Case No. D18/14

Profits tax – money lender – loan to a related company – whether a money lending transaction – whether in the ordinary course of money lending business – whether deductible – whether consent to proposed amendments to the Statement of Grounds of Appeal – sections 16(1)(d), 66(3), 70A and 68(4) of the Inland Revenue Ordinance ('IRO')

Panel: Lo Pui Yin (chairman), Choi Kwan Wing Kum Janice and James Todd Wood.

Dates of hearing: 10 October 2013, 14 January 2014 and 27 February 2014.
Date of decision: 14 October 2014.

The Taxpayer is a licensed money lender under the Money Lenders Ordinance (Chapter 163).

In its Profits Tax return for the year of assessment 2003/04, the Taxpayer claimed deduction of the Debt of $38,038,190 due from Company J, a related company.

Company J was a foreign investment enterprise incorporated in the Mainland. It was a wholly owned subsidiary of Company F, a private company in Hong Kong.

Mr E is the major shareholder and a director of both the Taxpayer and Company F. Mr E is also the Legal Representative of Company J.

The Deputy Commissioner rejected the Taxpayer's claims that the Debt due from Company J was revenue in nature and should be allowed for deduction.

The Taxpayer appeals.

During the course of hearing of the appeal, the Taxpayer, by way of an Amended Statement of Grounds of Appeal, asserted that the Debt had become HK$41,927,078.

Held:

1. The Amended Statement of Grounds of Appeal, seeking the correction of the amount of the Debt, should be dealt with under section 70A. Yet the Taxpayer made no application under section 70A to the Assessor whatsoever.

2. The Taxpayer failed to establish that the Loan to Company J were paid for the purpose of a money lending transaction:

2.1 The evidence of Mr T is of very limited value as he was not personally involved in the negotiation and finalization of the Loan.

2.2 Mr E's evidence is undermined by the purported contemporaneous documents to be relied upon for the purpose of evidencing the making of the Loan.

2.3 The alleged action taken by the Taxpayer to recover the Loan was contrary to the provision in the Loan agreement.

2.4 The explanation for the Taxpayer's two-year delay in producing the documents to the Revenue was neither satisfactory nor convincing.

2.5 The lack of an assigned loan number of the Loan, the absence of document or record on how the Loan was applied for and approved, and there being no record ever made into the Taxpayer's computer system rendered the Loan out of the ordinary.

3. Taking into account the following extraordinary features, though not necessary to, this Board finds that the Loan to Company J did not constitute lending in the ordinary course of the Taxpayer's money lending business:

3.1 Long maturity date;
3.2 Relatively low interest rate;
3.3 No tangible security;
3.4 No guarantee;
3.5 A specific provision that the Taxpayer could not demand early repayment;
3.6 No assigned loan number;
3.7 No documentation of application and approval; and
3.8 No record ever made into the Taxpayer's computer system.

Appeal dismissed.

Sung Lee Ming Alfred and Lee Wing Hong Alfred of Messrs Alfred Sung Taxation Service for the Appellant.
Paul Leung, Counsel, Gordon I H Chung, Government Counsel, Chow Cheong Po, To Yee Man and Ng Ching Man for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is the appeal by Company A ('the Taxpayer') against the assessment of Revenue for profits tax for the year of assessment 2003/04 raised on it. The issue of the appeal is whether a claimed bad debt should be allowed for deduction.

2. The Taxpayer has, through its representative, sought amendment of the notice of appeal in the course of the hearing of this appeal. The proposed amendment covers both the amount of bad debt claimed and the grounds of appeal. This Board will consider whether the amendment should be consented to in the course of this Decision.

Statement of Agreed Facts

3. The Taxpayer and the Revenue have agreed on a Statement of Agreed Facts, which is set out in the following paragraphs:

(1) (a) The [Taxpayer] was incorporated as a private company in Hong Kong in December 1998.

(b) The [Taxpayer] was registered as a licensed money lender under the Money Lenders Ordinance (Chapter 163). In its tax returns, the [Taxpayer] described its principal business activity as money lending.

(c) At all relevant times, the issued and paid up capital of the [Taxpayer] was $150,000,000, divided into 150,000,000 ordinary shares of $1 each. Details of the [Taxpayer's] shareholders were as follows:

	Number of shares held	
	Prior to 2-4-2004	2-4-2004 and after
Mr B	120,000,000	-
Mr C	15,000,000	-
Mr D	15,000,000	15,000,000
Mr E	-	135,000,000
	150,000,000	150,000,000

(d) The [Taxpayer's] directors were:

	Date of appointment	Date of resignation
Mr B	09-12-1998	27-02-2004

	Date of appointment	Date of resignation
Mr C	09-12-1998	27-02-2004
Mr D	04-05-1999	-
Mr E	27-02-2004	-

(2) (a) Company F was incorporated as a private company in Hong Kong in January 1987. The principal activities of Company F were described as property investment and development.

(b) At the relevant times, the issued and paid up capital of Company F was $100,000, divided into 100,000 ordinary shares of $1 each. Mr E, Mr B, Mr G and Mr H were the shareholders and directors of Company F. Details of the shareholdings were as follows:

	Number of shares held	
	Prior to 7-3-2003	7-3-2003 and after
Mr E	79,998	80,000
Mr B	10,000	10,000
Mr G	10,000	10,000
Mr H	2	-
	100,000	100,000

(3) (a) Company J was a foreign investment enterprise incorporated in the mainland of China ('the Mainland') in June 2002. It was a wholly owned subsidiary of Company F.

(b) The Business Licence for Enterprises as Legal Persons（企業法人營業執照）of Company J dated 18 October 2002 showed, *inter alia*, the following particulars:

(i) Legal Representative: Mr E
(ii) Registered capital: ¥28,000,000 (Paid-up capital ¥14,442,400)
(iii) Scope of business: Hotel management

(c) In 2002, Company J entered into a lease agreement with City K's 人民防空辦公室 to lease a hotel site in City K for a term of 15 years from 11 June 2002 to 31 May 2017. Company J carried out renovation and refurbishment works at the hotel site and on 10 January 2003, set up a hotel named as Hotel L ('the Hotel') there.

(4) The [Taxpayer] filed its Profits Tax return for the year of assessment 2003/04 together with audited financial statements for the year ended 31 March 2004 and a tax computation. In the return, the [Taxpayer]

declared an adjusted loss of $21,236,876 after deducting, *inter alia*, a specific provision for bad debts of $49,730,103 which included a sum of $38,038,190 due from Company J ('the Debt').

