

**Case No. D5/24**

**Profits tax** – meaning of ‘accrued’ – interest income never received – distinction between accrued and payable interest income – accounting treatment of interest income by taxpayer important factor – section 15 of the Inland Revenue Ordinance

Panel: Wong Man Kit Anson SC (chairman), Yeung Chung Chiu and Yuen Hoi Ying.

Date of hearing: 10 January 2024.

Date of decision: 9 August 2024.

The taxpayer is a private company incorporated in Hong Kong. By two separate agreements, the taxpayer assumed existing shareholder loans and/or advanced shareholder loans for two separate joint venture companies. Both shareholder loans were interest-bearing, and the loans and interest would be repayable or payable by the taxpayer subject to certain ‘distribution conditions’. Eventually, the taxpayer sold off its shareholding and interests in the two joint venture companies, and no interest income was ever received. Notwithstanding, in the income statement of the taxpayer’s financial statement for the relevant year (the ‘**2007 FS**’), the taxpayer reported an item known as ‘Interest income on loans to associated companies’.

In raising an Additional Profits Tax Assessment of HK\$3,340,062 for the year of assessment 2007/08, the Assessor rejected the taxpayer’s contention that the interest income should not be taxable as the payments were subject to various conditions, including the relevant companies having ‘sufficient reserve’. The Assessor also refused to set off the interest income by deducting interest expenses in borrowing loans to finance the relevant shareholder loans, and certain legal and professional expenses.

The issue to be determined by the Board is whether the relevant interest income falls within the scope of section 15(1)(f) of the Inland Revenue Ordinance (Chapter 112) (**‘Ordinance’**) in that it amounts to interest ‘accrued’.

**Held:**

1. The word ‘accrued’ is generally used to described the coming into being of a right or an obligation. The amount to which there is an entitlement may not be payable until a future date, but an entitlement may nevertheless have accrued (Tael One Partners Ltd v Morgan Stanley & Co International Plc [2015] Bus LR 278 and Forlee v CIR (No.2) [2022] 6 HKC 47 followed). As such, even if certain interest income was not received by a taxpayer in a particular year of assessment, it would be required to pay profits tax in respect of such income if such income was ‘accrued’ to it in that year.

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2. The accounting treatment of the interest income by a taxpayer in its audited accounts, though not conclusive, is of importance, as they indicate the view which was taken by those concerned at the time regarding what had happened. (D14/88, IRBRD, vol 3, 206 followed).
3. A taxpayer who acted on the advice of professional advisers and offered interest for assessment, but then sought to suggest that it was an error, bears a heavy onus of proof. While the previous accounting treatment would not be insuperable, the facts and interpretation of facts must be unequivocally in favour of the taxpayer's case (D14/88, IRBRD, vol 3, 206 followed).
4. The taxpayer failed to discharge its onus in proving that the accounting treatment of the interest income in the 2007 FS was an error. No witnesses or accounting expert were called to give evidence in support of its case. There was no evidence before the Board as to what materials or circumstances were taken into account by the directors and auditors at the time the view that the interest income ought to be reported as 'income' either. In fact, when the taxpayer's director raised the alleged error in 2007 FS with the taxpayer's auditors, they disagreed with such a suggestion. The 'distribution conditions' stipulated in the underlying contractual agreements were also not necessarily dependent upon profits being generated by the joint venture. The taxpayer's argument that it would be illegal to pay interest before profits were generated as a matter of Mainland laws was unsubstantiated and is in any event irrelevant.

**Appeal dismissed and costs order in the amount of \$20,000 imposed.**

Cases referred to:

Shui On Credit Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 392  
Commissioner of Inland Revenue v Common Empire Ltd (No. 2) [2007] 3 HKLRD 75  
China Map Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 486  
D14/88, IRBRD, vol 3, 206  
D20/99, IRBRD, vol 14, 234  
D73/91, IRBRD, vol 7, 8  
Tael One Partners Ltd v Morgan Stanley & Co International Plc [2015] Bus LR 278  
Forlee v Commissioner of Inland Revenue (No. 2) [2022] 6 HKC 47

Appellant's Director appeared for the Appellant.

Danny Tang, Counsel, instructed by the Department of Justice, for the Commissioner of Inland Revenue.

