letter dated 9 January 2003 issued by Company AA and signed by the 1st Appellant, it was stated that the 1st Appellant as Position AB would be the 'In-charge person' to deal with Company D matters.

167.2. Further, having observed the 1st Appellant in the witness box, we are satisfied that with his shareholding and other positions within the group, and especially the fact that the 'scheme' is considered by him to have been devised through his discussions with Mr V, he was in a position to significantly influence the actions of Company D and did.

167.3. We do not find the addition of 15% on this aggravating factor excessive. Instead we would have imposed 30% instead.

168. As far as the 2nd Appellant is concerned, we agree with the Appellants.

(b) 2nd Aggravating Factor

169. According to Ms X, the 2nd Aggravating Factor was 'There was no attempt to make payment regarding the profits tax, surcharges etc. and all the amount payable remained outstanding'.

170. The CIR should not penalise the 1st or 2nd Appellant for Company D's failure to pay its profits tax.

171. In an appropriate case, a failure to pay may be considered as an aggravating factor for imposing additional tax on the direct taxpayer like Company D.

172. Since we have taken the factor into account in the starting point of 100% for the third party case of the Appellants, this should not be considered twice as an aggravating factor. Indeed, where third parties are concerned, the fact that the Revenue has been kept out of pocket could be compensated by adding commercial interest. Thus, we are of the view that there is no need to add to the percentage as an aggravating factor.

(c) 1st Mitigating Factor

173. According to Ms X, the 1st Mitigating Factor was 'The accounting records showed descriptions on the various payments including the management fees to [Company L], which enabled identification of the issue'.

174. There is no disagreement between the parties and we find the facts for this factor proven.

175. We also agree that a deduction of 5% is justified.

(d) 2nd Mitigating Factor

176. According to Ms X, the 2nd Mitigating Factor was, 'There was disclosure regarding the transactions with non-residents in the Profits Tax Returns and tax computations filed'.

177. Again, there is no disagreement between the parties, and we find the facts for this factor proven.

178. We also agree that a deduction of 5% is justified.

(e) 3rd Mitigating Factor

179. According to Ms X, the 3rd Mitigating Factor was 'The Appellants' assertion that they had relied on the professional accountants, internal auditors and external auditors, in preparing the audited accounts and profits tax computations'.

180. A mere 'assertion' would not justify as mitigation.

181. There is no evidence that the 2nd Appellant took steps to consult outsiders. There is evidence that the 1st Appellant did take some steps to consult outsiders. However, given the strong mindedness of the 1st Appellant, they were not relied on. We do not consider that the conduct of the 1st Appellant merits any deduction for mitigation in this regard.

(f) 4th Mitigating Factor

182. According to Ms X, the 4th Mitigating Factor was 'The Appellants' claim that they genuinely believed that they were signing a true, correct and bona fide return of [Company D's] assessable profits for the relevant years'.

183. A mere 'claim' would not justify as mitigation.

184. Even if what is claimed is proven, that should not be a mitigating factor. There is no additional point to be gained by doing what every taxpayer or anyone who signs on behalf of a taxpayer ought to have done in the very first place.

(6) Grave Aggravating Factor

185. The Respondent submitted in subparagraph (7) of paragraph 112 of its closing submission that 'The management fees paid to [Company L] for which deductions were (wrongly) claimed were part of **a tax avoidance scheme** (as confirmed by the previous Board).[10] [Mr A] confirmed that he was involved in the more important decisions of [K] Group, and was the leader in formulating policies and discussing various major issues and the setup regarding the management fees structure was his idea and he must be personally culpable and responsible, by way of additional tax, for the incorrect return filed as a result of the tax avoidance scheme.' [Emphasis added.]

186. The relevant parts of the previous Board's decision reads:

> '*61. Having found that the expenses were not deductible, then our analysis with regard to s.61A in our view would be moot. However, we were asked by the parties to deal with and address this particular point.*

[10] In this regard, the Commissioner refered to and relied on the analysis of the seven factors under section 61A in the Determination, which was also adopted by the Board in B/R 66/07 at paragraph 62.

> *62. We have had the opportunity to review very carefully the Determination by the Deputy Commissioner and in particular, with regard to paragraph 7 onwards in his Determination. We have also considered the seven specific matters pursuant to s.61A, and having considered each of them as set out in the Determination, we would also come to the conclusion that the entering into the Service Agreements between the Taxpayer* [*i.e. Company D*] *and [Company L] and the purported payment of management fees to [Company L] are transactions entered into or carried out for the sole or dominant purpose of enabling the Taxpayer to obtain a tax benefit as provided for under s.61A of the IRO. We accept the analysis set out in the Determination by the Deputy Commissioner and would not say anything further regarding this particular point.'*

187. We are not bound by what the previous Board found in this regard. Section 70 has no application here. Section 70 only makes 'the assessment' of the previous Board 'final and conclusive.' Since the previous Board need not make the assessment as regards Section 61A, the previous Board's findings in paragraph 62 of its decision is not conclusive for our purposes.

