INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D108/03

Profits tax – sections 61 and 70A(1) of the Inland Revenue Ordinance ('IRO') – whether or not applications are within the time prescribed by section 70A(1) of the IRO – onus on appellant to demonstrate a mistake was made and such mistake arose through ignorance or inadvertence – whether section 61 of the IRO has the effect of annihilating for all purposes.

Panel: Ronny Wong Fook Hum SC (chairman), Nigel Kat and Thomas Mark Lea.

Date of hearing: 15 December 2003.
Date of decision: 15 March 2004.

The appellants are partners in Company B and are also the shareholders and directors of Company C. In the years of assessment 1995/96 to 1997/98, Company B has paid management fees to Company C and Company C has paid the rent for director accommodation.

The assessor was of the view that the management fees were excessive and revised the assessable profits of Company B in the relevant years of assessment. Company B objected to the assessment and challenged the determination before the Board in Case No B/R 75 of 2001. In that decision, the Board took the view that the central issue was whether the expenses for the accommodation of partners or staff of a firm paid by an associated corporation can be deducted as expenses for the computation of profits tax. The Board was of the view that such expenses cannot be deducted as expenses of the business and adverted to the suggestion of Company B that the Revenue was seeking to tax the income dollar twice in respect of the accommodation benefit reported by the appellants in their salaries tax returns.

By application dated 16 April 2002, the appellants invoked section 70A(1) of the IRO to correct the assessment raised on them for the years of assessment 1995/96, 1996/97 and 1997/98. The assessor refused such application. There are two issues before the Board. (1) Are the applications in respect of the year of assessment 1995/96 within the time prescribed by section 70A(1) of the IRO? (2) Is there any error or omission in any return or statement submitted for the years of assessment 1996/97 and 1997/98?

Held:

1. Under section 70A(1) correction by the assessor can only be triggered by an application 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. The relevant applications are out of time. The decision is irrelevant to the timing of the application as prescribed by section 70A(1) of IRO.

2. The onus is on the appellants to demonstrate that a mistake was made and such mistake arose through ignorance or inadvertence. The Board is of the view that on the decision the Board was there adverting to the procedural steps available to the appellants and did not express any view on the merits or otherwise of their position (Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394 followed).

3. The Board is of the view that the arguments of the appellants stem from a misunderstanding of the effect of section 61 of the IRO. The relevant word used in section 61 is 'disregard' and not 'annihilate' or 'avoid' or 'annul'. Where a transaction is found by the assessor to contravance section 61, he may 'disregard' it and 'the person concerned shall be assessed accordingly'. Section 61 therefore does not have the effect of annihilating Company C for all purposes (Cheung Wah Keung v Commissioner of Inland Revenue [2002] HKEC 1411; B/R 84/99 (unpublished) followed).

4. The appellants did not adduce any evidence to demonstrate that no contract of employment ever subsisted between them and Company C and that no salary or rentals had ever been paid by Company C. They did not identify any mistake which arose as a result of their ignorance or inadvertence. They had embarked upon a course of conduct which did not give the desired effect as previously hoped for. The Board is not persuaded that there is any error within section 70A of the IRO.

Appeal dismissed.

Cases referred to:

B/R 75/01 (unpublished)
Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394
Cheung Wah Keung v Commissioner of Inland Revenue [2002] HKEC 1411
B/R 84/99 (unpublished)

Tsui Nin Mei for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

Background

1. The Appellants ['Mr & Mrs A'] in these two appeals are husband and wife. With the consent of all parties, their respective appeals were heard at the same time due to the common issues involved.

2. At all relevant times, Mr and Mrs A were equal partners in a consultancy firm in the name of Company B ['the Firm'] providing taxation and counselling services.

3. Company C is a private company incorporated in Hong Kong on 30 December 1980. At all relevant times, the members of Company C were Mr and Mrs A, each holding one share. The directors of Company C were also Mr and Mrs A.