**Decision:**

**A. Introduction**

1. This is an appeal by Company A (the ‘**Company**’) against the Determination of the Deputy Commissioner of Inland Revenue dated 2 August 2023 (the ‘**Determination**’).

2. The relevant assessment which forms the subject matter of this appeal is the Additional Profits Tax Assessment raised for the year of assessment 2007/08 (the ‘**Subject Assessment**’), which was confirmed by the Determination.

3. At the appeal hearing, the Company was represented by its director, Mr B, and the Inland Revenue Department (‘**IRD**’) was represented by counsel Mr Danny Tang (‘**Mr Tang**’).

4. Having heard submissions from the parties, this Board reserved its decision which it now gives. As indicated towards the end of the appeal hearing, although the hearing was conducted in Chinese, this Board considered that it would be preferable for the decision of this appeal to be written in English in light of the materials before it.

**B. Undisputed Factual Background**

5. The facts stated in paragraphs 1(1) to 1(22) of the Determination are not in any serious dispute. In the interest of brevity, this Board will only provide a brief summary of those facts which are directly relevant to the issues involved in this appeal.

***B1. The Company***

6. The Company is a private company incorporated in Hong Kong in 1993. Its ultimate holding company is Company C, which is a company incorporated in the Mainland and listed on the City Q Stock Exchange. At the material time, the directors of the Company were Mr B and Ms D, who were also directors of Company C.

***B2. The Company E Loan of US\$8,162,000***

7. Company E<sup>1</sup> was a joint venture company formed between Company F<sup>2</sup> and Company G<sup>3</sup> under a Shareholders’ Agreement dated 16 September 2006 (the ‘**Company E Agreement**’) to carry on the business relating to a real estate development project in City H of the Mainland (the ‘**City H Project**’) through a wholly-owned foreign enterprise established under the laws of the Mainland.

8. By a Share Sale Agreement in relation to Company E dated 26 July 2007 (the ‘**Company E Purchase Agreement**’), the Company purchased Company F’s 25%

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<sup>1</sup> A company incorporated in the British Virgin Islands (‘BVI’).

<sup>2</sup> A company incorporated in BVI.

<sup>3</sup> A company incorporated in the State of Delaware.

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shareholding in Company E (the ‘**Company E Shares**’) and the shareholder’s loan of US\$8,162,000 advanced by Company F to Company E (the ‘**Company E Loan**’) at the total consideration of HK\$114,000,000.

9. The Company E Loan, which was advanced by Company F pursuant to the Company E Agreement (as subsequently amended by Shareholders’ Agreement – First Supplemental Agreement dated 23 November 2006), was interest bearing. Pursuant to Clause 5.3(a) of the Company E Agreement, the shareholders’ loans advanced to Company E (including the Company E Loan) should bear interest at a rate of 25% per annum compounded monthly until repaid.

10. Further, pursuant to Clause 5.3(b) of the Company E Agreement, subject to the fulfilment of the ‘Distribution Conditions’ (which is defined in Clause 1.1 of the Company E Agreement), the shareholders’ loans advanced to Company E (including the Company E Loan) and the interest thereon would be repayable or payable by the Company in accordance with the order of priority set out in Clause 8.1(d) of the Company E Agreement.

11. As defined in Clause 1.1 of the Company E Agreement, the ‘Distribution Conditions’ would only be fulfilled if all constructions costs and certain other loans have been fully repaid or paid or secured by sufficient reserve. Further, under the order of priority stipulated in Clause 8.1(d) of the Company J Agreement, the cash available for distribution should first be applied towards the payment of tax liabilities of the Company and the interest and principal of the loans advanced by Company G before it could be applied for the payment of accrued interest to the Company in respect of the Company E Loan.

***B3. The Company J Loan of US\$15,800,000***

12. Company J<sup>4</sup> was a joint venture company formed between the Company and Company G under a Shareholders’ Agreement dated 7 July 2007 (the ‘**Company J Agreement**’) to carry on the business relating to a real estate development project in City K of the Mainland (the ‘**City K Project**’).

13. Pursuant to Clauses 3.4(a) and 4.2(a) of the Company J Agreement, the Company advanced a shareholder’s loan to Company J in the principal sum of US\$15,800,000 (the ‘**Company J Loan**’).

14. Pursuant to Clause 8.1(a) of the Company J Agreement, the shareholders’ loans advanced to Company J (including the Company J Loan) should bear interest at a rate of 25% per annum compounded monthly until repaid.