(5) In response to the Assessor's enquiries concerning the Debt, Messrs Alfred Sung Taxation Service ('the Representatives') stated as follows:

(a) The Debt was made up of the following:

	$	
Loan principal lent to Company J	35,258,022	('the Loan')
Interest on the Loan	2,780,168	('the Interest')
	38,038,190	

(b) The Interest was included in the [Taxpayer's] reported income for the year ended 31 March 2004.

(c) As the registered capital of Company J was insufficient to meet the funds required for renovating and furnishing the Hotel and promoting its business, Mr E, on Company F's behalf, initiated an application for additional funds from the [Taxpayer]. In a way similar to any other outside third party applications, the application needed to be approved by the [Taxpayer's] board of directors and various management staff at a meeting.

(d) Subsequent to the opening of the Hotel, Company J's management staff tried their utmost effort to promote the business. But the result was unsatisfactory. Company J was forced to cease the business of the Hotel due to poor cash flow. The closure led to Company J's disposal of the Hotel to a local third party, Company M, at a consideration of ¥9,800,000.

(e) The [Taxpayer] did not take any legal action against Company J to recover the Debt.

(6) The Representatives claimed as follows:

(a) Regardless of whether the borrowers were related to the [Taxpayer] or not, the management of the [Taxpayer] would always consider the possibility of profit making as long as the business transactions fell within the ambit of the [Taxpayer's] activity. The transactions were conducted at arm's length. The Loan was in line with the [Taxpayer's] activity with a view for profit.

(b) Company J was wholly owned by Company F and the [Taxpayer] did not hold any shares of Company J. Although Mr E was involved in the [Taxpayer], Company F and Company J, the shareholding composition of the [Taxpayer] and Company F were different. Mr D, another shareholder and director of the [Taxpayer], had no relationship with Mr E and/or his family.

(c) The [Taxpayer] also advanced loans to and received interest from Company N, Company P, Company Q and Company R (collectively referred to as 'the Related Companies' below) in which Mr E had financial interest.

(d) Therefore, the Loan was advanced to Company J in the ordinary course of the [Taxpayer's] money lending business and thus was trading but not capital in nature.

(7) The Representatives provided copies of the following documents:

(a) A schedule showing the amounts of interest received/receivable (including the Interest) from loans (including the Loan) in respect of which bad debt deduction was claimed for the year of assessment 2003/04.

(b) A breakdown of the Debt showing the amounts of funds advanced during the period from 21 May to 9 December 2002 and interest computed at an interest rate of 5% or 5.125% per annum up to 31 March 2004.

(c) A deed of loan facility dated 18 May 2002 ('the Deed') made between the [Taxpayer] as the lender and Company J as the borrower which contained, *inter alia*, the following terms and conditions:

(i) The maximum amount to be advanced was HK$40,000,000.

(ii) The maturity date would be 5 years from the date of the Deed, i.e. 18 May 2007.

(iii) The principal sum that remained unpaid would bear interest at Hong Kong Dollar Prime Rate plus 2% per annum, to be accrued on daily basis and due and payable on the maturity date.

(iv) The [Taxpayer] would not be entitled to require to anticipate repayment of the loan principal before the

maturity date, provided that Company J would be entitled, at any time by notice to the [Taxpayer], to repay the outstanding principal together with interest payable up to the date of such payment.

(v) If Company J became bankrupt or made any arrangement with its creditors, the outstanding principal and interest thereon would immediately become payable but without prejudice to the rights of the [Taxpayer] to charge all real and personal properties of Company J whatsoever and wheresoever for the purpose of securing the repayment of the outstanding principal and interest thereon.

(d) A memorandum dated 18 May 2002 made between the [Taxpayer] as the lender and Company J as the borrower stating the general terms of the loan facility. It was stated that no security was required for the loan.

(e) An asset transfer agreement（財產轉讓合同）dated 25 October 2004 (Appendix F) entered into between Company J as the transferor and Company M as the transferee which stated, *inter alia*, that Company J agreed to terminate the lease with City K's 人民防空辦公室 [Fact (4)(c)] and transfer the replacements, equipment and facilities installed by it at the Hotel to Company M at a consideration of ¥9,800,000.

(f) Four deeds of loan facility made between the [Taxpayer] as the lender and the Related Companies as the borrower which showed, *inter alia*, the following particulars:

Date	**Borrower**	**Loan facility HK$**	**Term**	**Annual interest rate**	**Surety**
12-08-2004	Company N	50,000,000	36 months	10%	Letter of guarantee executed by 5 shareholders and/or directors
12-04-2005	Company P	14,000,000	18 months	10%	Letter of guarantee executed by 6 shareholders and/or directors
24-01-2005	Company Q	5,000,000	24 months	10%	Surety provided by a director and another Person
23-0502007	Company R	1,000,000	12 months	10%	Surety provided 2 shareholder and directors and a Mainland enterprise

(8) The Assessor considered that the Debt did not qualify for deduction as bad debt. Accordingly, he raised on the [Taxpayer] the following Profits Tax Assessment for the year of assessment 2003/04:

	$
Loss per return [Fact (5)]	(21,236,876)
Add: The Debt	38,038,190
Assessable Profits	16,801,314
Tax Payable thereon	2,940,229

(9) The Representatives, on behalf of the [Taxpayer], objected to the 2003/04 Profits Tax Assessment on the grounds that the Debt should be deductible as bad debt because it was revenue in nature and had actually become bad and written off in the [Taxpayer's] accounts.

(10) By a letter dated 30 April 2010, the Assessor requested the Representatives to provide, *inter alia*, the following information and documents in relation to the Debt:

(a) When and how Company J made the requests for the loan facility to the [Taxpayer] and copies of the relevant documents.

(b) Copies of the [Taxpayer's] minutes showing approval of the granting of the loan facility to Company J.

(c) The way in which the principal sums were made to Company J and copies of the [Taxpayer's] accounting payment vouchers.

(d) The [Taxpayer's] ledger accounts showing records of the Loan and how the Interest was recorded as interest income.

(e) Whether Company J was required to provide the [Taxpayer] with any guarantee to secure repayment of the Loan and if no, the reasons for the different treatments regarding Company J and the Related Companies so far as securities for loan facilities were concerned.

(f) The reasons why Company J was not required to provide any form of security for the [Taxpayer].

(g) The actions taken by the [Taxpayer] against Company J to recover the Debt and if no, the reasons for the inaction.

> Despite reminders sent, neither the Representatives nor the [Taxpayer] responded to the Assessor's enquiries.

