

Case No. D18/08

Profits tax – whether or not ‘offshore’ profits – section 68 (4) of the Inland Revenue Ordinance (‘IRO’) – guiding principle on whether profits are of Hong Kong source and therefore taxable or of foreign source and therefore not taxable.

Panel: Kenneth Kwok Hing Wai SC (chairman), Leung Lit On and Percy Wong Wai Wah.

Date of hearing: 11 July 2008.

Date of decision: 5 August 2008.

In its Profits Tax Return of the appellant for the year of assessment 2002/03, the appellant declared assessable profits excluding ‘offshore’ profits. The appellant appealed against the Determination on the additional profits tax assessment for the year of assessment 2002/03 and reducing the profits tax assessment for the year of assessment 2003/04. The effect of the additional profits tax assessment was to disallow the ‘offshore’ claim. The appellant adduced no evidence, whether oral or documentary, and said nothing in support of the appeal.

Held:

1. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.
2. Whether profits are of Hong Kong source and therefore taxable or of foreign source and therefore not taxable is a practical, hard matter of fact. It is well established in this as in a number of other jurisdictions that the source of profits is a hard practical matter of fact to be judged as a practical reality. It is, in other words, not a technical matter but a commercial one. The guiding principle is ‘one looks to see what the taxpayer has done to earn the profit in question and where he has done it’. The operations ‘from which the profits in substance arise’ must be taken to be the operations of the taxpayer from which the profits in substance arise; and they arise in the place where his service is rendered or profit-making activities are carried on. There are thus two limitations: (i) the operations in question must be the operations of the taxpayer; and (ii) the relevant operations do not comprise the whole of the taxpayer’s operations but only those which produce the profit in question (Ing Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue [2008] 1 HKLRD 412 followed).

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3. In the absence of any evidence on the operations of the appellant which produced the profits in question, there is simply no factual basis for the appellant to contend that any part of the profits was of a foreign source. It would be added that there is no contention how the appellant could or should succeed in whole or in part on its 'offshore' claim.

Appeal dismissed and costs order in the amount of \$5,000 imposed

Case referred to:

Ing Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue
[2008] 1 HKLRD 412

David Cheung of Chang Leung Hui & Li CPA Limited, certified public accountants, for the taxpayer.

Chan Tak Hong for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the Determination of the Deputy Commissioner of Inland Revenue dated 17 January 2008:

- (a) confirming the additional profits tax assessment for the year of assessment 2002/03 under charge number 1-1108043-03-6, dated 26 January 2005, showing additional assessable profits of \$1,817,779 with tax payable thereon of \$290,845; and
- (b) reducing the profits tax assessment for the year of assessment 2003/04 under charge number 1-1088436-04-6, dated 28 January 2005, showing assessable profits of \$2,200,000 with tax payable thereon of \$385,000 to assessable profits of \$1,055,540 and tax payable thereon of \$184,719.

2. In its Profits Tax Return for the year of assessment 2002/03, the appellant declared assessable profits of \$360,435 after excluding 'offshore' profits of \$1,817,779, apportioning its 'onshore' profits using the following formula:

'Onshore' profits = Salaries and allowance attributable to a computer maintenance staff in Hong Kong ÷ (Total salaries and allowances + Contribution to MPF).

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3. By letter dated 8 June 2004, the assessor wrote to Chang Leung Hui & Li CPA Limited, the appellant's tax representative, informing the appellant that a profits tax assessment for the 2002/03 year of assessment had been raised on the appellant as per the appellant's return, subject to further consideration upon receipt of evidence and information requested in that letter.

4. In the absence of any response from the appellant or Chang Leung Hui & Li CPA Limited, the assessor raised on the appellant the additional profits tax assessment referred to in paragraph 1(a) above. By letter dated 14 February 2005 which the Revenue said was received on 26 February 2005, Chang Leung Hui & Li CPA Limited objected against it on behalf of the appellant on the ground that it was excessive. The effect of the additional profits tax assessment was to disallow the 'offshore' claim.

5. The appellant failed to submit its Profits Tax Return for the year of assessment 2003/04 within the stipulated time limit. Pursuant to section 59(3) of the Inland Revenue Ordinance, Chapter 112, ('the Ordinance'), the assessor raised on the appellant the following profits tax assessment for the year of assessment 2003/04:

	\$
Estimated assessable profits	<u>2,200,000</u>
Tax payable thereon	<u>385,000</u>

By letter dated 14 February 2005 which the Revenue said was received on 26 February 2005, Chang Leung Hui & Li CPA Limited, objected against it on behalf of the appellant on the ground that it was excessive.

6. In its Profits Tax Return for the year of assessment 2003/04 the appellant declared adjusted losses of \$81,482, after excluding 'offshore' profits of \$1,137,022, apportioning its 'onshore' profits using the same formula as it did for the 2002/03 year of assessment.

7. By letter dated 21 March 2005, the assessor wrote asking Chang Leung Hui & Li CPA Limited to furnish the information required by her letter of 14 February 2005.

8. By letters dated 17 May 2005, 15 June 2005 and 31 August 2005, the assessor wrote direct to the appellant requiring it to furnish similar information for the 2002/03 and 2003/04 years of assessment.

9. Mr A was an employee of Chang Leung Hui & Li CPA Limited. He was also the former liquidator of the appellant. By letter dated 20 May 2005, he referred to the assessor's letter dated 17 May 2005 and alleged that arrangement had been made to retrieve the records of the appellant. That was May 2005.