188. We have to make our own findings.

189. There is evidence of the 1st Appellant devising the scheme for Company D. He vetoed and persuaded 'professionals'. According to the 1st Appellant himself, his professional advisers at Company U did initially express reservation about his scheme in writing, but he had subsequently gone so far as to mistrust them and seek out Mr V, the most senior tax partner in an informal meeting, with a view to converting him into seeing things his way and eventually succeeded. This takes the 1st Appellant's case away from the normal case of passive recklessness into the realm of active recklessness.

190. For this grave aggravation alone we impose an additional 50% tax on top of the 100% starting point for the 1st Appellant. Given that there is some overlap with the 1st Aggravating Factor, we would exercise our discretion not to add the 30% we would otherwise impose for the 1st Aggravating Factor.

(7) Base Portion of Additional Tax

191. In summary, without taking into account commercial restitution or interest, the portion of the additional tax to be imposed by this Board ('Base Portion of Additional Tax'):

191.1. on the 1st Appellant is 140% on the tax undercharged, being:

(a) starting off point of 100%;

(b) plus 50% for the grave aggravating factor as per paragraph 190 herein; and

(c) less a total of 10% of the tax undercharged for the 1st Mitigating Factor and the 2nd Mitigating Factor at 5% each; and

191.2. on the 2nd Appellant in the case D33/16 is 90% on the tax undercharged, being:

(a) starting off point 100%;

(b) less a total of 10% of the tax undercharged for the 1st Mitigating Factor and the 2nd Mitigating Factor at 5% each.

(8) Commercial Restitution or Interest

192. In her witness statement, Ms X gave evidence of the rates of commercial restitution as set out in paragraph 117 herein. In a case of additional tax against the direct taxpayer like Company D, the Commissioner and the law abiding citizens of Hong Kong have been kept out of the money so long as the tax has not been paid. Subject to the jurisdictional limit of 300% of the tax undercharged, interest at judgement rate or commercial rate ought to be levied on the shortfall. If nothing other than such interest is levied, in effect there is nothing to show the disapproval of society for such defaulter - a function which additional tax serves. That is why we have reservation on the Penalty Policy where interest is considered in determining the different levels of additional tax in the first place.

193. In the present type of cases where a third party is affixed with additional tax where the liability of a taxpayer like Company D had been understated, the default of the Appellants is a first cause for the Commissioner and the law abiding citizens of Hong Kong being kept out of the money. The Appellants have been reckless. Unless Company D (by the action, if any, of its management) have intervened to pay and have the resources to pay, the Commissioner and the law abiding citizens of Hong Kong will be kept out of the money. In the present case, Company D has not paid the tax. There is no reason why the Appellants should not be visited with interest so long as the tax remains unpaid. Notwithstanding the aggravating factors, we refrain from adding interest on that part of the additional tax levied but will give credit for mitigating factors in the calculation of interest.

194. We would therefore exercise our discretion so that the commercial interest at the rates for commercial restitution set out in paragraph 117 herein compounded monthly is to be calculated on the amount of tax understated from the respective dates when the tax would have been due if the original return filed were correct, to the date of the actual demand note.

(9) Mr W

195. The assessment of quantum must be compared with the treatment of Mr W.

196. What the argument suggests is that Mr W should have been charged and not that the Appellants should not have been charged.

197. Further, such is not a case of disparity in reasoning in cases before the same tribunal.

198. Just as it is not open to a 'defendant' to say that merely because others are not 'prosecuted', his starting point for sentencing is that he should also be let off scot free, it is not open to the Appellants to run a similar argument in this case.

(10) Whether Additional Tax Assessments Were Excessive

199. Given our views, we are satisfied that the original net percentages set out in paragraph 113 herein are not excessive for the 1st Appellant.

200. We are of the view that:

200.1. they are too low for the 1st Appellant and substitute the rate of 140% for the 1st Appellant in respect of the Base Portion of Additional Tax; and

200.2. there shall be added commercial interest at the rates for commercial restitution set out in paragraph 117 herein compounded monthly on 100% of the tax undercharged for each of the two years of tax assessment from the respective dates when the tax would have been due if the original return filed were correct to the date of the actual demand note subject to the jurisdictional limit, under Section 82A(1) of the Ordinance, of 300% of the tax undercharged.

201. For the 2nd Appellant:

201.1. we would in the decision D33/16 substitute the rate of 90% in respect of the Base Portion of Additional Tax; and

201.2. there shall be added commercial interest at the rates for commercial restitution set out in paragraph 117 herein compounded monthly on 90% of the tax undercharged from the date when the tax would have been due if the original return filed were correct to the date of

the actual demand note, subject to jurisdictional limit, under Section 82A(1) of the Ordinance, of 300% of the tax undercharged.