The Deputy Commissioner's Determination

4. The Deputy Commissioner considered that the issue for determination was whether the Debt should be regarded as bad and allowed for deduction. Reference was made to section 16(1)(d) of the Inland Revenue Ordinance (Chapter 112). The Deputy Commissioner decided that he was unable to accept the Taxpayer's claims that the Debt was revenue in nature and should be allowed for deduction on the grounds that the Loan was lent by the Taxpayer to Company J in ordinary course of its money lending business; that the Interest had been reported as its income; and that the Debt had become bad and written off in the Taxpayer's accounts for the year ended 31 March 2004. The Deputy Commissioner considered that the Taxpayer had not shown to his satisfaction that the Interest was included in the Taxpayer's reported income, bearing in mind that the Taxpayer provided a schedule that only showed the amounts of interest received and receivable from the loans concerned; there was no evidence that the Interest was included as a trading receipt for the year ended 31 March 2004. The Deputy Commissioner also considered that the Taxpayer had not shown to his satisfaction that the Loan was made by the Taxpayer in the ordinary course of its money lending business in Hong Kong. This was because firstly the Taxpayer had not provided evidence that the Loan was advanced by the Taxpayer to Company J. Secondly, even if the Taxpayer did advance the Loan to Company J, he was of the view that the sums were not lent to Company J in the ordinary course of the Taxpayer's money lending business in Hong Kong. Several features of the Loan, as well as the absence of evidence of any action taken by the Taxpayer to recover the Debt from Company J were noted. The Deputy Commissioner further considered that the Taxpayer had not shown to his satisfaction that the Debt became bad during the year ended 31 March 2004 in the light of the circumstances. The Deputy Commissioner's Determination was dated 6 June 2013. The date of issue of the Revenue's notification of the Deputy Commissioner's Determination was also 6 June 2013.

The Taxpayer's Appeal

5. The Taxpayer authorized the Representatives to represent it before this Board on 10 June 2013. The authorization was executed on behalf of the Taxpayer by Mr E. On 5 July 2013, the Clerk to the Board of Review received the Taxpayer's Statement of Grounds of Appeal. This Statement outlined the incorporation of the Taxpayer and its capital structure in the year of assessment 2003/2004, which showed that Mr E was the substantial shareholder (through shareholding by his two brothers on trust for him) and the chairman/managing director of the Taxpayer. Mr E also carried on other businesses including property investment, property development and property agency principally through Company F, in which he held personally the substantial part of its shares. This Statement then claimed that Mr E 'perceived a good chance to start to invest into the PRC market' in 2002 and decided to use Company F to invest in a hotel management business in City K, Province S. Company J was established and registered as a wholly owned foreign investment enterprise on 13 June 2002 with Mr E as the legal representative. Company J

then signed a lease agreement with City K's 人民防空辦公室 to lease the Hotel for a duration of 15 years from 11 June 2002 to 31 May 2017. The Hotel would have to be refitted as a four-star hotel and in the course of the renovation various complications developed and 'the co-ordinator anticipated that a significant sum of money would be required additional to the original budget in order to satisfy the local government's regulations. As this bad news came suddenly and Company F did not have extra funds available, Mr E, had therefore, on Company J's behalf, to request [the Taxpayer] to finance the additional funds for the Company J's project. Hence a deed of loan facility was entered into between [the Taxpayer] and Company J dated 18 May 2002'. This Statement then sought to explain that loans advanced by the Taxpayer to related companies that Mr E was interested in did not follow 'certain office internal procedures/documentation', such as the filling of a formal loan application form. Rather, approval of the loans was granted verbally during weekly meetings between the Taxpayer's directors. While the loans to other related companies were repaid in both principal and interest, Company J's inability to repay was 'purely caused by its poor cash inflows as the business volume was unsustainable. No matter how much additional funds is injected and/or effort put into Company J, the management believed that it was quite impossible to improve Company J's business.' The Taxpayer as a result claimed the Debt comprising of the Loan and the Interest as bad debt in the 2003/2004 profits tax return.

6. Turning to the Deputy Commissioner's Determination, the Taxpayer's Statement of Grounds of Appeal first referred to the audited accounts of the Taxpayer and indicated that of the amount for interest as per the audited accounts (namely HK$30,349,559), the interest derived from Company J was HK$2,780,168, the interest from another related company HK$523,479 and the remainder derived from outsiders. It then explained that there was 'leniency' in the formal documentation in respect of loans application and approval procedures by related companies which, however, did not mean that the transactions were not done at arm's length. This Statement then contended that the total amount of the Debt of HK$38,038,190 should be allowed as a deduction as a bad debt within the meaning of section 16(1)(d) of the Inland Revenue Ordinance. The loan advanced by the Taxpayer to Company J was said to be at arm's length like any other lending. When the loan was advanced in the present case, the Taxpayer booked the advances as a trade receivable. The same rule applied to the interest payable by Company J to the Taxpayer. The accrued interest, whether it was received or receivable, would have been credited to the Taxpayer's income account. Should Company J had made a success in its business, the amount of the interest of HK$2,780,168 would have been assessed for profits tax. However, it was impossible for Company J to pay the interest or to repay the principal due the extremely low business volume and insufficiency of cash inflows. 'This situation lasted for a period of time before the management has come to a conclusion to cease its operation. At such point of time, the debt (both principal and interest) would have become bad as Company J was unable to keep itself afloat.' Hence it was contended that the conditions in section 16(1)(d) were satisfied.

7. The Taxpayer at first indicated that it would call Mr E to give oral evidence. Later, the Representatives wrote to inform that one more witness (Mr T) would attend to

represent Mr E to explain the case in English to this Board. Shortly thereafter, the Representatives wrote to inform that Mr T would replace Mr E 'to appear in the interview as he is more proficient in English speaking' and served copies of an unsigned witness statement.

8. On 7 October 2013, the Representatives wrote to the Clerk to this Board stating that following a scrutiny of documents, the Taxpayer had 'noted that the interest income returned to the company's profit and loss account in respect of the subject year of assessment has been booked twice' and that relevant amount not included in the Taxpayer's profit and loss account was a sum of HK$3,888,888. The Representative thus claimed that the tax loss of the Taxpayer should be HK$25,125,764 (i.e. HK$21,236,876 + HK$3,888,888) instead of HK$21,236,876 and attached a revised profits tax computation for the year of assessment 2003/2004. A breakdown of the calculation of the sum of interest of HK$3,888,888 was provided on 9 October 2013.

This Board's Hearing of 10 October 2013

9. This Board was convened on 10 October 2013 to hear the Taxpayer's appeal. Prior to the commencement of the hearing, the Representatives and the Revenue's representative had signed a Statement of Agreed Facts which has been reproduced in paragraph 3 above.