4. The Firm submitted profits tax returns and financial statements of each of the years of assessment 1995/96 to 1997/98. The income statements disclose the following particulars:

Year	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Professional fee	564,201	681,195	718,212
Interest income	2,007	8,596	7,138
Other income	3,946	3,746	648
	570,154	693,537	725,998
Expenses:			
Management fee	(487,543)	(566,668)	(580,557)
Other expenses	(78,388)	(105,461)	(117,421)
Profit	4,223	21,408	28,020

5. In correspondence with the assessor, the Firm asserted that the management fees for each of the years 1995/96 to 1997/98 were paid to Company C.

6. Company C submitted profits tax returns, financial statements and tax computations for each of the years 1995/96 to 1997/98. Company C's profit and loss accounts and profits tax returns disclosed the following particulars:

Year	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Management fee income	487,543	566,668	580,557
Less: Expenditure	(465,543)	(570,349)	(579,578)

Net profit for the year	22,284	(3,681)	979
Assessable profit for the year	17,920	14,805	6,601
Assessable profit for the year Converted into HK$	133,622	115,479	51,044
Less: Loss brought forward in HK$	(285,792)	(152,170)	(36,691)
Loss carried forward in HK$	(152,170)	(36,691)	
Net assessable profit in HK$			14,353

7. In the notes to the financial statements, Company C reported the following directors' remuneration having been paid during the years of assessment 1995/96 to 1997/98:

Year	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Fees	0	0	0
Other emoluments	126,470	150,364	155,368
	126,470	150,364	155,368

8. The directors' emoluments referred to in paragraph 7 above were made up as follows:

Year	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Salaries of Mr A	19,756.00	12,435.51	14,516.00
Salaries of Mrs A	13,076.92	14,230.77	13,846.16
Employee's bounus/13th month	3,846.15	15,897.44	15,383.72
Rent for director accommodation	89,790.77	107,800.39	111,621.92
	126,469.84	150,364.11	155,367.80

9. Company C, Mr and Mrs A each submitted returns in respect of the emoluments outlined in paragraph 8 above:

Year of assessment	**Returns submitted by Company C**		**Return submitted by Mr A**	**Return submitted by Mrs A**
	In resepct of Mr A	**In respect of Mrs A**		
1995/96	Undated	Undated	15-7-1996	15-7-1996
1996/97	16-4-1997	16-4-1997	Undated	Undated
1997/98	Undated	undated	22-7-1998	22-7-1998

All the returns of Company C were signed by Mr A on its behalf.

10. According to the returns summarised in paragraph 9 above, Company C paid Mr and Mrs A the following amounts by way of 'Salary/wages':

Year of assessment	**1995/96**	**1996/97**	**1997/98**
	HK$	HK$	HK$
Mr A	154,100	165,997	164,862
Mrs A	132,000	166,000	176,359

Converted into US$ at the rate of HK$7.8 : US$1, the 'Salary/wages' paid by Company C to Mr and Mrs A were as follows:

Year of assessment	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Mr A	19,756.00	21,282.15	21,135.74
Mrs A	16,923.07	21,281.57	22,610.14
Total	36,679.07	42,563.72	43,745.88

11. Company C and Mrs A further reported to the Revenue the provision of 'Quarters' at Address D ['the Flat'], by Company C to Mrs A. Rentals in respect of the Flat were paid by Company C to the landlord. The rent in respect of such accommodation amounted as follows:

Year of assessment	**1995/96**	**1996/97**	**1997/98**
In HK$	700,368.00	840,843.00	870,651.00
In US$	89,790.77	107,800.39	111,621.92

12. The sum total of the salary referred to in paragraph 10 above and the rental referred to in paragraph 11 above is as follows:

Year of assessment	**1995/96**	**1996/97**	**1997/98**
	US$	US$	US$
Salary	36,679.07	42,563.72	43,745.88
Rental	89,790.77	107,800.39	111,621.92
	126,469.84**	150,364.11**	155,367.8**

** These are the figures referred to in the financial statements of Company C summarised in paragraphs 7 and 8 above.

13. On the basis of the returns submitted by Mr and Mrs A, the following salaries tax assessments were levied on the income which they reported.