15. Further, pursuant to Clause 8.1(c) of the Company J Agreement, subject to the fulfilment of the ‘Distribution Conditions’ (which is defined in Clause 1.1 of the Company J Agreement), the shareholders’ loans advanced to Company J (including the

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<sup>4</sup> A company incorporated in BVI.

Company J Loan) and the interest thereon would be repayable or payable by the Company in accordance with Clause 12 of the Company J Agreement.

16. As defined in Clause 1.1 of the Company J Agreement, the ‘Distribution Conditions’ would only be fulfilled if all constructions costs and certain other loans have been fully repaid or paid or secured by sufficient reserve. Further, under the order of priority stipulated in Clause 12 of the Company J Agreement, the cash available for distribution should first be applied towards the interest and principal of the other loans as well as the shareholder’s loan of Company G, before it could be applied for the payment of accrued interest to the Company in respect of the Company J Loan.

***B4. The Sale of the Company’s Interest in Company E and Company J***

17. By two sets of agreement both dated 30 November 2012, the Company agreed, *inter alia*, to sell and transfer its shareholding in Company E and the Company E Loan to Company L at valuable consideration.

18. By an agreement dated 28 November 2014, the Company agreed to sell its shareholding in Company J and its interest thereon to Company M at valuable consideration.

***B5. The Subject Assessment***

19. On 16 April 2008, the Company submitted its Profits Tax return for the year of assessment 2007/08, together with its financial statement for the year ended 31 December 2007 (the ‘**2007 FS**’).

20. In the income statement of the 2007 FS, there was an item known as ‘Interest income on loans to associated companies’<sup>5</sup> (the ‘**Interest Income**’). In reply to the Assessor’s enquiries, the Company through its representatives<sup>6</sup> confirmed that the Interest Income included the interest income derived from the Company E Loan (the ‘**Company E Interest Income**’) as well as the interest income derived from the Company J Loan (the ‘**Company J Interest Income**’).

21. The Company argued that the Company E Interest Income and the Company J Interest Income should not be taxable since their payments were subject to the relevant companies having sufficient reserve. This is a matter which this Board will further consider below.

22. Additionally, the Company sought to set off the Interest Income by deducting (i) interest expenses in borrowing loans to finance the Company E Loan and the Company J Loan, and (ii) certain legal and professional expenses.

23. The Assessor did not accept the Company’s contention that the Company E Interest Income and the Company J Interest Income should not be taxable. He also

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<sup>5</sup> See Note 4 of 2007 FS

<sup>6</sup> See Letter dated 14 February 2011 from the Company’s first representatives, Scan Ngai Company Limited; see also Letter dated 3 December 2013 from the Company’s second representatives, Ng & Lui CPA Limited.

considered that the interest expenses and certain legal and professional fees were not deductible. As a result, the Assessor raised an Additional Profits Tax Assessment of HK\$3,340,062 for the year of assessment 2007/08 on 12 July 2012, ie the Subject Assessment.

### **C. The Determination**

24. The Company disputed the Subject Assessment.

25. As noted in paragraph 3(1) of the Determination, the Company initially offered the Company E Interest Income and the Company J Interest Income for assessment and claimed deduction of, *inter alia*, interest expenses on short term loans and legal and professional expenses. Later, upon being challenged, the Company withdrew the deduction claims, but objected to the assessment on the basis that the Interest Income was derived outside Hong Kong. The Company further objected on the basis that provision for bad debt should be made for the Company E Interest Income and the Company J Interest Income for the year of assessment 2007/08, and that no such interest income should be recognised since the City H Project and the City K Project at the time did not generate any profits available for distribution, and the Company had no chance of receiving them.

26. In the Determination, the Deputy Commissioner rejected the Company's objections and confirmed the Subject Assessment.

### **D. Procedural History of this Appeal**

27. By a Notice of Appeal dated 29 August 2023 (the '**Notice of Appeal**'), the Company appealed against the Determination.

28. In relation to this appeal, this Board by a letter dated 12 October 2024 informed the parties that the hearing of the appeal would be fixed on 10 January 2024 and gave directions to the parties for the filing of documents, witness statements and submissions. As far as the Company is concerned, it was directed to file its documents, witness statements and submissions by 4 December 2023.