10. Mr Sung of the Representatives then made an opening statement. Mr Sung clarified that he would need to amend the Taxpayer's grounds of appeal because an amount of interest of HK$3,888,888 (computed in accordance with prime interest rate plus 2%) had not been claimed in the account and undertook to produce the proposed amended grounds of appeal for the consideration of this Board. Mr Sung underlined that notwithstanding that the Loan was made by the Taxpayer to Company J, a related company and that certain procedures were omitted, the Taxpayer lent the money in the ordinary course of business and the interest due had been properly included and booked as income in the Taxpayer's accounts. Mr Sung also stated that the terms of the Loan indicated that the transaction was at arm's length. Mr Sung further mentioned that it was the first time that the Taxpayer lent to a related company.

11. Mr Sung then called Mr T to give oral evidence. Mr T was at first referred to the unsigned witness statement the Representatives served on this Board and confirmed and adopted that as part of his evidence, save that he wished to modify the part of the witness statement concerning the recording of the sum of interest. Mr T elaborated that the Taxpayer had calculated the interest on the basis of an interest rate of 5% or 5.125% in its previous submission to the Revenue but it was found in the deed of loan facilities that the interest rate should be calculated as prime rate plus 2%, so there may have been a mistake in the submission in 2003 to the Revenue. At the clarified interest rate, the actual interest should be around HK$3.88 million. Mr T also explained that while it may be said that the interest rate in the Loan to Company J was low when compared to other loans (which were

at a fixed interest rate of 10%), the interest rate of prime rate plus 2% did carry a risk of fluctuation of the prime rate over the relatively long duration of the Loan.

12. Mr T was then asked by this Board's chairman as to his employment with the Taxpayer. Mr T stated that he had been in the company since August 1999. The first position was marketing manager. In 2002, he was assistant manager at the marketing side. At that time he was not personally involved in the arranging of the Loan to Company J. A senior manager called Mr U was responsible but he resigned in September 2003. Thereafter, the Taxpayer recruited Mr V to handle the accounting and documentation. Although Mr T was promoted to senior manager at the end of 2003, it was in 2006, after Mr V had left the company, that Mr T became personally involved in handling the Loan with Company J. The Taxpayer did not notice the duplication until an in-depth investigation was done shortly prior to the hearing of this Board. Mr T indicated that the Taxpayer now wished to increase the claim of the interest portion of the Debt to HK$3,888,888.

13. Mr T was cross-examined. Mr T confirmed that he was now the most senior employee of the Taxpayer; that the information in the witness statement came from him and some of his colleagues such as the accounting manager; that the information in the Statement of Grounds of Appeal was provided by his colleagues on the accounting side. Mr T further indicated that the Taxpayer was set up to lend money for the building of small village houses in the New Territories, as well as to other people with or without mortgaged properties. Documents in respect of each loan would be put in a file and kept in a cabinet. Several of these loan agreements with respect to the building of small village houses and their terms were referred to. Recovery of some such loans by way of legal action in Hong Kong was also referred to. Mr T thereafter confirmed that he did not know the procedure how the accounting details had been handled for submission of the relevant documents of the Taxpayer to its tax representative. He did not do the relevant work. He did not check the relevant work. He recognized that the Taxpayer had the loan documents, the loan facility and the memorandum in its records but did not know why they were not submitted to the Revenue at the time but rather two and a half years afterwards. He also did not know why a loan number was not assigned to the Loan like other loans. Mr T was referred to the deed of loan facility and its terms. It was pointed out to him that some of the terms there were not consistent with the memorandum said to have been produced on the same day. He answered that there was a mistake in the deed of loan facility, saying that this was the first time the Taxpayer prepared 'such kind of facility', which he later apparently clarified as loans to a related company. There may also be mistakes in checking the documents. (At a later stage, he added that the clauses providing for no entitlement to call the loan early in the subsequent loan facilities to related companies were incorporated by mistake.) And he expressed the view that the memorandum was the most important one because of the requirements under the money lender licence and the related legislation.

14. Mr T confirmed during cross-examination that he was not involved in the negotiation and finalization of the terms of the Loan. He confirmed that the Taxpayer had no document or record on how the Loan was applied for and approved, though in his witness statement he referred to the loan approval procedure as a guarantee for the benefit of the

Taxpayer's shareholders and testified on the details of the same. It was nonetheless suggested to him that the terms of the agreement for the Loan were extraordinary in that it had long maturity date, low interest rate, no tangible security and a specific provision that the lender could not demand early repayment. To that he explained that the Taxpayer could not get tangible security because the hotel was not owned by Company F but leased from government bodies. As to the interest rate, one could not compare with outside third party borrowers because the Taxpayer did not know them. Rather the per annum rate of prime rate plus 2% was very similar or close to 10% which was the rate charged for subsequent loans to related companies. Other finance companies in Hong Kong at that time charged 2 to 3% per month (annualized to about 24 or 36% per annum) in respect of loans to outsiders. As to the repayment period, the Taxpayer had to set a tight loan period for outsiders. Given the long time for legal action to recover defaulted loans from outsiders, the exposed risk of the Taxpayer was very high and a high interest rate was charged. He also suggested that Mr E could have instructed Mr U at that time that there was no need to sign any guarantee because the same party was involved in substance; and that Mr E may have decided on 5 years so that documents would not have to be prepared frequently for directors to sign. He denied the suggestion that the Loan was not negotiated at arm's length and countered that the Taxpayer had done the evaluation and approval. He further suggested that the documentation was prepared by the Taxpayer's staff 'maybe it will save time and save money … because all parties involved are mainly Mr E'; and that he 'know that the time is very rush, they need money very urgent'.

15. As to the loan drawdown, Mr T at first said that at the time Mr E stayed in the Mainland and drawdown requests were made over the telephone and the Taxpayer's staff would remit first and later Mr E would sign the drawdown notice later when he was back in Hong Kong. He said that there was a lack of experience in handling ' this kinds of document, when the timing and the accounting record not as perfect as those we can do for the outsider parties'. Later, upon challenge, he said that Mr E had not informed him directly at that time because he was not in the position. Rather he gained a general understanding of the procedures through participating in regular meetings that were apparently held every three months. Further, he said that he had made a mistake and said that he did not know if there was any drawdown notice. He believed that Mr E was shown by the accountant the remittance receipts and gave verbal confirmation. The relevant communication was not to his knowledge since the accounting manager at the time was Mr V and there was another female accounting staff. He had no knowledge of the actual procedures, what happened at that time. He added that between 2002 and 2004, Mr E stayed in the Mainland for considerable periods of time and there was a lack of manpower at that time too in the Taxpayer. The accounting system was very confusing. Accounting staff also lacked experience in handling the kind of business associated with the Mainland. But he accepted that there must be records but maybe staff had problems finding them.