	1995/96		1996/97		1997/98	
	Date of the notice of assessment	**Tax assessed**	**Date of the notice of assessment**	**Tax assessed**	**Date of the notice of assessment**	**Tax assessed**
Mr A	26-9-1996	HK$3,627	8-8-1997	HK$7,519	13-10-1998	HK$3,312
Mrs A	30-9-1996	HK$5,854	15-8-1997	HK$10,720	6-11-1998	HK$7,198

Mr and Mrs A duly paid the salaries tax so assessed.

14. Disputes arose between the Firm and the Revenue in relation to the profits tax liability of the Firm. The assessor was of the view that the management fees referred to in paragraph 4 above were excessive. The assessor revised the assessable profits of the Firm for the relevant years of assessment as follows:

Year of assessment	**1995/96**	**1996/97**	**1997/98**
	HK$	HK$	HK$
Profit per return	32,636	165,495	216,678
Add: Management fees disallowed	795,327	905,287	864,309
Revised assessable profits	827,963	1,070,782	1,080,987
Tax payable thereon	124,194	160,617	145,933

15. The Firm objected to the assessments. Their objections were considered by the Acting Deputy Commissioner. By his determination dated 8 June 2001, the Acting Deputy Commissioner took the view that the interposition of Company C was artificial within the terms of section 61 of the Inland Revenue Ordinance ['IRO'] in that it did not provide any services which the partners could not and did not provide. The Acting Deputy Commissioner noted that some of the expenses charged in Company C's account were expenses genuinely attributable to the operation of the Firm under section 16 of the IRO and expressed the view that these have been properly allowed by the assessor. He further noted that section 17 of the IRO provides that no deduction shall be allowed in respect of domestic and private expenditure and expenses not being money expended for the purpose of producing the profits of the business, and agreed with the assessor that such expenses should not be allowed.

16. The Firm challenged the determination of the Acting Deputy Commissioner before this Board (differently constituted) in Case No B/R 75 of 2001. According to the decision of this Board dated 17 December 2001 (unpublished) ['the Decision']. '[Mr A] appears to be content not to challenge the Assessor's opinion that the transaction between the Firm and [Company C] was artificial or fictitious' [per paragraph 7 of the Decision]. After considering the arguments of the Firm, the Board took the view that the central issue before them was 'whether the expenses for the

accommodation of partners or staff of a firm paid for by an associated corporation can be deducted as expenses for the computation of profits tax' [per paragraph 6 of the Decision]. The Board concluded that '... the wording and intention of the provisions in sections 16 and 17 [of the Ordinance] are clear. A partner of a business cannot deduct the expenses for his accommodation as expenses of his business where such expenses are not incurred for the production of the profits being assessed' [per paragraph 14 of the Decision].

17. The Decision further adverted to the suggestion of the Firm that the Revenue was seeking to tax the same income dollar twice. The Board said this:

> '*This argument appears to be founded upon the fact that the Partners were required to lodge their salaries tax returns and have been assessed for salaries tax in respect of the remuneration (including accommodation benefit) received by them from [Company C]. [Mr A] did not suggest that this would constitute an estoppel against the Revenue in seeking to apply s. 61 of the Ordinance. ...All we can say is that this is not a matter which this Board can adjudicate on the context of this appeal. This Board is not seised of any objection over the salaries tax assessment of [Mr A] or [Mrs A]. That was not part of the Determination which forms the subject matter of this appeal. If, consequent on the view taken by the Assessor on the transaction or the determination of this appeal, [Mr A] and [Mrs A] have an objection over their respective salaries tax assessment, this would be a matter for them to raise with the Revenue. If they are dissatisfied with the treatment of their objection by the Revenue, they can then raise the matter by way of appeal to this Board'* [per paragraph 15 of the Decision].

