

Hong Kong Tax Controversy Insight

15 July 2020

2020 Issue No. 3

Inland Revenue Department (IRD)'s penalty policy involving Field Audit and Tax Investigation - Penalty consideration

When a taxpayer (including corporation or individual) is selected for tax audit or investigation, one of the most concerning questions is whether there is penalty in addition to tax payable in case there is any tax undercharged.

In this insight, we will look at the penalty consideration for cases involving Field Audit and Investigation.

Penalty provisions under Inland Revenue Ordinance (“IRO”)

Penalties may be imposed due to non-compliance with the IRO. The Commissioner of Inland Revenue is authorized to initiate prosecution, to compound, or to assess additional tax in respect of any offence. Sections 80, 82 and 82A of the IRO stipulate the general penalty rules.

Section 80 of the IRO would be imposed on a person who, without reasonable excuses, makes incorrect returns and fails to submit returns within the time limit etc. The maximum penalty is a fine at level 3 (HK\$10,000) plus treble the amount of tax undercharged.

Section 82 of the IRO would be imposed on a person who, willfully with the intent to evade tax by making any false statement in returns etc. The maximum penalty is:

- ▶ On summary conviction: a fine at level 3 (HK\$10,000) plus treble the amount of tax undercharged and imprisonment of 6 months.
- ▶ On indictment: a fine at level 5 (HK\$50,000) plus treble the amount of tax undercharged and imprisonment of 3 years.

Section 82A of the IRO would be imposed for assessing additional tax if no prosecution has been instituted under Sections 80 and 82 of the IRO. The maximum penalty is an additional tax of treble the amount of tax undercharged.

Common offences found in Field Audit and Investigation cases

- 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.

Level of penalty for Field Audit and Investigation cases

The quantum of penalty would depend on a number of factors including but not limited to the seriousness of the case, the loss suffered by the IRD, the taxpayer's attitude and cooperation, and the time required to settle the case.

For the field audit and investigation cases, tax offences are classified into three group of culpability: (a) intentional disregard (b) recklessness and (c) no reasonable care. Each group of offence is further classified into four categories of co-operation ranging from voluntary disclosures to disclosure denied for computing the penalty. Please refer to the following penalty loading table for reference:

Category of disclosure and work involved and penalty loading (expressed as a percentage of the tax undercharged)								
Nature of omission / understatement	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

Source: “Penalty Policy” <http://www.ird.gov.hk/eng/pol/ppo.htm>

For example, if a case falls into the category of Group (b) and the third type under ‘Incomplete or Belated Disclosure’ in the above penalty loading table, a penalty loading of 110% will be the starting point plus the commercial restitution (“C.R.”) with a cap of 150%. The C.R. was computed at 7% per annum monthly compounded for periods up to 30 November 2003 and at the best lending rate monthly compounded for periods after 30 November 2003.

Factors for penalty consideration

In assessing the penalty, general factors to be considered in determining the ultimate penalty are specified as below:

a) Background of the taxpayer

If the taxpayer is illiterate or has a low standard of education or his business is simple and unsophisticated, then the penalty would be mitigated. Otherwise, if the taxpayer is sophisticated or with complex business, the penalty would be heavier.

b) Attitude of the taxpayer

Taxpayer's behavior is a key factor. For instance, if a taxpayer is cooperative and responsive, sincere and willing to compromise and able to provide documents and records, to substantiate the tax position. These would be helpful factors to defend against high penalty.

c) Time span

If the field audit and investigation cases involved multiple or repeated evasion acts over a consecutive number of years, for example, there is persistent default in returns and making of incorrect returns, these would generally trigger a high level of penalty. On the other hand, if the field audit cases could be closed within 3 months or within 6 months for investigation cases from the date of initial interview, the level of penalty would be lower.

d) Quantum of the understatements of profits/income

Field audit and investigation cases with substantial tax undercharged, intentional under-reporting or non-disclosure of profits or over-reporting of expenses would generally trigger a high level of penalty.

Possible adjustments of penalty made by the IRD

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

Recommendations

The attitude of the taxpayer and the remedial actions taken by the taxpayer e.g. making prompt and full disclosure of information, and facilitating the early settlement of field audit/investigation are major factors to be considered when imposing penalties.

Also, experience in negotiations with the IRD is critical for settlement of the tax audit case and mitigation of penalty. If taxpayer intends to mitigate the penalty position during the tax audit, they are highly recommended to seek professional advice.