16. Mr T was referred to the demand letters in Appendix 3 to his witness statement and asked why they were only produced shortly before this Board's hearing, bearing in mind that the Revenue had asked for them years ago. His answer was that he believed they were kept by the accountant and he had no idea why the accountant did not submit them to the

Revenue. It was suggested to him that the demand letters were not contemporaneous documents. Particular attention was given to the demand letter issued in March 2003, bearing in mind that the loan was only due to be repaid in 2007 and by the time of the demand letter, the renovated Hotel had only commenced business for two to three months. The running cost was low in the light of the sums already put in and it did not appear to make any sense to call the Loan at that juncture. Mr T explained that there was SARS in 2003 and Mr E decided to suspend business in April 2003 due to an advisory from the Province S Government and the fact that the business was running at a loss. Later, he accepted that he had never heard from Mr E about why he would call the Loan since he was not the person in charge at the time.

17. Mr T was then asked about Company F's commitment to the investment of the Hotel. He could not confirm the time. He was referred to the lease in respect of the Hotel which was dated 30 May 2002 and the documentary record of the establishment of Company J on 13 June 2002. He testified that Mr E had 'actually entered into the hotel' before the signing of the formal agreements. Mr E had permission from the government body to use the Hotel for doing a lot of preliminary work and that some money had to be spent first before signing the lease. He was then referred to the Statement of Grounds of Appeal of the Taxpayer, which suggested that it was after Company J had been incorporated and entered into the Hotel and began work that various complications arose which required an addition of funds to the amount originally budgeted. Company F did not have the funds available and so Mr E requested the Taxpayer, on Company J's behalf, to finance the additional funds. He was then asked whether this part of the Statement of the Grounds of Appeal made any sense as the agreement of the Loan was apparently signed on 18 May 2002. The documents provided by the Taxpayer suggested that there was the Loan, and then there was the incorporation of Company J and slightly before that the lease was signed. He replied that Mr E went to Province S at least several months before to check the environment and promise to the Province S government body an investment in the Hotel. However, Mr T was not able to confirm when Mr E and his partners found out that much more money than they originally budgeted for was required because Mr T was not personally involved.

18. Mr T was also asked whether the Taxpayer had sought to get information from Company J regarding its financial position. His answer was that he did not know whether his previous colleagues had such financial information. He had not asked Mr E for such information. He had not seen any such information. On the other hand, he was able to say that there was a meeting of all who were financially involved in the Hotel to make the decision to close the Hotel and the minutes of that meeting were produced.

19. Mr T was also referred to the audited accounts of Company F showing that Company J and the assets associated with the Hotel were sold in 2004 nearly at par at 98% of the investment. He was asked about the efforts of the Taxpayer to recover the Loan from Company J after 2004 before it closed in 2007. He answered that no money went to the account of Company J after the asset disposal. All the money from the disposal was used to repay loans from suppliers and unpaid decoration fees and the government body in Province S kept the remainder.

20. Mr T stated during re-examination that all the figures reported to the auditor and submitted to the Revenue were true and correct. And he elaborated a bit further on the disposal of the assets associated with the Hotel. After Company J had for some time been unable to find a suitable buyer of the business, the Province S government bodies told Company J to find a government entity to take up the Hotel at RMB9.8 million with conditions. Liabilities including unpaid decoration fees, loans to suppliers and outstanding wages had to be paid. Charges incurred even though the Hotel had suspended its business including rental and water and electricity charges also had to be paid. The remaining sum if any was kept by the government bodies. No money had been remitted to Hong Kong or given back to the account of Company J. He also said that if the Hotel were not sold or sold in good time, the personal safety of Mr E and his relatives who were in Province S may be adversely affected. Mr E could not get back the investment and the Taxpayer could only claim a bad debt.

21. Mr Wood, member of this Board, asked Mr T when he became involved in the Hotel project. Mr T confirmed that he was not involved in the project in 2003. He held a marketing role at that time. All documentation related to the Loan was the responsibility of other staff who had since left the Taxpayer. His understanding of the case came from his review of the documents since 2006 or 2007. He also had a general understanding of the case since 2002 or 2003 through discussion at regular meetings of the Taxpayer.

22. After the completion of the evidence of Mr T, Mr Sung of the Representatives claimed that Mr E wished to be a witness notwithstanding the prior communication from the Representatives that Mr T would replace Mr E as witness at the hearing of this Board. Mr Sung thus asked this Board to consider adjourning the hearing to allow Mr E to give evidence.

23. Having considered the application, this Board decided to adjourn the hearing with a timetable for production of documents.

This Board's Hearing of 14 January 2014

24. Prior to the next hearing of this Board, the Representatives provided this Board and served on the Revenue's representative on 24 October 2013 an Amended Statement of Grounds of Appeal, which asserted that the correct interest income accrued for Company J's Loan was HK$3,888,888 (at the rate of prime rate plus 2%) and this sum should also have been claimed as part of the bad debt for the year of assessment 2003/2004 in addition to the sum claimed of HK$2,780,168. Amendments were proposed to the effect that the total bad debt claim has become HK$41,927,078.

25. On 14 January 2014, Mr E attended the hearing of the Taxpayer's Appeal, and confirmed and adopted the signed witness statement that the Representatives had provided to this Board and served on the Revenue's representative prior to the hearing.

26. Mr E was cross-examined. He stated that the Taxpayer's financing business was mainly related to the building of houses in the New Territories. Such business was primarily based in Hong Kong in 2002, 2003 and 2004. He also stated that he was the legal representative of Company J between 2002 and 2004. While the operations of Company J were handled by managers and managerial staff of the operations department there, he was fully aware of what was happening in the Hotel project managed by Company J between 2002 and 2004.

27. Mr E was referred to the business licence of Company J, which was one for some 20 years. This hotel project of the Hotel was the first hotel project he had engaged. The lease was for 15 years. Mr E testified that when he entered into this project, he considered that it required medium or long-term investment and that in 2002, he and his partners were very confident in this project. They did not feel it was a high risk project.

28. Mr E recalled that prior to the opening of the Hotel in January 2003, he spent about two-thirds of his time in City K managing the Hotel project. He and his team moved into the Hotel in March 2002 even though the parties were still negotiating and the lease was not in effect until June 2002. Nine months were spent refurbishing and decorating the Hotel. He said that it was in May 2002 when Company F was discussing financial matters with the Taxpayer.

29. Mr E accepted that every new business would involve some loss at the beginning and one should not expect to be making a profit in the first two or three months of the Hotel project, bearing in mind that the hotel business was a bit seasonal. He was then asked why he decided on 25 April 2003 to cease business. He confirmed that the decision was made unanimously during a meeting. At the time, the SARS epidemic was going on, there was not one single guest coming to the Hotel and the government also ordered that the Hotel should cease business. He also confirmed that prior to 25 April 2003, there was no plan to close the business. Rather the plan was to hold on for longer to see if it would turn around.