18. By application dated 16 April 2002, Mr and Mrs A invoked section 70A(1) of the IRO and invited the Commissioner to correct the assessments raised on them for the years of assessment 1995/96, 1996/97 and 1997/98. By letters dated 20 June 2002 and 12 July 2002, the assessor refused the couple's application on the basis that they were out of time in respect of the year of assessment 1995/96 and that the assessor was not satisfied that there was any error or omission in respect of the years of assessment 1996/97 and 1997/98. The Acting Deputy Commissioner upheld the stance of the assessor by his determinations dated 30 June 2003. Mr and Mrs A now appeal before us against that determination.

Issue 1: Are the application in respect of the year of assessment 1995/96 within the time prescribed by section 70A(1) of the IRO

19. Section 70A(1) of the IRO provides that:

> '*Notwithstanding the provisions of section 70, if, upon application made within 6 years after the end of a year of assessment or within 6 months after the date*

> *on which the relative notice of assessment was served, whichever is the later, it is established to the satisfaction of an assessor that the tax charged for that year of assessment is excessive by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the amount of the ... assessable income or profits assessed or in the amount of the tax charged, the assessor shall correct such assessment'.*

20. Under section 70A(1) correction by the assessor can only be triggered by an application 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. On the facts of this case and in relation to the year of assessment 1995/96, the application should have been lodged before 31 March 2002 or six months from 26 September 1996 (in the case of Mr A) or six months from 30 September 1996 (in the case of Mrs A), whichever be the later. The relevant applications were not made until 16 April 2002. the applications are out of time.

21. Mr and Mrs A contend that their applications were made within six months after the Decision. We are of the view that the Decision is irrelevant to the timing of the application as prescribed by section 70A(1) of the IRO. The assessor and the Acting Deputy Commissioner are right in not entertaining their applications in respect of the year of assessment 1995/96.

Issue 2: Is there any error or omission in any return or statement submitted for the years of assessment 1996/97 and 1997/98?

22. The classic exposition on the construction of section 70A is to be found in the judgment of Patrick Chan J *(as he then was)* Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394. The Learned Judge explained at page 428 that:

> *'This section seems to draw a distinction between two types of errors or omissions – those which are arithmetical and those which are not arithmetical. There is usually no problem in identifying the first type of errors or omissions, i.e., arithmetical errors or omissions. It is the second type which will present some difficulty since it covers a variety of situations. I think it would be unwise to attempt to give a comprehensive definition of what is or is not an error or omission which can cater for all situations. It would be easier to identify cases in which it is not.*
>
> *In my view, for the purposes of section 70A, the meaning of "error" given in the Oxford English Dictionary would be appropriate, that is, "something incorrectly done through ignorance or inadvertence, a mistake". I do not think that a deliberate act in the sense of a conscientious choice of one out of two or more courses which subsequently turns out to be less than advantages*

or which does not give the desired effect as previously hoped for can be regarded as an error within section 70A. It is even worse if the deliberate act is motivated by fraud or dishonesty. But the question of fraud or dishonesty need not arise'.

23. Mr A further drew our attention to paragraph 2.01/70A of Inland Revenue Legislation Annotated by Professor Willoughby where the learned author pointed out that:

> '*In order to take advantage of section 70A the taxpayer must persuade the assessor that tax has been over-charged by reason of an error or omission made by himself, by the assessor or by a third party. With regard to errors or omissions made by the taxpayer there are four categories of mistakes. These are (a) arithmetical errors, (b) omissions to claim allowances, relief or deductions, (c) errors and omissions of fact and (d) errors of law ... Errors of law can occur where a taxpayer includes a fee in a return for Salaries Tax which ought to have been included in a return for Profits Tax. In such cases any expenses incurred are more likely to be deductible for Profits Tax than for Salaries Tax. This kind of mistake of law occurs with freelance writers, journalists and broadcasters whose fees are often returned by the payer who treats the payee erroneously as an employee. In such cases the action of the employer can mislead both the taxpayer and the assessor'.*