29. On 7 December 2023, the Company wrote to this Board to request for an adjournment of the appeal hearing alleging that its representative, Mr B, would not be able to attend the appeal hearing in Hong Kong fixed on 10 January 2024.

30. By a letter dated 8 December 2023, this Board notified the parties that it refused the Company's request for adjournment of the appeal hearing. Noting that the Company had not yet filed any document, witness statement or submission in support of this appeal despite the deadline of 4 December 2023, this Board by the same letter also extended the said deadline and directed the Company to file and serve those documents no later than 15 December 2023, and the IRD to file and serve its documents and submissions in response by 29 December 2023.

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31. The Company later filed documents and submissions in support of this appeal before the extended deadline. However, no witness statement was filed by the Company.
32. On 18 December 2023, the Company wrote to this Board and once again requested this Board to adjourn the appeal hearing to a later date. The request was made on the basis that Mr B was subject to a court order restricting him from leaving the Mainland.
33. On 19 December 2023, this Board informed that the parties that it would not accede to the Company's request for adjournment of the appeal hearing. However, this Board also indicated that if the Company wished to do so, it could apply for permission to attend the appeal hearing via video-conferencing facility on or before 3pm of 22 December 2023.
34. On 22 December 2023, the Company made the application for permission to attend the appeal hearing via video-conferencing facility. On the same day, this Board informed the parties that it granted such permission.
35. On 29 December 2023, the IRD filed and served its documents and submissions in opposition to this appeal.
36. On 3 January 2024, the Company submitted 3 additional documents (the '**3 Additional Documents**') in support of this appeal. By another letter dated 3 January 2024, the Company informed this Board that the Company intended to call two witnesses, one Ms N and one Mr P (the '**Proposed Witnesses**'), to testify at the appeal hearing.
37. On 4 January 2024, the IRD wrote to this Board indicating its objection to the calling of the Proposed Witnesses to testify at the appeal hearing. The IRD complained that the Company had failed to comply with the directions of this Board to file and serve any witness statement prior to the extended deadline of 15 December 2023, and that it would cause serious prejudice to the IRD if the Proposed Witnesses were to be allowed to testify without putting in any of their witness statements. Further, the IRD also objected to the Company's reliance on the 3 Additional Documents.
38. On 5 January 2024, the Company wrote two further letters to this Board. In those letters, the Company stated that (i) the appeal hearing had been fixed without consulting it; (ii) it would not object to any adjournment of the appeal hearing if the IRD required more time to prepare for the appeal hearing; and (iii) the Proposed Witnesses would testify at the appeal hearing via video-conferencing facility.
39. Having considered the parties' correspondence, this Board wrote to the parties on 5 January 2024 that it would not allow the Proposed Witnesses to testify at the appeal hearing. This was because not only had the Company failed to submit any witness statement from any of the Proposed Witnesses, the Company's submissions also did not mention anything about its intention to adduce evidence from the Proposed Witnesses. In fact, there was nothing before this Board to explain what evidence that the Proposed Witnesses would give and why such evidence would be relevant to this appeal. This

Board, therefore, rejected the Company's request to adduce evidence from the Proposed Witnesses.

40. As to the 3 Additional Documents, this Board by the said letter of 5 January 2024 informed the parties that it would determine whether or not to allow their admission at the appeal hearing after hearing the parties' further submissions. At the appeal hearing, Mr Tang on behalf of the IRD confirmed that the IRD did not object to the admission of the 3 Additional Documents, but maintained that such documents have no or little relevance to the issues involved in this appeal.

41. Accordingly, this Board will determine this appeal based on the documents adduced by the parties, but without any evidence from any witness.

## **E. Discussions**

### ***E1. Grounds of Appeal***

42. In the Notice of Appeal, the Company advances the following grounds of appeal:-

- (1) The Company E Agreements and the Company J Agreements only provided for the Company's 'rights' to receive interest income in respect of the Company E Loan and the Company J Loan. They, however, did not guarantee that the Company must receive such interest income. As a matter of fact, the Company did not receive any such interest income at the time of the Subject Assessment.
- (2) Although Company C in its financial statement for the year ended 31 December 2007 (the '**Company C 2007 FS**') projected the amount interest payable on the shareholders' loans of the projects, which included the Company E Loan and Company J Loan, such financial statement cannot be relied upon to ascertain the state of affairs in the subsequent years.
- (3) In the year of assessment of 2007/08, the Company did not receive any interest income in respect of the Company E Loan and the Company J Loan. According to the contractual clauses of the Company E Agreement and Company J Agreement, before Company G receiving its interest from Company E/Company J, the Company would not be entitled to receive any payment of interest.
- (4) According to the terms of the Company E Agreement and the Company J Agreement, the source of payment of interest had to be derived from the profits arising from the City H Project and the City K Project respectively. Since both the City H Project and the City K Project did not generate any profits in the first few years (including