30. Mr E was then asked generally on how the Taxpayer did its financing business in 2002. He accepted that loan applications would be recorded. He also accepted that most of the loans would have tangible securities. He further accepted that at the beginning the rate of interest charged was 40% per annum and later on adjustments were made to lower the rate to around 25% per annum and eventually to about 10% per annum as the Taxpayer began selecting borrowers in order to be more safe in its operation. Turning to the Loan, he accepted that the rate of interest of prime plus 2% was different from many of the other loans granted at the time and explained that it was because the amount was large and a preferential rate was given in the calculations. He accepted that documents relating to the coming into existence of the Loan should be with the Taxpayer but the documents relating to lending in the Mainland were stored separately; they were put in 'independent storage' in a safe within the Taxpayer. He was asked why the agreement in respect of the Loan was only provided two and a half years after the initial request. He responded that the management of the Taxpayer was not good and there were personnel changes within the Taxpayer in September

2003, so that the staff of the Taxpayer did not do a good job in responding to the request from the Revenue. But he accepted that the colleagues at the managerial department of the Taxpayer had access to the safe where the agreement in respect of the Loan was kept. He also accepted that the Taxpayer was not very good at responding to the Revenue's requests. At that time the Taxpayer was shrinking in size.

31. Mr E was also asked about what actions had been taken to recover the outstanding debt from Company J. He replied that his colleague in the Taxpayer reported the matter to him. His colleague in Hong Kong did contact Company J to follow up with the matter. But in the case of Company J, because both the major shareholder in the Mainland and the major shareholder in Hong Kong were both Mr E himself, no legal action was brought.

32. Mr E was also asked about the lease between Company F and City K's 人民防空辦公室. The lease provided that once the limited company invested by Company F in City K was incorporated, the newly set up company would replace Company F as the contract party. He confirmed that the City K company had not yet been incorporated when the lease was signed on 30 May 2002. He accepted that Company J, which was just being established at the end of May 2002, was not in any position to enter into any agreement with anybody. He also accepted that it was not until Company J was formally incorporated and the business licence was issued by the Mainland authorities that Company J was given the company chop.

33. Mr E was then referred to the agreement in respect of the Loan. He was referred to the terms which provided that the interest would only have to be paid at maturity of the Loan, and that the lender was not entitled to require anticipatory or early repayment of the sum before the maturity date. However, the Taxpayer's staff demanded repayment of the Loan in March 2003. He explained that the colleagues at the finance department learnt that the business at the Hotel was very poor or ordinary and took action to recover. He described them as operating independently. Then he said that the staff (who was apparently Mr U) did ask for his consent and his response was that they should go ahead and chase after Company J; he did not object to the action as he thought that Mr U was being responsible, notwithstanding that it was a term of the Loan not to demand payment before 2007.

34. It was put to Mr E that the demand letters or the copies produced before this Board were not made contemporaneously. He disagreed. It was also put to him that the demands were not made on his instructions, and he disagreed . It was further put to him that Company J was not at the time of its disposal in financial trouble because somebody was willing to pay for its acquisition at a price very close to the value of the investment according to the audited accounts of Company F and he disagreed. It was furthermore put to him that there was in truth no effort to recover the Loan. He disagreed.

35. Mr E accepted that the Loan was an extraordinary type of loan, being one with no guarantee, no tangible security, a low interest rate compared to other loans the Taxpayer was offering at the time, and a comparatively long duration. On the other hand, Mr E

disagreed that the risk of lending the Loan was particularly high at the time because at that point of time he was very confident. In doing the preparations, he and his partners had some investment plans in place. The preparation had already started even before the lease was signed.

36. On the other hand, while there was at the time a computer system to calculate the interest, Mr E stated that the Loan was given independent treatment because it was the first loan made to a Mainland party. The Loan was not put into the computer system for record. He did not want other staff in the Taxpayer to have knowledge about the Loan. By that he meant staff other than those in the managerial department.

37. It was put to Mr E that the money paid by the Taxpayer to Company J was in truth the investment by the Taxpayer and not actually a loan and he disagreed. His response was that from the beginning, the whole arrangement was that the Loan was a revolving loan, arranged and provided by the Taxpayer. It had always been planned that money would be borrowed from the Taxpayer. He then elaborated. At the beginning, the plan was that the whole project could be completed with RMB12 million. But when the project entered the refurbishment stage after Mr E and his team gained entry to the Hotel site in March 2002, it was discovered that the whole air conditioning and ventilation system of the building would need to be replaced; and that the machinery in the laundry room had all broken down and had to be replaced. He and his partners faced the situation of either giving up the whole project when dismantling had already started or trying to raise financing. Banks in Hong Kong would not approve loans to projects in the Mainland. Banks in the Mainland would only advance loans when the company had been incorporated and up-and running. Mr E and his partners were left with no choice but to go to the Taxpayer for the Loan. It was pointed out to Mr E that the lease provided for a renovation period from June to October 2002 that was rent free. His reply was that the truth was that the landlord turned over the property earlier.

38. It was suggested to Mr E that since he had already invested or transferred funds up to RMB30 to 40 million into the Hotel project he should have reopened the Hotel and waited to see how the business developed after SARS. His reply was that inspections by government officials and approvals must be secured before business could reopen. Different government departments made requests for the Hotel to hire specified lists of people. Staff at the procuring department filed false entries and receipts to pocket company money. Furthermore, many revenue producing equipment had been stolen by insiders. It was felt that one could not adjust to the culture of doing business in the Mainland. As the major investor, he feared how much money would need to be pumped into the project before it could be turned around, bearing in mind that each member of the management team seemed to be satisfying their individual selfish motives rather than conducting the business of the Hotel.

39. During re-examination, Mr E was asked about how the purchase price of the assets associated with the Hotel project was negotiated. He stated that the commercial bureau of the municipal government referred the case to a power company which was

willing to accept the assets. The consideration of RMB9.8 million was enough to cover all outstanding debts including rental payment and wages of the staff, as well as payments for goods and renovation works. The arrangement would also lead to release from the lease and exemption from future responsibilities. The said consideration was not enough to repay the outstanding debt in the Mainland. No part of the money was wired back to Hong Kong. The buyer also imposed the condition barring the taking of any items from the property, including documents and account books. He was also asked why at the outset he was confident of the business of the Hotel project. His answer was that initially the whole business sentiment in the Mainland was very buoyant and the evaluation was that two of the four facilities in the Hotel project were good revenue generators. The evaluation turned out to be different from the actual business situation. Moreover, shortly after the commencement of business, the SARS epidemic hit the Mainland.

