

# Hong Kong Tax Alert

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## Taxpayer penalized for being late in notifying IRD its chargeability to tax<sup>1</sup>

- While directors or shareholders residing overseas or having insufficient knowledge or experience in financial or accounting matters would not generally constitute a reasonable excuse for such an offence, depending on the factual context of a case, reliance on professional advice in good faith could.*
- A lingering issue of the case may be whether the tax tribunal could have decided the case differently if the taxpayer had been able to produce evidence justifying why it initially believed its profits were non-taxable offshore income, albeit abandoned later.*

*Clients who take the position that they are not required to notify the Commissioner of Inland Revenue (CIR) of their chargeability to tax on the grounds that their profits are offshore sourced should seek professional tax advice.*

<sup>1</sup> The decision can be retrieved from the link below:  
<https://www.info.gov.hk/bor/en/decisions/D1523.pdf>

## Facts

The Taxpayer is a private company incorporated in Hong Kong and closes its accounts on 31 December each year. It engaged in rendering sea and flight services to its customers during the period from 14 July 2016 to 31 December 2017, and for the years ended 31 December 2018, 2019 and 2020.

### *Nil tax return filed for the first year and thereafter no annual tax returns issued*

On 5 February 2018, the Inland Revenue Department (IRD) issued a profits tax return for the year of assessment 2016/17 (2017 Return) to the taxpayer. The Taxpayer later submitted the 2017 Return and declared that it had no business activities for the initial year.

Subsequently on 29 November 2018, as a result of the Taxpayer filing the 2017 Return as Nil, the IRD issued a letter to the Taxpayer (Form IR1812) advising that the IRD would not require it to furnish tax returns on an annual basis.

Nevertheless, the Taxpayer was reminded by the letter to notify the CIR in writing within four months after the end of the basis or accounting period for any year of assessment if it derived assessable profits for the year as required by section 51(2) of the Inland Revenue Ordinance (IRO). Failure to notify its chargeability to tax within the stipulated time may render the Taxpayer liable to a fine up to HK\$10,000 and treble of the amount of tax undercharged under section 82A of the IRO.

### *IRD's subsequent issuance of a tax return to Taxpayer in its review cycle*

On 5 May 2020, the IRD issued a profits tax return for the year of assessment 2019/20 (the 2020 Return) to the Taxpayer. On 27 July 2021, the Taxpayer filed the 2020 Return showing assessable profits of HK\$14,656,917 for the year.

### *Taxpayer being late in notifying IRD its chargeability to tax*

It was only on 22 March 2022 that the Taxpayer through its tax representative submitted a letter to the IRD notifying its chargeability to tax for the years of assessment 2017/18 and 2018/19 and requested the IRD to issue the profits tax returns for the said years to it.

On 11 April 2022, the IRD issued the profits tax returns (the Returns) for the years of assessment 2017/18, 2018/19 and 2020/21 (the Years) to the Taxpayer. The Returns which made no offshore claims were furnished to the IRD on 15 July 2022.

The IRD later issued the profits tax assessments for the Years and the Taxpayer did not object to the assessments.

### *Penalties imposed on Taxpayer for being late in notifying chargeable to tax*

On 13 February 2023, the CIR issued a notice of intention to impose penalties in the form of additional tax pursuant to section 82A(4) of the IRO in respect of the Taxpayer's failure to notify its chargeability to tax within the stipulated time for the Years.

The Taxpayer, through its tax representative, submitted written representations in response to the above notice, stating that the failure was unintentional with justifications. This was primarily because the shareholders had insufficient knowledge or experience in financial and accounting matters.

Having considered the written representations made, on 13 April 2023 the IRD issued additional tax assessments for the Years to the Taxpayer in the following sums:

Year of Assessment	2017/18	2018/19	2020/21
Tax undercharged	HK\$2,428,230	HK\$1,862,329	HK\$1,554,819
Additional tax	HK\$360,000	HK\$169,000	HK\$50,000

A summary of the above events and other facts of the case is shown in the table below:

Year of assessment	Deadline for notification of chargeability	Date of signing of audited accounts	Date of filing of notification of chargeability	Date of issue of return	Date of receipt of return
2017/18	30 Apr 2018	15 Jul 2021	23 Mar 2022	11 Apr 2022	15 Jul 2022
2018/19	30 Apr 2019	15 Jul 2021	23 Mar 2022	11 Apr 2022	15 Jul 2022
2020/21	30 Apr 2021	31 Jan 2022	-----	11 Apr 2022	15 Jul 2022

Year of assessment	Period of delay (days)	Tax undercharged	Additional Tax	Percentage of additional tax over tax undercharged
2017/18	1,423#	HK\$2,428,230	HK\$360,000	14.83%
2018/19	1,058#	HK\$1,862,329	HK\$169,000	9.07%
2020/21	346*	HK\$1,544,819	HK\$50,000	3.24%

#counted up to 23 March 2022, being the date of filing of notification of chargeability.