H. Conclusion and Disposal

202. In accordance with Section 68(8)(a) of the IRO as applied by Section 82B(3) of the IRO, we remit the case to the Commissioner with our opinion in paragraph 200 herein for the 1st Appellant for determination of the amount in accordance with our opinion herein.

203. Formal disposition of the case concerning the 2nd Appellant will be given in a separate decision in the case D33/16.

204. The Chairman apologises for the time taken in his deliberation and thanks the parties for their patience.

Annexure I

INLAND REVENUE BOARD OF REVIEW

APPEAL NO. B/R XX/XX AND B/R XX/XX

STATEMENT OF AGREED FACTS

(References to numbered liem numbers are to items in the Bundles enclosed to the Notice of Appeal dated 24 May2013]

The parties to the above appeal agree to the following facts:

Introduction

1. This is an appeal by Mr A ('1st Appellant') and Mr F ('2nd Appellant') (collectively referred to hereunder as 'the Appellants') against the following assessments [Item 47], all dated 26 April 2013, issued by the Commissioner of Inland Revenue ('the Commissioner'), assessing the Appellants to Additional Tax under section 82A of the Inland Revenue Ordinance ('the Ordinance'), Chapter 112, for making incorrect Profits Tax Returns on behalf of Company D2 formerly known as Company D1, in liquidation pursuant to the Winding-up Order dated 4 June 2012):

Assessments issued to the 1st Appellant:

Year of Assessment	Charge number	Additional Tax
1996/97	X-XXXXXXX-XX-X	$6,400,000
1999/2000	X-XXXXXXX-XX-X	$6,200,000

Assessment issued to the 2nd Appellant:

Year of Assessment	Charge number	Additional Tax
1997/98	X-XXXXXXX-XX-X	$5,400,000

2. The Additional Tax was assessed following the dismissal of Company D's appeal to the Board of Review ('the Board') in respect of the assessments referred to in paragraphs 16 to 18 below, whereby Company D was denied deductions for management fees paid to its parent company (the main issue in dispute), and legal and professional fees paid to its parent company and its subsidiaries in the mainland of China.

3. Company D was incorporated as a private company in Hong Kong in November 1983 and commenced business in January 1984. In the directors' reports, the principal activities of Company D were described as:

- trading of electronic products (for the years ended 31 December 1996 and 1997);

- trading of electronic products and moulds (for the years ended 31 December 1998 and 1999).

4. At all relevant times, the parent company of Company D was Company L, a Territory AC company listed on the NASDAQ National Market of the United States of America. Company L was also the ultimate holding company of various subsidiaries including:

- Company M

- Company AD

- Company AE

- Company AF

5. At all relevant times, Company AD, AE and AF were wholly owned subsidiaries of Company D. The principal activities of Company AD and AE were 'manufacturing' while that of Company AF as 'software development'. A chart showing the structure of the group of companies consisting of Company L, D, M, AD, AE & AF is at Appendix A to the Determination of the Deputy Commissioner dated 31 October 2007 ('the Determination'). [Note: The Determination is omitted in this publication]

6. At all relevant times, the Appellants were directors of Company D. They also held the following positions on the board of directors of Company L:

	Year ended	Position
The 1st Appellant	31 December 1996	Position AG
	31 December 1997	Position AG and AH
	31 December 1998	Position AI
	31 December 1999	Position AI
The 2nd Appellant	31 December 1996	Position AK and AL
	31 December 1997	Position AK and AL
	31 December 1998	Position AM
	31 December 1999	Position AM

Returns and Accounts

7. The directors' reports for Company D for the year ended 31 December 1996, 31 December 1997 and 31 December 1999 were signed by the 1st Appellant, and the directors' report for the year ended 31 December 1998 was signed by the 2nd Appellant.

The audited accounts for those years were signed by the Appellants. The directors' reports and audited accounts are at [Item 4].

8. On 27 July 1997 and 26 July 2000, the 1st Appellant signed, in the capacity of director, the Profits Tax Returns of Company D for the years of assessment 1996/97 and 1999/2000 respectively and declared Company D's Assessable Profits (Adjusted Loss) as follows:

Year of assessment	Assessable Profits (Adjusted Loss)
1996/97	$9,889,250
1999/2000	($3,803,183)

9. On 30 July 1998, the 2nd Appellant signed, in the capacity of director, the Profits Tax Return of Company D for the year of assessment 1997/98 [Item 3] and declared Company D's Assessable Profits as follows:

Year of assessment	Assessable profits
1997/98	$8,667,488

10. The Profits Tax Return of Company D for the year of assessment 1998/99 [Item 3] was signed by a Mr W, in the capacity of Position Z, who declared Company D's Assessable Profits as follows:

Year of assessment	Assessable profits
1998/99	$2,071,402

11. The Assessor issued to Company D the following Profits Tax Assessments and statement of loss, as the case might be, in accordance with the profits or loss returned [paragraphs 8 to 10 above]:

	1996/97	1997/98	1998/99	1999/2000
Profit/(loss) per returns	$9,889,250	$8,667,488	$2,071,402	($3,803,183)
Date of assessment/statement of loss	8 August 1997	27 August 1998	6 October 1999	24 October 2000
Tax payable	$1,631,726	$1,287,121	$331,424	-

Tax Audit

12. In December 2002, the Assessor commenced an audit on tax returns and accounts filed by Company D.

13. The Assistant Commissioner, having examined the facts, applied the provisions in sections 16, 17, 61 and 61A of the Ordinance and raised on Company D Additional Profits Tax Assessments for the years of assessment 1996/97 to 1998/99 and Profits Tax Assessment for the year of assessment 1999/2000 to disallow certain expenses

including management fees paid to Company L:

	1996/97	1997/98	1998/99	1999/2000
Date of assessment/additional assessment	28 February 2003	31 March 2004	31 March 2005	31 March 2006
Profit/(loss) per return [Paragraph 11]	$9,889,250	$8,667,488	$2,071,402	($3,803,183)
Add: Management fee paid/payable to Company L	32,313,540	34,790,641	25,622,804	35,873,789
Legal and professional fee paid/payable to Company L and Company AD	4,429,290	-	-	-
Cost of sales adjustment	24,388,988	-	-	-
Salaries and allowances	4,800,000			
Assessable profits	75,821,068	43,458,129	27,694,206	32,070,606
Less: Profits already assessed	9,889,250	8,667,488	2,071,402	-
Assessable Profits/ Additional Assessable Profits	$65,931,818	$34,790,641	$25,622,804	$32,070,606
	$10,878,750	$5,166,411	$4,099,648	$5,131,296

14. After consideration of the seven matters set out in section 61A of the Ordinance, the Assistant Commissioner came to the conclusion that the entering into of the service agreements between Company D and Company L and the purported payment of management fees to Company L were transactions entered into or carried out for the sole or dominant purpose of enabling Company L to obtain tax benefits.

Objection and Appeal

15. By letters of 20 March 2003, 23 April 2004, 8 April 2005 and 19 April 2006 from Company AN, Company D's then tax representative, the company raised objections against the assessment and additional assessments listed out in paragraph 13.

16. By the Determination, the Deputy Commissioner revised or confirmed the assessments concerned. The amounts of assessable profits and tax payable as revised or confirmed were as follows:

	1996/97	1997/98	1998/99	1999/2000
Profit/(loss) per return [Paragraph 8 to 10]	$9,889,250	$8,667,488	$2,071,402	($3,803,183)
Add: Management fee paid/payable to Company L	32,313,540	34,790,641	25,622,804	35,873,789
Legel and professional fee paid/payable to Company L and Company AD	4,429,290	-	-	-
Cost of sales adjustment (no adjustment)	-	-	-	-
Salaries and allowances (no adjustment)	-	-	-	-
Legal and professional fees	-	-	-	4,624,023
Management fee written off	-	-	3,955,874	-
Assessable profects	46,632,080	43,458,129	31,650,080	36,694,629
Less: Profits already assessed	9,889,250	8,667,488	2,071,402	-
Assessable Profits/ Additional Assessable Profits	$36,742,830	$34,790,641	$29,578,678	$36,694,629
Tax payable	$6,062,567	$5,166,411	$4,732,588	$5,871,140

Having considered the facts of the case, the Deputy Commissioner accepted that no adjustments for cost of sales and salaries and allowances for the year of assessment 1996/97 were required. The Deputy Commissioner also considered that the following expenses were not deductible under sections 16(1) and 17(1)(b) of the Ordinance:

- management fees to Company L for the years of assessment 1996/97 to 1999/2000;

- legal and professional fees of $4,429,290 to Company L and Company AD for the year of assessment 1996/97;

- legal and professional fees of $4,624,023 for the year of assessment 1999/2000;

- management fees of $3,955,874 written off in the year of assessment 1998/99.

The Deputy Commissioner further determined that section 61A of the Ordinance was applicable in relation to the first two items stated above.

17. By a Notice of Appeal dated 29 November 2007, the representative of Company D appealed to the Board against the Determination.

18. By a decision dated 9 December 2008 ('Board Decision'), the Board dismissed Company D's appeal and upheld the Determination under sections 16(1), 17(1)(b) and 61A of the Ordinance.