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10. By letter dated 5 September 2005, Mr A wrote to the assessor alleging that:
 - (a) the records were not yet available as they 'had been dispatched overseas since the closing of the Hong Kong office';
 - (b) he was trying to contact the former management to locate the records; and
 - (c) he was sending some copy documents alleged to be 'sample copies of the contracts and sale invoices prepared by the company before the closing of the company's Hong Kong office'. These copy documents seem to be the sum total of what the appellant cared to send to the Revenue in response to its repeated enquires.

11. By letter dated 17 November 2005, the assessor wrote to the appellant again for outstanding information.

12. By letter dated 8 October 2006, Mr A again alleged that the documents were overseas and that the requested information was not available. He also stated that Chang Leung Hui & Li CPA Limited was arranging for the appointment of a new liquidator. That was October 2006.

13. The assessor's reminder letter to the appellant dated 8 November 2007 was not favoured with any response.

14. By his Determination, the Deputy Commissioner:
 - (a) confirmed the additional profits tax assessment referred to in paragraph 1(a) above; and
 - (b) agreed with the assessor's view that the profits tax assessment referred to in paragraph 1(b) above should be revised as per the appellant's return but disallowing the 'offshore' claim so as to show assessable profits of \$1,055,540 and tax payable thereon of \$184,719.

15. By letter dated 15 February 2008, Chang Leung Hui & Li CPA Limited gave notice of appeal on behalf of the appellant. The copy documents sent by Chang Leung Hui & Li CPA Limited were incomplete in that a full set of the appendices to the Determination had not been supplied.

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16. By letter dated 27 February 2008, the assessor wrote to Chang Leung Hui & Li CPA Limited to ask if the appellant accepted the facts asserted in paragraph 1(1) to (12) of the Determination.

17. By letter dated 21 February 2008, the Clerk to the Board of Review wrote to Chang Leung Hui & Li CPA Limited asking for a full set of the appendices to the Determination and for an estimate of the length of hearing of the appeal together with other information relevant to the fixing of dates for the hearing of the appeal.

18. The Clerk's letter crossed with the letter dated 20 February 2008 from Chang Leung Hui & Li CPA Limited enclosing a set of what it called the 'Decision'. This set was again incomplete in that Addendum A to Appendix D was missing.

19. By letter dated 22 February 2008, Chang Leung Hui & Li CPA Limited wrote to the Clerk enclosing a written authorisation dated 15 February 2008 signed by Mr B, the appellant's liquidator, to represent the appellant in the tax appeal.

20. By letters dated 19 March 2008, 11 April 2008 and 15 May 2008, the Clerk wrote again to Chang Leung Hui & Li CPA Limited to ask for information about the estimate length of hearing etc.

21. By letter dated 3 June 2008, the Clerk gave the parties notice of hearing of the appeal and asked to be furnished with copies of documents and authorities. The respondent supplied her bundle of documents and authorities under cover of the assessor's letter dated 30 June 2008.

22. Chang Leung Hui & Li CPA Limited did not respond to the assessor's letter of 27 February 2008. Nor did it reply to the Clerk's repeated enquiries. Nor did it lodge any bundle. The lack of response from the appellant, the liquidators and Chang Leung Hui & Li CPA Limited is the norm in this case.

23. At the hearing of the appeal on 11 July 2008, Mr David Cheung of Chang Leung Hui & Li CPA Limited told us that he was a certified public accountant and that he represented the appellant in this appeal.

24. Mr David Cheung claimed that he did not know who was the liquidator of the appellant and whether the liquidator was an employee of Chang Leung Hui & Li CPA Limited. If he was telling the truth, he had not read the letter dated 22 February 2008 from Chang Leung Hui & Li CPA Limited enclosing the liquidator's written authorisation. He adduced no evidence, whether oral or documentary, and said nothing in support of the appeal. He was given an opportunity to address us on costs under section 68(9) of the Ordinance. After he had concluded what he had to say, we told Ms Chan Tak Hong that we need not trouble her and that we would give our decision in writing which we now do.

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25. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant. Whether profits are of Hong Kong source and therefore taxable or of foreign source and therefore not taxable is a practical, hard matter of fact¹. It is well established in this as in a number of other jurisdictions that the source of profits is a hard practical matter of fact to be judged as a practical reality. It is, in other words, not a technical matter but a commercial one². The guiding principle is ‘one looks to see what the taxpayer has done to earn the profit in question and where he has done it’. The operations ‘from which the profits in substance arise’ must be taken to be the operations *of the taxpayer* from which the profits in substance arise; and they arise in the place where his service is rendered or profit-making activities are carried on. There are thus two limitations: (i) the operations in question must be the operations of the taxpayer; and (ii) the relevant operations do not comprise the whole of the taxpayer’s operations but only those which produce the profit in question³.

26. In the absence of any evidence on the operations of the appellant which produced the profits in question, there is simply no factual basis for the appellant to contend that any part of the profits was of a foreign source. We would add that there is no contention how the appellant could or should succeed in whole or in part on its ‘offshore’ claim. The appeal is doomed to failure and must be dismissed.

27. It is plain and obvious that this is a hopeless appeal which has no prospect of success at all. Proceeding with the hearing of this appeal wasted the Board’s time and resources. It also wasted the Revenue’s costs, time and resources.

28. We dismiss the appeal and confirm the assessments as confirmed or reduced by the Deputy Commissioner.

29. Pursuant to section 68(9) of and Part I of Schedule 5 to the Ordinance, we order the appellant to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.

¹ Per Bokhary PJ in Ing Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue [2008] 1 HKLRD 412 at paragraph 1.

² Per Lord Millett NPJ in Ing Baring Securities at paragraph 131.

³ Per Lord Millett NPJ at paragraphs 128 & 129.