the year of 2008), no payment of interest could be made to the Company at the time. In any event, it would be illegal under the laws of the Mainland to pay interest to the Company in such circumstances.

43. The gist of the above grounds of appeal is that the Company E Interest Income and the Company J Interest Income ‘did not exist’ in the year of assessment 2007/08. Mr B (on behalf of the Company) submitted at the appeal hearing that such interest income was neither ‘accrued’ or ‘payable’ at the time. He stressed that no interest in respect of the Company E Loan and the Company J Loan was received by the Company, and both Company E and Company J at the time did not have any financial sources to pay any interest to the Company in respect of such loans.

44. As correctly pointed out by Mr Tang at paragraphs 18, 19 and 35 of his submissions filed on behalf of the IRD, the Company did not seek to appeal against the Determination on the grounds that certain interest expenses and legal and professional fees were deductible, or that the Company E Interest Income and the Company J Interest Income were derived from sources outside Hong Kong, or that such interest income should be regarded as ‘bad debts’ in the year of assessment 2007/08. Accordingly, this Board is not required to consider those issues in this appeal.

## ***E2. Function and Approach of this Board***

45. In an appeal of this nature, the function of this Board is to consider the matter *de novo* and to form a second opinion in substitution for the opinion of the assessor: *see Shui On Credit Co Ltd v. CIR* (2009) 12 HKCFAR 392 *per* Lord Walker NPJ at paragraphs 29-30.

46. Pursuant to section 68(4) of the Inland Revenue Ordinance, chapter 112 (‘IRO’), the onus of proving that the assessment appealed against is excessive or incorrect is rested on the appellant and, in this case the Company.

47. If the appellant calls no evidence on any disputed facts, this Board shall determine the appeal on the basis of the materials before it, ie the Commissioner’s reasons for his determination and his statement of facts: *see CIR v. Common Empire Ltd (No. 2)* [2007] 3 HKLRD 75 *per* DHCJ Anthony To at paragraphs 31-32.

48. Pursuant to IRO section 66(3), a taxpayer appellant is bound by the grounds set out in his notice of appeal, and cannot rely on any other grounds of appeal unless with the consent of this Board. If such consent is sought by the taxpayer appellant, it should be sought fairly, squarely and unambiguously: *see China Map Ltd v. CIR* (2008) 11 HKCFAR 486 *per* Bokhary PJ at paragraph 10.

## ***E3. Relevant Statutory Provisions and Authorities***

49. IRO section 14(1) provides that:-

*‘Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.’*

50. IRO section 15(1) provides, *inter alia*, that:-

*‘For the purposes of this Ordinance, the sums described in the following paragraphs shall be deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong —*

*...*

*(f) sums **received by or accrued to** a corporation carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong.’ (emphasis added)*

51. In D14/88, the taxpayer company made a loan to an associated company. The loan agreement provided that interest would accrue on a day-by-day basis, but that no interest was payable unless the borrower’s directors so resolved. No such resolution was ever made. The taxpayer company included the accrued interest in its profit and loss account and offered such interest for assessment to profits tax in 1981 and 1982. Due to the borrower’s financial position, it subsequently appeared that the interest would never be paid. The taxpayer decided to write back the interest in the 1993 and subsequent accounts. This gave rise to losses in the 1983 and subsequent accounts, against which no profits were available for setting off. The taxpayer therefore sought to argue that the interest had been improperly taxed in 1981 and 1982 in that such interest had not ‘accrued’ within the meaning of IRO section 15(1)(f). This Board rejected the taxpayer’s argument and confirmed that the interest was assessable to profits tax.