19. Company D then sought to appeal by way of case stated pursuant to section 69 of the Ordinance. On 16 January 2009, the Board replied that the questions formulated by Company D were unparticularised and did not identify questions of law that at that stage the Board was prepared to state. By a Letter dated 30 March 2009, the legal representative of Company D asked the Board to confirm whether or not it was willing to state any questions for the opinion of the Court of First Instance. On 15 April 2009, before receiving the Board's reply, Company D applied to the Court of First Instance in HCAL XX/XXXX for leave to apply for judicial review of the Board's 'de facto refusal' to state a case.

20. On 22 April 2009, the Board issued its decision and declined to state a case on the ground that the questions formulated by Company D were not proper questions of law.

21. Leave to apply for judicial review in HCAL XX/XXXX was refused by the Court of First Instance on 23 April 2009 without a hearing. Company D then appealed to the Court of Appeal (CACV XXX/XXXX). The appeal was dismissed by the Court of

Appeal's judgment of 14 October 2009. No further appeal was lodged by Company D.

Winding-up of Company D (HCCW XXX/XXXX)

22. According to Company D's audited accounts for the year ended 31 December 2003, the company disposed its entire interest in Company D to a fellow subsidiary during the year and then ceased its trading business. Regarding the Profits Tax payable as determined by the Deputy Commissioner and upheld by the Board Decision (paragraph 16 above), Company D failed to pay any of the tax payable as stated in paragraph 16 above despite repeated demands and enforcement actions.

23. In or around June 2011, the Commissioner petitioned for the winding-up of Company D by reason of the unpaid tax. The petition was heard on 13 March 2012, and judgment of the Court was handed down on 4 June 2012 ordering Company D be wound up.

Discrepancies

24. The discrepancies between the profits or loss as stated in the returns signed by the Appellants (paragraphs 8 and 9 above), and the assessable profits for each relevant year of assessment as determined in the Determination and upheld by the Board Decision and tax undercharged are tabulated as follows:

Discrepancies

Year of Assessment	Total Assessable Profits $	Assessable Profits (Loss) reported $	Amount of Discrepancy $	% of profits understated to total Assessable Profits
1996/97	46,632,080	9,889,250	36,742,830	78.79%
1997/98	43,458,129	8,667,488	34,790,641	80.06%
1999/2000	36,694,629	(3,803,183)	40,497,812*	110.36%
Total	126,784,838	14,753,555	112,031,283	

*For the year of assessment 1999/2000, the amount of discrepancy comprises of profits understated $36,694,629 and loss over-claimed $3,803,183

Tax Undercharged

Year of Assessment	Total Tax Profits $	Tax already charged $	Tax undercharged $	% of tax undercharged to total tax payable
1996/97	7,694,293	1,631,726	6,062,567	78.79%
1997/98	6,453,532	1,287,121	5,166,411	80.06%
1999/2000	5,871,140	0	5,871,140	100%
Total	20,018,965	2,918,847	17,100,118	

Additional Tax under section 82A

25. On 17 January 2011, the Commissioner gave notices ('the Notices') [Item 8] to the 1st Appellant and 2nd Appellant respectively under section 82A(4) of the Ordinance that he intended to assess the 1st Appellant to Additional Tax for making incorrect returns in respect of Company D by understating its profits and overclaiming its losses for the years of assessment 1996/97 and 1999/2000 and to assess the 2nd Appellant to Additional Tax for making incorrect return in respect of Company D by understating its profits for the year of assessment 1997/98.

26. No prosecution under sections 80(2) or 82(1) of the Ordinance has been instituted in respect of the incorrect returns filed by Company D.

27. On 16 February 2011, the Appellants, via their former tax representative, Company AP, submitted written representations to the Commissioner. Further representations for the 1st Appellant were made in Company AP's letters of 25 February 2011, 13 May 2011 and 30 June 2011, and for the 1st Appellant, or the Appellants, in the letters of the new tax representative, Company T of 3 September 2012, 1 February 2013, 18 February 2013 and 8 March 2013.

28. On 14 April 2011, the Appellants filed a notice of application for leave to apply for judicial review (HCAL XX/XXXX) to challenge the Commissioner's decision to issue the Notices to the Appe1lants.

29. Before the application was considered by the Court, the Appellants filed a notice of discontinuance of the application for leave to apply for judicial review on 27 June 2011.

30. Having considered all the written representations and submissions, the Commissioner made the Additional Tax assessments referred to in paragraph 1 above which were issued to the Appellants on 26 April 2013.

31. On 24 May 2013, Company AQ, on behalf of the Appellants, appealed to the Board against the assessments to Additional Tax.

32. On 22 July 2013, the Appellants filed a Notice of Application for Leave to Apply for Judicial Review in relation to the Commissioner's decision to issue the said assessments of Additional Tax (HCAL XXX/XXXX). The said application for leave was refused by the High Court on 21 August 2013 after an oral *ex parte* hearing.