Hong Kong office
Agnes Chan, Managing Partner, Hong Kong & Macau
22/F, CITIC Tower, 1 Tim Mei Avenue, Central, Hong Kong
Tel: +852 2846 9888 / Fax: +852 2868 4432

Ian McNeill Deputy Asia-Pacific Tax Leader +852 2849 9568 ian.mcneill@hk.ey.com				
Non-financial Services				Financial Services
David Chan Tax Leader for Hong Kong and Macau +852 2629 3228 david.chan@hk.ey.com				Paul Ho Tax Leader for Hong Kong +852 2849 9564 paul.ho@hk.ey.com
Greater China Tax Controversy Co-Leader Hong Kong Tax Controversy Leader	Greater China Tax Controversy Co-Leader China Tax Controversy Leader	Greater China Tax Policy Leader		Business Tax Services / Global Compliance and Reporting
Wilson Cheng +852 2846 9066 wilson.cheng@hk.ey.com	Carrie Tang +86 21 2228 2116 carrie.tang@cn.ey.com	Becky Lai +852 2629 3188 becky.lai@hk.ey.com		Paul Ho +852 2849 9564 paul.ho@hk.ey.com
Business Tax Services / Global Compliance and Reporting				Sunny Liu +852 2846 9883 sunny.liu@hk.ey.com
Hong Kong Tax Services				Michael Stenske +852 2629 3058 michael.stenske@hk.ey.com
Tracy Ho +852 2846 9065 tracy.ho@hk.ey.com	Chee Weng Lee +852 2629 3803 chee-weng.lee@hk.ey.com	May Leung +852 2629 3089 may.leung@hk.ey.com	Ada Ma +852 2849 9391 ada.ma@hk.ey.com	International Tax and Transaction Services
Grace Tang +852 2846 9889 grace.tang@hk.ey.com	Karina Wong +852 2849 9175 karina.wong@hk.ey.com	Wilson Cheng +852 2846 9066 wilson.cheng@hk.ey.com		
China Tax Services				International Tax Services
Ivan Chan +852 2629 3828 ivan.chan@hk.ey.com	Lorraine Cheung +852 2849 9356 lorraine.cheung@hk.ey.com	Sam Fan +852 2849 9278 sam.fan@hk.ey.com	Carol Liu +852 2629 3788 carol.liu@hk.ey.com	James Badenach +852 2629 3988 james.badenach@hk.ey.com
Tax Technology and Transformation Services				Jacqueline Bennett +852 2849 9288 jacqueline.bennett@hk.ey.com
Albert Lee +852 2629 3318 albert.lee@hk.ey.com	Robert Hardesty +852 2629 3291 robert.hardesty@hk.ey.com			Vanessa Chan +852 2629 3708 vanessa-ps.chan@hk.ey.com
International Tax and Transaction Services				Adam Williams +852 2849 9589 adam-b.williams@hk.ey.com
International Tax Services		Transfer Pricing Services		Transfer Pricing Services
Cherry Lam +852 2849 9563 cherry-lw.lam@hk.ey.com	Jeremy Litton +852 3471 2783 jeremy.litton@hk.ey.com	Martin Richter +852 2629 3938 martin.richter@hk.ey.com	Kenny Wei +852 2629 3941 kenny.wei@hk.ey.com	
Jo An Yee +852 2846 9710 jo-an.yee@hk.ey.com				Justin Kyte +852 2629 3880 justin.kyte@hk.ey.com
Transaction Tax Services				Transaction Tax Services
David Chan +852 2629 3228 david.chan@hk.ey.com	Jane Hui +852 2629 3836 jane.hui@hk.ey.com	Tami Tsang +852 2849 9417 tami.tsang@hk.ey.com	Eric Lam +852 2846 9946 eric-yh.lam@hk.ey.com	Rohit Narula +852 2629 3549 rohit.narula@hk.ey.com
Indirect Tax Services	People Advisory Services			
Andy Leung +852 2629 3299 andy-sy.leung@cn.ey.com	Ami Cheung +852 2629 3286 ami-km.cheung@hk.ey.com	Robin Choi +852 2629 3813 robin.choi@hk.ey.com	Jeff Tang +852 2515 4168 jeff.tk.tang@hk.ey.com	Paul Wen +852 2629 3876 paul.wen@hk.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation is available via ey.com/privacy. For more information about our organization, please visit ey.com.

© 2020 Ernst & Young Tax Services Limited.
All Rights Reserved.

APAC no. 03010463
ED None

ey.com/china

About EY’s Tax services

Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 50,000 talented tax professionals, in more than 150 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service – wherever you are and whatever tax services you need.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

Follow us on WeChat

Scan the QR code and stay up to date with the latest EY news.