40. After the completion of the testimony of Mr E, the Representatives closed its case.

41. The Revenue did not call any evidence.

42. This Board then adjourned to 10 February 2014 for the hearing of final submissions with directions for the filing of written submissions beforehand.

This Board's Hearing on 27 February 2014

43. Due to the need to accommodate changes in the diaries of members of this Board, the hearing date of 10 February 2014 was vacated. The date for final submissions was refixed to 27 February 2014.

44. The hearing of this Board on 27 February 2014 proceeded in the afternoon of that day, the parties having filed and exchanged their written closing submissions in the morning of that day.

45. Mr Sung of the Representatives and Mr Leung of the Revenue's representative were able to assist this Board with particular points it raised after reading the written submissions. Mr Leung's oral submissions focused on the contents of the documents the Taxpayer produced in support of its case and the claimed chronological sequence of the Taxpayer's case. One point that was made in this connection concerned the company chop of Company J that appeared in the agreement in respect of the Loan dated 18 May 2002. Since Company J appeared to have been incorporated in June 2002, the company chop should not have existed in May 2002. Together with the fact that there was a two year delay in the production of the documents to the Revenue, Mr Leung submitted that the documents could not have been contemporaneous. Mr Leung also focused on the treatment of interest by the Taxpayer in respect of certain borrowers, particularly the setting aside of 'interest in suspense' apparently without booking. Mr Leung submitted that if an item of interest had not been booked, it could not be written off. The claimed additional amount of interest of HK$3,888,888 was, according to Mr Leung, not properly explained

with ledger and vouchers. There ought to have been some contemporaneous evidence to explain how the mistake came about as opposed to the production of a table some 10 years down the track.

46. Mr Sung emphasized that the Province S government authorities had allowed Mr E and his team to gain access to the Hotel to do preliminary work before the signing of the lease. He also responded to Mr Leung's submissions about the interest in suspense item in the accounts. After the Taxpayer had lent money to a customer, such as 'Company W', the interest attributable to that loan would be calculated after a certain period of time and then the Taxpayer would debit the interest receivable from Company W and at the same time credit as interest income to its income statement. When Company W was unable to pay then the Taxpayer would reverse the interest income it had earlier credited, debiting the interest income and crediting the same to interest in suspense. This treatment reflected the doubt as to the collectability of the loan capital and interest due. When the loan interest was actually received, the interest income would be credited to the income account. Interest in respect of accounts that had been treated as interest receivable in a particular year was considered to be possibly doubtful and not claimed as a bad debt.

47. Turning to the interest in the Loan, Mr Sung sought to explain why there were two interest income items. He said that when the interest was calculated, it was done by one outgoing staff and one replacing staff. He guessed that one staff would have looked at the deed of facilities for the Loan and calculated on the basis of the rate of interest of prime plus 2% giving rise to the amount of interest of HK$3.88 million. The other staff (he guessed) became aware of the Loan and adopted the prime rate. The interest income attributed to the Loan had been computed and booked as income twice. The correct interest income attributable to the Loan was HK$3.88 million and should have been claimed as part of the bad debt for the year of assessment 2003/2004. Both the income and the bad debt had been overstated by HK$2.78 million.

48. This Board then sought assistance from the parties on whether the time limit under section 70A of the Inland Revenue Ordinance would operate against the Taxpayer. This issue was relevant to the Taxpayer's additional claim by way of proposed amendment as bad debt of the amount of interest of HK$3,888,888. Mr Leung considered that this was an attempt to correct an error in the return or the tax computation. Mr Sung's view was that section 70A was not applicable because the Taxpayer's case had been dragging on for a period of time so that the assessment of profits tax for the year of assessment of 2003/2004 was not final.

49. Having heard the parties in final submission, this Board reserved its decision.

The Issues in this Appeal

50. This Board considers that there are three issues for determination in this Appeal. The first is whether the proposed amendment of the Taxpayer should be consented to. The second is whether the sums paid by the Taxpayer to Company J were paid for the

purpose of a money lending transaction. The third is consequential to the second and it is whether on the assumption that the sums paid were in the nature of a money lending transaction or a loan, they were money lent in the ordinary course of the Taxpayer's money lending business.

First Issue: Proposed Amendments

51. Section 66(3) of the Inland Revenue Ordinance provides that the consent of this Board is required before an appellant may rely on a ground of appeal other than the grounds contained in his statement of grounds of appeal.

52. The Taxpayer's proposed amendments to the Statement of Grounds of Appeal do not disclose a proposal to rely on a ground of appeal other than the grounds contained in his statement of grounds of appeal.

53. The three amendments put forward by the Taxpayer on 24 October 2013 propose a change in the claim of the *amount* of the bad debt in the year of assessment of 2003/2004. The reason for the proposed change was said to be the result of a recent re-calculation of the amount of interest receivable by accounting staff of the Taxpayer which revealed that the Taxpayer had booked interest income twice. The Amended Statement of Grounds of Appeal submitted indeed states that 'the *correct* interest income accrued for Company J's loan under the loan deed is HK$3,888,888 (P+2 Rate) and should have been claimed as bad debt for the year of assessment 2003/2004, and not only the amount of HK$2,780,168 for which had also been included as interest income and claimed as bad debt' (emphasis supplied). In other words, the Taxpayer now says that the bad debt that should be allowed for deduction in the year of assessment of 2003/2004 is a different amount and not the amount it had stated in the profits tax return submitted in respect of the year of assessment of 2003/2004.

54. This Board considers that Taxpayer's proposed change is one that should be dealt with under section 70A of the Inland Revenue Ordinance by application to the Revenue's Assessor made within six years after the end of a year of assessment or within six months after the date on which the relative notice of assessment was served, whichever is the later for correction. The relevant year of assessment here is the year of assessment of 2003/2004. The relevant notice of assessment was issued on 7 July 2008. It appears therefore that the Taxpayer is out of time in seeking the correction from the Assessor. This Board only has jurisdiction under section 70A(2) to deal with a matter of correction if an Assessor refuses to correct an assessment in accordance with an application under section 70A. In the Taxpayer's case, there has been no application made under section 70A to the Assessor for correction and no notice of refusal of the Assessor in respect of any such application.

55. This Board declines to consent to the amendment proposed by the Taxpayer to its statement of grounds of appeal because the proposed amendments do not disclose any arguable ground of appeal.

Second Issue: The Nature of the Sums Paid by the Taxpayer to Company J

56. Having considered the evidence, this Board concludes that the Taxpayer has failed to establish that the sums paid by the Taxpayer to Company J were paid for the purpose of a money lending transaction. This Board sets out its reasons for reaching this view in the paragraphs that follow.