52. With regard to the term ‘accrued to’ used in IRO section 15(1)(f), this Board in D14/88 held as follows:-

*‘We take the view that the word “accrue” means interest earned which has been and should have been brought to account in the books of the Taxpayer for commercial reasons as opposed to tax reasons. It would in our opinion be wrong to make a hard and fast rule that all interest must have accrued for tax purposes regardless of whether or not it has been or its likely to be in the future to be paid. Likewise, it would be wrong to adopt the rule that interest never accrues unless and until it is received or a fixed date for payment has been set. **Each case must depend upon its own particular facts and the directors acting in conjunction with their professional accounting advisers must decide on the then facts whether or not sound commercial accounting principles permit or require the***

*taking into account in any particular year interest earned...*’ (emphasis added).

53. On this issue, Mr Tang helpfully brought the attention of this Board to the following passages in D14/88 in which the significance of the position taken by a taxpayer corporation in its audited financial statement was explained:-

*‘The onus of proof in a case where a taxpayer, acting on advice of professional advisers, has offered interest for assessment to and has paid tax thereon and then submits that it has done in error is heavy. However, that does not mean that it is insuperable, but it does mean that the facts and interpretation of facts must be unequivocally in favour of the Taxpayer’s case.*

...

*... Accounts are the method in which companies and business record their transactions and audited accounts are particularly important because they indicate the view which was taken by those concerned at the time regarding what had happened. The fact that a profit or a loss appears in accounts or audited statements does not mean that such profit or loss was in fact made or incurred. It does however indicate that those concerned at the time took a particular view with regard to the transaction.*

...

*It can be argued that the directors and indeed the auditors of the Taxpayer should have been more cautious and should not have brought to account 100% of the interest earned, but that was a decision for the directors and their auditors at the relevant time with the facts then available to them. Knowing that the interest had not yet become payable they decided that it should nevertheless be brought to account as interest without any provision being made and indeed that tax should be paid thereon. With the benefit of hindsight this may not have been the best decision, but it is not for this Board of Review or indeed the Commissioner or the Taxpayer to rewrite accounts or change decisions taken in good faith at the time based on sound commercial principles.’* (emphasis added).

54. The above passages in D14/88 were later adopted with approval in D20/99 (at paragraph 53).

55. In D73/91, this Board was called upon to decide whether interest of fixed deposits accrued over a period of time or on the date when it became payable. In coming to the view that interest accrued over a period of time, this Board observed that:-

*‘The Inland Revenue Ordinance uses the word “accrue” in relation to income including interest and not the words “accrue due” or the words*

*“become payable” or “received”. The Inland Revenue Ordinance uses the simple word “accrue” and in our opinion this is intended to be used in normal accounting sense. Indeed the Ordinance in section 15 frequently uses the words “received by or accrued to” in relation to income subject to profits tax. It is the clear intention of these words to bring into the tax net not just moneys received but also profits as they are earned according to ordinary and accepted accounting principles.*

*It would be wrong if a company in maintaining its accounts and publishing its audited figures were to ignore interest as an income item or expense until such time as it becomes payable. It is basic and fundamental corporate accounting practice to accrue such item as they are accrued or earned. ... The taxable income of the Taxpayer should follow its normal sound accounting principles. Accounts should only be re-written or adjusted for tax purposes where there is a clear statutory requirement so to do ...’*

56. In Tael One Partners Ltd v. Morgan Stanley & Co International Plc [2015] Bus LR 278 (which is a non-tax case), the UK Supreme Court defined the term of ‘accrue’ as follows:-

*‘[42] The word “accrue” is generally used to describe the coming into being of a right or an obligation (as, for example, in Aitken v South Hams District Council [1995] 1 AC 262), so that the person in question then has an accrued right, or is subject to an accrued liability, as the case may be. That is the meaning which accrual usually bears, in particular, in relation to interest and other payments. The amount to which there is an entitlement may not be payable until a future date, but an entitlement may nevertheless have accrued. For example, under section 2 of the Apportionment Act 1870, rents, annuities, dividends and other periodical payments may be considered as accruing from day to day, although they may be payable at longer intervals ...’.*

57. The said definition of the term ‘accrue’ in Tael One was later adopted by our Court of Appeal in Forlee v. CIR (No. 2) [2022] 6 HKC 47 *per* G Lam JA (at paragraph 48) in a tax context.