33. On 2 September 2013, the Appellants issued Notice of Appeal appealing against the refusal (CACV XXX/XXXX). The appeal was heard by the Court of Appeal on 30 May 2014, and the appeal was dismissed on the same day after the hearing (the

attendance by the Commissioner was excused). Written Reasons for Judgment were handed down by the Court of Appeal on 9 June 2014.

Dated this 15th day of December 2014.

(sd.) [Name and Rank of Government Counsel]	(sd.) [Name of Solicitors Firm] For the Appellant

Annexure II

Inland Revenue Department
The Government of the Hong Kong Special Administrative Region

Penalty Policy

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A. Introduction

1. The effective operation of Hong Kong's simple tax system with low tax rates requires a high degree of compliance by taxpayers. It is also the primary duty of every taxpayer under law to file timely and accurate tax returns to the Inland Revenue Department ("the Department").

2. If the requirements under the Inland Revenue Ordinance ("IRO") are not complied with, the relevant punitive provisions empower the Commissioner, depending on the nature and/or the degree of culpability of the offence and at his discretion, to institute prosecution, to compound or to assess additional tax (which is a form of penalty) in respect of the offence. Factors which may affect the course of action to be taken include the strength of evidence, the amount of tax undercharged or would have been undercharged (hereinafter collectively

referred to as "tax undercharged"), the sophistication of the scheme and the period of time over which the offence was committed.

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B. Penalty Provisions

1. Punitive actions under Part XIV of the IRO include:

   (a) Prosecution under section 80(1) on any person as an employer who without reasonable excuse fails to comply with the requirements specified under section 52(2), (4) to (7) of the IRO.

   The offence is subject to a fine of $10,000 and the court may order the person convicted to do the act which he fails to do.

   (b) Prosecution under section 80(1A) on any person who without reasonable excuse fails to comply with the record-keeping requirement under section 51C.

   The offence is subject to a fine of $100,000 and the court may order the taxpayer to do the act which he has failed to do within a specified time.

   (c) Prosecution under section 80(2) on any person who without reasonable excuse:

      (i) makes an incorrect return;

      (ii) makes an incorrect statement;

      (iii) gives any incorrect information;

      (iv) fails to furnish a return in time; or

      (v) fails to inform chargeability to tax.

   The offence is subject to a fine of $10,000 and treble the amount of the tax undercharged.

   (d) Prosecution under section 82 on any person who wilfully with intent to evade or to assist any other person to evade tax:

      (i) omits from a return any sum which should be included;

      (ii) makes any false statement or entry in any return;

(iii) makes any false statement in connection with a claim for any deduction of allowance;

(iv) signs any untrue statement/return;

(v) gives any false answer to any question or request for information asked or made in accordance with the provisions of IRO;

(vi) prepares or maintains any false books of accounts; or

(vii) makes use of any fraud etc to evade tax.

The offence is subject to a fine of $50,000 ($20,000 for an offence committed before 1 August 1994 and $25,000 for an offence committed between 1 August 1994 and 18 July 1995), and treble the amount of the tax undercharged and 3- year imprisonment.

(e) Compounding of any of the offences under sections 80 and 82 in lieu of prosecution [sections 80(5) and 82(2)].

(f) Assessing additional tax under section 82A in respect of any of the offences in lieu of prosecution [section 82A(1)].

2. Penalty actions under section 82A will be taken only after the Department has considered the taxpayer's representations, if one has been made, but found that there is no reasonable excuse for the alleged offence.

3. When invoking section 82A, the Commissioner or his deputy will issue a written notice to the taxpayer indicating his intention to assess additional tax and setting out the particulars of the alleged offence. He will also invite the taxpayer to submit written representations with regard to the proposed additional tax assessment. The taxpayer will be given a period of not less than 21 days from the date of service of the notice to make his representations.

4. The maximum amount of penalty provided under section 82A is treble the amount of the tax undercharged.

5. A taxpayer who has been assessed to additional tax has the right to appeal to the Board of Review ("the Board") within one month from the date of issue of the notice of the additional tax assessment. For details, please click here.

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C. Penalty Policy for Assessing Additional Tax under Section 82A

1. Offences which do not involve any wilful intent to evade tax are generally dealt with administratively by the imposition of monetary penalties in the form of additional tax under section 82A of the IRO.

2. In general, section 82A penalties are imposed by the Department on the following three categories of cases:

   (a) Profits Tax cases;

   (b) Salaries Tax and Property Tax cases;

   (c) Personal Assessment cases.

3. A field audit / investigation might have been conducted in relation to cases falling within the above categories. Field audit / investigation conducted would heighten the chance of section 82A penalty being imposed and would have a material impact on the level of penalty assessed.