57. This Board finds as facts the facts agreed by the Taxpayer and the Revenue in the Statement of Agreed Facts set out above.

58. This Board considers that the evidence of Mr T is of very limited value to the Taxpayer's case of establishing that the sums paid by the Taxpayer to Company J were paid for the purpose of a money lending transaction and that those sums paid were money lent in the ordinary course of the Taxpayer's money lending business. This Board has reached this view because Mr T was not personally involved in the negotiation and finalization of the Loan in 2003. He only became a senior manager of the Taxpayer at the end of 2003 and only became concerned with the Taxpayer's treatment of the Loan in 2006 . His knowledge of the Taxpayer's case in respect of the Loan came from documents that he said he had access to since 2006 or 2007.

59. Mr E's evidence of how the Taxpayer came to arrange the Loan contended by the Taxpayer with Company J is undermined by the purported contemporaneous documents put before this Board and relied upon for the purpose of evidencing the making of the Loan. As Mr Leung for the Revenue has pointed out, since Company J was presumably incorporated in June 2012 (as it was shown on the company constitution（公司章程）of Company J and the Business License for Enterprises as Legal Persons （企業法人營業執照） of Company J), it would have been rather surprising, to say the least, to find the company chop of Company J affixed on an agreement in respect of the Loan dated 18 May 2002, if the said agreement were what it purports to be, namely an agreement concluded on or about 18 May 2002. Indeed Mr E accepted during cross-examination that Company J was not in any position to enter into any agreement with anybody in May 2002 and that the relevant procedure was that it was after Company J was formally incorporated and its business licence was issued that it was given the company chop.

60. Another questionable aspect of the evidence of Mr E relates to the alleged action taken by the Taxpayer to recover the Loan. According to demand letters that first came to light only when they were produced in an appendix attached to Mr T's witness statement shortly before this Board's hearing (notwithstanding the requests of the Revenue for the documentary evidence of action taken to recover the Loan many years ago), the Taxpayer took action to demand repayment of the Loan by letters to Company J, the first of which was dated March 2003. If the Taxpayer did indeed take such action in March 2003 as asserted by way of the said demand letter, this would be contrary to the provision in the agreement in respect of the Loan that the Taxpayer as lender could not demand early repayment and that the Loan was only to due to be repaid in 2007. Mr E's explanation that

his colleagues in the finance department 'operating independently' took action to recover when they learnt that the business of the Hotel was poor is neither satisfactory nor convincing. The managerial staff of the Taxpayer (who, according to Mr E, would have access to the documents in respect of the Loan) must have realized that the Loan was not repayable until 2007 and demand for early repayment was specifically not allowed.

61. Mr Leung for the Revenue also points to the Taxpayer's two year delay in producing the documents to the Revenue. Mr E's explanation for the delay appears to this Board to be neither satisfactory nor convincing. This Board finds it difficult to appreciate why documents relating to the Loan had to be stored separately from other loans made in the Taxpayer's financing business given that they were all presumably documents associated with the money lending business of the Taxpayer and were accessible only by the Taxpayer's staff. In any event, the managerial staff of the Taxpayer had access to the safe in which, according to Mr E, the documents relating to the Loan were kept. Nevertheless, the documents relating to the Loan were not produced promptly in response to the requests of the Revenue but rather more than two years after the first of such requests.

62. This Board also finds the following features of the Loan to be out of the ordinary. No loan number was assigned to the Loan unlike the other loans made by the Taxpayer. The Taxpayer has no document or record on how the Loan was applied for and approved. The Loan was not put into the computer system of the Taxpayer for record. Together these facts add to the questionability of the Taxpayer's case that the sums paid by the Taxpayer to Company J were paid as drawdowns of the Loan and thus for the purpose of a money lending transaction.

63. For the reasons set out above, this Board finds that the Taxpayer has failed to establish that the sums paid by the Taxpayer to Company J were paid for the purpose of a money lending transaction.

64. The Revenue had in the course of the hearing suggested that the sums were paid by the Taxpayer to Company J to be the Taxpayer's investment into Company J's Hotel project. In the light of this Board's findings above, it may not be necessary for this Board to reach a finding on this suggestion. Nevertheless, this Board considers that there is force in the Revenue's suggestion. The Hotel project was in need of money in 2002. There appeared to be difficulty in obtaining financing from banks in Hong Kong and in the Mainland at the time. Mr E and his business associates in Company F could have regarded the Taxpayer as a source or repository of funds that could be used at relatively short notice to transfer money into the Mainland. Also, if one takes into account the dismal view taken by Mr E and his business associates in Company F of the prospects of the Hotel as an investment and profit-making venture after the SARS epidemic, then one may be able to understand the purported calling for repayment of the Loan several months after the Hotel had been in business (notwithstanding the fact that the running cost was low in the light of the sums already invested) and the purported writing off as bad debts of the Loan within the same year of assessment of 2003/04 as acts following such an outlook of the Hotel project.

Third Issue: Whether Money Lent in the Ordinary Course of the Taxpayer's Money Lending Business

65. Given this Board's findings on the Second Issue above, strictly it is not necessary to make findings on the Third Issue. Nevertheless, this Board considers it appropriate to highlight the following extraordinary features of the money transfer transactions between the Taxpayer and Company J that together would entitle this Board to conclude by way of inference that the money transferred to Company J did not constitute lending in the ordinary course of the Taxpayer's money lending business.

66. The first of the extraordinary features is the alleged terms of the Loan. The Loan had a long maturity date, relatively low interest rate, no tangible security, no guarantee and a specific provision that the lender could not demand early repayment. It could not be said that the risk the Taxpayer had purported to expose itself under the Loan was low when compared with loans to outsiders bearing in mind the nature of the business of Company J, and the absence of a tangible security. Thus it would have been curious to say the least for the Taxpayer to charge a relatively low interest rate. Another telling point was the specific provision that the lender could not demand early repayment. This again illustrates the risk that the Taxpayer had purported to expose itself.

67. Other extraordinary features have been mentioned above. In summary, no loan number was assigned to the Loan unlike any other loans made by the Taxpayer. The Taxpayer has no document or record on how the Loan was applied for and approved. The Loan was not put into the computer system of the Taxpayer for record. All these also point towards the inference that this Board is entitled to draw that the money transferred to Company J did not constitute lending in the ordinary course of the Taxpayer's money lending business.

Conclusion

68. This Board therefore finds that the Taxpayer has not discharged its burden under section 68(4) of the Inland Revenue Ordinance of proving that the Profits Tax Assessment for the year of assessment 2003/04 of the Taxpayer under appeal was excessive or incorrect. This Board dismisses the Taxpayer's appeal and affirms the Deputy Commissioner's Determination.