24. In their returns to the Revenue, Mr and Mrs A asserted that they were employed by Company C, the former as it managing director and the latter as its paralegal secretary. They further asserted that Company C paid them 'Salary/wages' and (in the case of Mrs A) Company C further provided her with quarters in the Flat. Each of them further declared the information furnished to be true. On the basis of the judgment of Chan J in Extramoney, the onus is on Mr and Mrs A to demonstrate that a mistake was made and such mistake arose through ignorance or inadvertence.

25. Mr and Mrs A prayed in aid the terms of settlement endorsed by this Board in B/R 84/99 (unpublished). The taxpayer in that case was a dental surgeon. He paid profits tax in respect of profits from his practice. In the years of assessment under appeal, the taxpayer caused management fees to be paid by his practice to a service company beneficially owned by the taxpayer. The management fees so paid were claimed as allowable deduction in arriving at the assessable profits of the taxpayer's practice. The assessor took the view that the management fees allowed for deduction should only be restricted to those expenses incurred in the production of assessable profits of the practice. The taxpayer however argued that the disallowance of management fees in the assessments issued to his practice would result in assessing the same income twice. According to paragraph 1 of the terms of settlement between the taxpayer and the Commissioner, the Deputy Commissioner accepted that 'the same dollar income should not be assessed twice and the assessment under appeal should be so adjusted'. We derive little assistance from this settlement.

The Board there was merely endorsing a private settlement between the parties. There was no discussion of principle that is of assistance to our determination.

26. Mr and Mrs A placed considerable reliance on the Decision as a means to discharge their onus. Particular emphasis was placed on the passage which we quoted in paragraph 17 above. We are of the view that the Board was there adverting to the procedural steps available to Mr and Mrs A. The Board did not express any view on the merits or otherwise of their position.

27. The true grievance of Mr and Mrs A stems from the different stance adopted by the Revenue in dealing with the profits tax liability of the Firm and in dealing with their personal liabilities for salaries tax. In the context of the Firm's liability for profits tax, the Revenue invoked section 61 of the IRO and took the view that the interposition of Company C was artificial 'in that it did not provide any services which the Partners could not and did not provide' [see paragraph 3 of the Decision]. In the context of Mr and Mrs A's liability for salaries tax, the Revenue refused to apply section 8(2)(k) of the IRO on the basis that the salary in question was paid by Company C and not by the Firm who is chargeable to profits tax under Part IV. Implicit in the arguments of Mr and Mrs A is the suggestion that consequential upon the application of section 61, Company C should no longer figure in assessing their fiscal position.

28. We are of the view that the arguments of Mr and Mrs A stem from a misunderstanding of the effect of section 61 of the IRO. As explained by the Court of Appeal in Cheung Wah Keung v Commissioner of Inland Revenue [2002] HKEC 1411 the relevant word used in section 61 is 'disregard' and not 'annihilate' or 'avoid' or 'annul'. Where a transaction is found by the assessor to contravance section 61, he may 'disregard' it and 'the person concerned shall be assessed accordingly'. Section 61 therefore does not have the effect of annihilating Company C for all purposes.

29. Mr and Mrs A had by their returns declared that they received salary from Company C. Mr and Mrs A did not adduce any evidence before us to demonstrate that no contract of employment ever subsisted between them and Company C and that no salary or rentals had ever been paid by Company C. They did not identify any mistake which arose as a result of their ignorance or inadvertence. They had embarked upon a course of conduct which did not give the desired effect as previously hoped for. We are not persuaded that there is any error within section 70A of the IRO.

30. For these reasons, we dismiss the appeal of Mr and Mrs A.