4. Taxpayers will be advised of the category and / or the group of penalty loading applicable to them in the relevant additional tax assessments.

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D. Section 82A Penalty Policy for cases involving Field Audit & Investigation

1. This part applies to profits tax, salaries tax, property tax and personal assessment cases where a field audit or investigation has been conducted. The most common offences for this type of cases are -

   (a) Omission or understatement of income or profits;

   (b) Making incorrect statement in connection with a claim for any deduction or allowance;

   (c) Failure to notify chargeability to tax.

2. The scale of penalty to be imposed on a taxpayer is basically a function of the nature of omission or understatement of income or profit, the degree of his co-operation or disclosure and the length of the offence period. For the purposes of maintaining consistency in penalty calculation, the following penalty loading table is used:

Category of Disclosure and Work Involved								
Nature of Omission / Understatement (see Note 1 below)	**Full Voluntary Disclosure**		**Disclosure with FULL Information Promptly on Challenge**		**Incomplete or Belated Disclosure**		**Disclosure Denied**	
	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.
Group (a)	15	60	75	100	140	180	210	260
Group (b)	10	45	50	75	110	150	150	200
Group (c)	5	30	35	60	60	100	100	150

(see Notes 2 and 3 below)

Note 1 : **Group (a)** - cases where the taxpayers show intentional disregard to the law and adopt deliberate cover-up tactics involving the preparation of a false set of books, padded wage rolls and fictitious entries or multiple omissions over a long period of time.

Group (b) - cases with slightly less serious acts of omission resulting from recklessness including the "hand in the till" type of evasion, failure to bring to account sales of scrap, and sheer gross negligence.

Group (c) - cases where the taxpayers fail to exercise reasonable care and omit profits/ income such as lease premium, one-off commission, etc.

Note 2 : The penalty loading is expressed as a percentage of the tax undercharged.

Note 3 : For cases completed after 30 November 2003, the CR (commercial restitution) is at 7% per annum monthly compounded for periods up to and including 30 November 2003 and at the best lending rate monthly compounded for periods after 30 November 2003.

3. To conclude that a taxpayer has intentionally disregarded the provisions of the IRO requires a finding that the taxpayer consciously decided to disregard clear obligations imposed on him. Such a finding may be based on direct evidence on the taxpayer's intention (such as an admission) or may be inferred from the taxpayer's behaviour. Recklessness is gross carelessness. A taxpayer will be found to have behaved recklessly if his conduct clearly showed disregard of, or indifference to, consequences that are foreseeable by a reasonable person as being a likely result of his actions. It is not necessary for a finding of

recklessness that the taxpayer should have been acting dishonestly, nor that the taxpayer intended to bring about the consequences that his actions caused. The reasonable care test requires a taxpayer to take the care that a reasonable, ordinary person would take in all the circumstances of the taxpayer to fulfil the taxpayer's tax obligations.

4. The percentages in the penalty loading table in paragraph D2 are for general guidance only. The penalty imposed may be adjusted upwards or downwards depending on the circumstances of each case. The following table contains the general aggravating and mitigating factors to be considered in determining the ultimate penalty:

Factors for Consideration	**Mitigating**	**Aggravating**
1. Background of the Taxpayer and Sophistication of the Business	• being illiterate or having a low standard of education	• sophisticated taxpayers
	• simple and unsophisticated business	• established and sophisticated business
2. Attitude of the Taxpayer	• genuine concern, seriousness, responsiveness and co-operation	• undue delay or obstruction to the progress of audit and investigation
	• sincerity and willingness to compromise	• passiveness and unwillingness to compromise
	• readiness to accept the discrepancy when quantified	• evasiveness and belated acceptance of the discrepancy quantified

Factors for Consideration	Mitigating	Aggravating
3. Time Span	• casual or one-off understatement	• multiple or repeated evasion acts over a consecutive number of years (e.g. persistent default in rendering returns and making of incorrect returns when pressed with estimated assessments)
4. Scale of Business and Quantum of the Understatements	• relatively small cases	• cases with substantial quantum of understatements having regard to the operating scale of the business
	• accepted discrepancy includes substantial contentious items	• discrepancy consisting of specific fictitious items with cover-up tactics

Depending on the facts peculiar to each case, the penalty may be scaled upwards or downwards to a maximum of 25% in the generality of cases. Further adjustment would be made only when exceptional warranted circumstances exist.

5. Taxpayers are encouraged to make full voluntary disclosure of their offences and work out reasonable proposals for the Department's consideration. Failing that and for the sake of expediency, field audit cases (including anti-avoidance cases) closed within 3 months from the date of initial interview as well as investigation cases closed within 6 months from the date of initial interview, can be classified as falling into the category of "Disclosure with Full Information Promptly on Challenge".