58. Based on the above authorities, this Board take the view that the following legal propositions are well-established:-

- (1) A taxpayer company is required to pay profits tax in respect of interest income that was received by *or* accrued to it in a particular year of assessment. In other words, even if certain interest income was not received by the taxpayer company in a particular year of assessment, it would be required to pay profits tax in respect of such income if such income was ‘accrued’ to it in that year of assessment.

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- (2) Whether an interest income was ‘*accrued*’ or ‘*payable*’ to a taxpayer company are different and distinct concepts. ‘*The word ‘accrue’ is generally used to describe the coming into being of a right or an obligation*’. An entitlement could be ‘*accrued*’ at a particular point of time even though it may be only ‘*payable*’ at a future date.
- (3) An interest income was ‘*accrued*’ to a taxpayer company in a particular year of assessment if it ‘*has been and should have been brought to account in the books of the taxpayer for commercial reasons*’. There is no hard and fast rule. ‘*Each case must depend upon its own particular facts and the directors acting in conjunction with their professional accounting advisers must decide on the then facts whether or not sound commercial accounting principles permit or require the taking into account in any particular year interest earned*’.
- (4) The accounting treatment of the interest income by a taxpayer company in its audited accounts, though not conclusive, is of importance. This is because it does ‘*indicate that those concerned at the time took a particular view with regard to the transaction*’.
- (5) A taxpayer company who seeks to suggest the treatment previously made in its audited accounts was an error bears a ‘*heavy*’ onus.

**E4. The Analysis**

59. The above authorities clearly demonstrate that interest income, so long as it was ‘*accrued*’ to the taxpayer company in a particular year of assessment, would be assessable to profits tax in that year of assessment even if it was not ‘*received by*’ or ‘*payable to*’ the taxpayer company during that period of time.

60. Accordingly, with regard to the Company’s submission that no interest was ‘*received by*’ or ‘*payable to*’ the Company in respect of the Company E Loan and Company J Loan in the year of assessment 2007/08, they are irrelevant unless the Company also succeeds in discharging its burden to show that no such interest was ‘*accrued*’ to it in such year of assessment.

61. As to whether the relevant interest income was ‘*accrued*’ to the Company, there is no dispute that the Company in the 2007 FS reported and offered for assessment the Company E Interest Income and Company J Interest Income for the year of assessment 2007/08. The burden, therefore, is rested upon the Company to make out and prove its case that such accounting treatment was done in error. This burden is a heavy one.

62. For the purposes of this appeal, the Company did not call any witness to give evidence in support of its case that the said accounting treatment in the 2007 FS was an error.

63. In the Company's written and oral submissions, a great deal of emphasis was placed on the accounting adjustment made on 28 April 2009 to the 2008 Annual Report of Company C, which provided that Company C took the view that the interest payable in respect of the Company E Loan and Company J Loan should not be regarded as '*present liabilities* (現時義務)' and the accounting treatment of such interest income by the Company in the financial year of 2007 should be rectified<sup>7</sup>. The Company further submitted that whatever accounting position was taken by Company C in its 2007 Annual Report on such interest income, such position cannot be relied upon to determine the nature of the interest income in 2008, particularly in light of the said accounting adjustment.

64. At the appeal hearing, Mr B (on behalf of the Company) further made an oral assertion that in 2008, he had raised the said accounting error in the 2007 FS with the Company's auditors, but the Company's auditors disagreed with such suggestion.

65. In our view, the fact that accounting adjustment was subsequently made by Company C in its 2008 Annual Report is *per se* insufficient to show that the accounting treatment of the Interest Income made by the Company and its auditors in 2007 FS was an error. This is because such accounting adjustment was made by Company C in accordance with the relevant accounting principles applicable in the Mainland. It is unclear whether such adjustment would be justified if the relevant accounting principles applicable in Hong Kong at the time were considered. As a matter of fact, no adjustment was made to the accounting treatment made by the Company in the 2007 FS.

66. Further, the said oral assertion made by Mr B at the appeal hearing goes to show that despite a different view being raised by Mr B subsequently in 2008, the Company's auditors maintained their view on the correctness of the accounting treatment in the 2007 FS.