\*counted up to 11 April 2022, being the date of issue of the profits tax return for the year of assessment 2020/21.

#### *Taxpayer's appeal against the additional tax assessments to the BOR*

The Taxpayer appealed against the additional tax assessments to the tax tribunal of the Board of Review (BOR) arguing that (i) it had reasonable excuse for its failure to notify chargeability to tax within the stipulated time and therefore not liable to the additional tax; and (ii) failing (i), the additional tax assessments were excessive in the circumstances.

#### **BOR decision**

The Taxpayer was represented by its tax representative at the BOR hearing and did not call any witness to give evidence to substantiate its case.

The tax representative argued that at all relevant times the two shareholders of the Taxpayer were residing overseas. The Taxpayer had no place of business in Hong Kong, had not employed any persons in Hong Kong and had no customers or suppliers in Hong Kong. The two directors in Hong Kong were nominee directors not involved in the operations of the Taxpayer. All the operations of the Taxpayer were carried out outside Hong Kong and managed by the two shareholders outside Hong Kong.

Thus, the Taxpayer originally took the view that its profits were offshore sourced and therefore had derived no assessable profits chargeable to tax in Hong Kong. However, the management of the Taxpayer later changed their mind when the first accounts were almost finalized in July 2021 and decided not to claim the profits as offshore. It was for this reason that the Taxpayer was late in notifying the IRD of its chargeability to tax in Hong Kong.

However, the BOR noted that other than producing its employer's returns and the travel records of the two shareholders, the Taxpayer had not produced any or sufficient evidence to substantiate the basis on which it originally believed that its profits were offshore sourced. Furthermore, many questions raised by the CIR had not been satisfactorily addressed and answered by the Taxpayer.

The BOR added that this contention now raised by the Taxpayer at the BOR hearing was not mentioned when the Taxpayer filed its notice to inform the IRD of its chargeability to tax on 22 March 2022. Nor was the contention raised in the written representations made on 22 February 2023 in response to the CIR's notice of intention to impose penalties in the form of additional tax.

In any event, the BOR considered that even if the Taxpayer was to be believed, the Taxpayer's subjective belief that its profits were non-taxable offshore income would not constitute a reasonable excuse for its failure to notify chargeability to tax.

The BOR also rejected the submission that the shareholders at the relevant times were residing overseas and lacked sufficient knowledge or experience in financial and accounting matters would constitute a reasonable excuse.

In this regard, the BOR noted that not only had the Taxpayer adduced no evidence to show the educational background and commercial experience of the two shareholders, more importantly, lack of knowledge or experience or the place of residence of a taxpayer are not generally regarded or accepted as reasonable excuses.

Thus, the BOR held that the Taxpayer had no reasonable excuse for its failure to notify chargeability to tax within the stipulated time.

The BOR also held that the additional tax assessments were not excessive given that the amounts of additional tax charged represented no more than the IRD recouping the interest element on the tax undercharged given the delay in issuing the profits tax assessments involved.

On the above basis, the BOR dismissed the Taxpayer's appeal.

## **Commentary**

Taxpayers may take the position that their profits are non-taxable offshore income and therefore do not notify the IRD of their chargeability to tax within the stipulated time.

This would not generally be an issue if their profits are ultimately proved and accepted by the IRD to be non-taxable.

However, issues could arise if their offshore claims cannot eventually be proved or accepted by the IRD, and they then concede their claims. Or, as alleged in this case, taxpayers for some reasons do not pursue what they originally believed to be their entitlement to an offshore claim.

Notably, the BOR in this case was at pains to point out that (i) the Taxpayer had adduced no evidence to substantiate its original belief that its profits were offshore sourced and (ii) such contention was not raised earlier in its notice to inform chargeability to tax nor in its written representations to the CIR, apparently thus casting a shadow of doubt on the truthfulness of the claim.

As such, a lingering issue of the case may be whether the BOR could have decided the case differently if the Taxpayer had been able to produce evidence, e.g., by personal testimony justifying the reasonableness of its initial belief that its profits were non-taxable offshore income and the reasons for its subsequent change of mind.

In any case, while a taxpayer's subjective belief may not be sufficient given that the validity of an offshore claim is by nature a very technical issue, reliance on professional tax advice in good faith, depending on the factual context of a case, could constitute a reasonable excuse (e.g., BOR case D18/91).

Clients who take the position that they are not required to notify the CIR of their chargeability to tax on the grounds that their profits are offshore sourced should seek professional tax advice.



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