6. Cases often fall within the categories of "Disclosure with Full Information Promptly on Challenge" Group (a) and "Incomplete or Belated Disclosure" Group (b). In the generality of cases, subject to various aggravating or mitigating factors, a penalty of about 100% of the amount of tax undercharged is considered appropriate in the following circumstances:

(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the Ordinance; and

(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax; and

(c) where the failure by the taxpayer to fulfill his or its obligations under the Ordinance has persisted for a number of years.

7. Strictly speaking, each offence should be considered separately. However, if multiple offences (not limited to those stipulated in paragraph 1 above) were committed by the taxpayer in respect of the same year of assessment, the Commissioner would normally penalize the taxpayer for the offence of the most serious nature only.

8. As section 82A makes no distinction between, among other things, transgression for understatement of income and late filing of return, the exposure to treble the amount of tax undercharged is applicable to both. Furthermore, the rule mentioned in paragraph D6 above is equally applicable. However, as most of the late return cases do not involve these factors, the level of penalty is much lower (see Parts E and F below).

9. For cases involving late filing of returns with no omission or understatement of income/profit detected after field audit or investigation, the penalty policy under Parts E to G is to be applied. However, a higher penalty loading will be applied if the taxpayer intentionally delays the submission of the returns pending the result of the field audit or investigation.

10. The penalty for a second or subsequent offence uncovered during an audit / investigation would be more severe.

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E. Section 82A Penalty Policy for Profits Tax Cases

1. This part applies to profits tax cases which do not involve any field audit or investigation.

2. For failure to notify chargeability to tax or failure to submit tax return in time, the Department will make reference to the following penalty loading scale:

(a) <u>First offence</u>

Group (i) 10% of the amount of tax undercharged.

Group (ii) 20% of the amount of tax undercharged, if the return is filed after two or more estimated assessments are issued.

(b) Second offence within 5 years

Group (i) 20% of the amount of tax undercharged.

Group (ii) 30% of the amount of tax undercharged, if the return is filed after two or more estimated assessments are issued.

(c) Third or subsequent offences within 5 years

Group (i) 35% of the amount of tax undercharged.

Group (ii) 50% of the amount of tax undercharged, if the return is filed after two or more estimated assessments are issued.

3. The above percentages are for general guidance only. They may be adjusted upwards or downwards depending on the circumstances of each case. The general relevant factors to be considered include the length of delay, the amount of tax involved, the reasons given for committing the offence, the attitude of and the remedial steps taken by the taxpayer.

4. For the purpose of counting the number of offences within 5 years, "offence" means one in respect of which a warning letter, a compound, a court fine or a section 82A penalty assessment has been issued.

5. For omission or understatement of profits, the penalty policy under Part D will apply. However, the fact that no field audit or investigation has been conducted will be considered as a mitigating factor.

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F. Section 82A Penalty Policy for Salaries Tax and Property Tax Cases

1. This part applies to salaries tax and property tax cases which do not involve any field audit or investigation.

2. For failure to notify chargeability to salaries tax or property tax or failure to submit such returns in time, the Department's policy is normally to compound such offences under section 80(5). Save in exceptional cases, no penalty action under section 82A will be taken having regard to the large number of such cases and the relatively small amount of tax involved in each case. Nevertheless, in cases of repeated offences of the same nature or the degree of culpability of the offence in

any particular case is considered serious, the Department may institute prosecution actions under section 80(2).

3. For simple and inadvertent omission or understatement of income or making an incorrect statement in respect of a claim for an allowance or deduction, the Department will make reference to the following penalty loading scale:

   (a) First offence

   10% of the amount of tax undercharged.

   (b) Second offence within 5 years

   20% of the amount of tax undercharged.

   (c) Third or subsequent offences within 5 years

   35% of the amount of tax undercharged.

4. For blatant cases, e.g. a claim for dependent parent allowance in respect of a deceased parent, a higher percentage, currently at 100%, will normally be imposed.

5. The above percentages are for general guidance only. They may be adjusted upwards or downwards depending on the circumstances of each case. The general relevant factors to be considered include the time span over which the offence is committed, the amount of tax involved, the reasons given for committing the offence, the attitude of and the remedial steps taken by the taxpayer.

6. For the purpose of counting the number of offences within 5 years, "offence" means one in respect of which a warning letter, a compound, a court fine or a section 82A penalty assessment has been issued.

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G. Section 82A Penalty Policy for Personal Assessment Cases

1. This part applies to personal assessment cases which do not involve any field audit or investigation.

2. For making incorrect statements in respect of a claim for an allowance or deduction under personal assessment, the Department will make reference to the penalty loading scale in paragraphs F3 and F4.

3. The fact that the taxpayer elects for personal assessment would not affect the applicability of the penalty policy under Parts D to F to appropriate cases. However,

the amount of tax undercharged in such cases will be computed by reference to that charged under personal assessment.

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