67. In the present case, there is no evidence to enlighten this Board as to what materials or circumstances were taken into account by the directors and auditors *at the time* when they formed the view that the Company E Interest Income and Company J Interest Income should be reported as 'income' in the financial year covered by the 2007 FS. There is also no accounting expert called by the Company to support a case that the accounting treatment made in the 2007 FS involved misapplication of applicable accounting principles to the circumstances known by those concerned at the time. Without such evidence, the Company in our view is unable to discharge its heavy burden to show that the then decision of the directors and the auditors to bring the Interest Income in the Company's accounts for the financial year of 2007 was an error.

68. Further, as correctly pointed out by Mr Tang, it was respectively provided in Clause 5.3(a) of the Company E Agreement and Clause 8.1(a) of the Company J

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<sup>7</sup> See Company C 2008 Annual Report, pages 46-47, which provides 「如果 K 城市「XXXX」項目無盈利，則 [the Company] 不向 [Company J] 計收利息... 如果 H 城市「XXXX」項目無盈利，則 [the Company] 不向 [Company E] 計收利息。依照本公司對該筆權益性貸款利息不屬於現時義務的判斷，[the Company] 於 2007 年度對該等權益貸款利息已計提利息收入港幣 19,853,476.03 元（折合人民幣 18,590,794.95 元）應作為 2008 年度財務報表的前期差錯。」

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Agreement that interest would be accrued in respect of the Company E Loan and the Company J Loan until those loans were repaid. Viewed in this light, and in the absence of any evidence proving the existence of an error at the time, there is no basis for this Board to conclude that it was an error for the directors and auditors of the Company to book the Company E Interest Income and the Company J Interest Income as accrued ‘income’ in the 2007 FS.

69. The Company also stressed that under the Company E Agreement and the Company J Agreement, the Company only had a ‘right (有權)’ to charge interest, but it does not mean that the Company ‘must (一定)’ receive such interest in due course.

70. In our view, this submission also does not assist the Company. As stated above, the taxpayer company in D14/88 would only receive interest if it was so resolved by the directors of the borrower, but interest was booked by the taxpayer company as its income in a particular year of assessment. Notwithstanding that the actual payment of interest to the taxpayer company was subject to such contingency which had not yet happened at the time, the Board in D14/88 had no difficulty to conclude that the taxpayer company should be bound by such accounting treatment in relation to its tax liabilities, and that there was no basis for that to be re-written. Following the reasoning in D14/88, this Board takes the view that the fact that the Company might not necessarily receive the Company E Interest Income and Company J Interest Income in a future date is not a sufficient reason to hold that it was wrong to book such interest income as ‘accrued’ in the 2007 FS.

71. This Board also rejects the Company’s submission that interest could only be paid in respect of the Company E Loan and/or the Company J Loan when profits were generated from the relevant projects and that it would involve infringement of Mainland laws if interest were paid before profits:-

- (1) For the reasons explained in the foregoing paragraph, this Board is unable to see the relevance of the Company’s submission. This submission is just another way of putting the same point that the Company could not receive the interest accrued on the Company E Loan and the Company J Loan in the year of assessment 2007/08. This, however, is different from the question as to whether such interest was properly booked as ‘accrued’ income in that year of assessment.
- (2) Additionally, as pointed out by Mr Tang, it appears to be factually incorrect for the Company to suggest that interest in respect of the Company E Loan and/or Company J Loan could only be paid when sufficient profits were generated from the relevant projects. In Clause 1.1 of both the Company E Agreement and the Company J Agreement, the ‘Distribution Conditions’ would be fulfilled when Company E/Company J or the project companies had ‘sufficient reserve’ to fully satisfy the construction costs and certain other loans. The satisfaction of such ‘Distribution Conditions’ is not necessarily dependent upon profits being generated by the City H Project and/or

City K Project. Further, the Company also adduced no evidence to support its case that, as a matter of Mainland laws, it was illegal to pay interest in respect of the Company E Loan and the Company J Loan before profits were generated. Thus, the Company's submission (which is in any event irrelevant) lacks evidential basis.

72. For the above reasons, this Board has come to the conclusion that the Company has failed to discharge its onus to prove that the Subject Assessment is excessive or incorrect.

**F. Conclusion**

73. In the circumstances, this Board dismisses this appeal and confirms the Subject Assessment.

74. In light of the outcome of this appeal as well as the Company's conduct in the appeal process, the Company is ordered to pay a sum of HK\$20,000 as costs, which shall be added to the tax charged and recovered therewith, pursuant to IRO section 68(9).