Case No. D25/01

Profits tax – excessive – error or omission in the return – assessable profits not derived from Hong Kong – failure to supply information to the Inland Revenue Department (' IRD') – sections 64(1) and 70A of the Inland Revenue Ordinance (' IRO').

Panel: Patrick Fung Pak Tung SC (chairman), Benjamin Chain and Nigel Kat.

Date of hearing: 29 March 2001.
Date of decision: 8 May 2001.

The taxpayer appealed against the assessor' s refusal to correct the profits tax assessment for the year of assessment 1995/96. In the audited accounts it was recorded that ' No provision for Hong Kong profits tax has been made as in the opinion of the directors all the income of the company is derived from sources outside Hong Kong and is therefore not subject to Hong Kong profits tax' . Despite the assessor' s request for the supply of information relating to the said audited accounts, including details of sales profits made by the taxpayer, the taxpayer refused to entertain the request.

On 28 October 1997, the taxpayer filed its profits tax return for the year of assessment 1996/97 which reported a loss but did not claim it for profits tax purpose on the basis that the loss was offshore.

By a letter dated 4 November 1998, the taxpayer applied for correction of the profits tax assessment for the year of assessment 1995/96 pursuant to section 70A of the IRO on the basis that the income earned during the period from 9 August 1994 to 31 March 1996 was derived from offshore operation. On 19 March 1999, the assessor advised the taxpayer that section 70A of the IRO did not apply as the Assessment was raised to disallow the offshore claim on purpose.

On 5 May 1999, the taxpayer' s offshore claim in relation to the 1997/98 assessment was accepted by the assessor. In view of that, the taxpayer, in a letter dated 10 May 1999, contended that there was an error in assessing the profits tax for the year of assessment 1995/96.

Held:

1. The IRO prescribes a fixed time limit of one month for the lodging of an objection by a taxpayer against an assessment (see section 64(1)). Despite the fact that a taxpayer

has not lodged any objection against an assessment pursuant to section 64(1), it is open to him to apply for a correction of the assessment within six years pursuant to section 70A of the IRO if 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 net assessable value [within the meaning of section 5(1A)], assessable income or profits assessed or in the amount of the tax charged (Sun Yau Investment Co Limited v The Commissioner of Inland Revenue 2 HKTC 17 and Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394 considered and applied).

2. The Board was of the view that there was no ' error' or ' omission' or ' arithmetical error' or ' arithmetical omission' on the part of anybody within the meaning of section 70A of the IRO. It was a deliberate and conscious act on the part of the taxpayer to claim that its profits made in the year of assessment 1995/96 were exempt from profits tax on the basis that such profits were made offshore. It was an equally deliberate and conscious act on the part of the assessor to reject such claim for exemption and to raise the Assessment after continuous failure on the part of the taxpayer to supply the further information requested.

3. The fact that a similar claim for exemption in respect of subsequent years of assessment does not affect the situation because:

   (a) each year of assessment must be looked at by itself in light of all the materials relevant thereto;

   (b) there is no sufficient material before the Board to prove if the relevant further information requested had been supplied to the assessor, he would or should have allowed the exemption claimed;

   (c) the burden of proof is on the taxpayer and it has not discharged such burden.

4. If the argument of the taxpayer were to prevail, it would mean that any taxpayer could simply sit back and not file any tax return or supply any information requested by the IRD and wait for the Department to make an assessment and the taxpayer can then challenge the assessment on the basis that there has been ' an error or omission' or ' an arithmetical error or omission' within the meaning of section 70A of the IRO as long as he makes his challenge within a period of six years. That cannot be correct.

Appeal dismissed and a cost of $5,000 charged.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Cases referred to:

D23/96, IRBRD, vol 11, 369
Sun Yau Investment Co Limited v The Commissioner of Inland Revenue 2 HKTC 17
Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394

Lee Yun Hung for the Commissioner of Inland Revenue.
Leung Seh Wing of Messrs Chan Nip Sun Wong & Co for the taxpayer.

Decision:

1. This is an appeal by the Taxpayer against an assessor's notice of refusal dated 13 May 1999 refusing to correct the profits tax assessment for the year of assessment 1995/96 ('the Assessment') dated 10 November 1997 showing assessable profits of $1,340,913 with tax payable thereon of $221,250. An objection was lodged by the Taxpayer against such notice of refusal on 24 May 1999. By his letter dated 26 September 2000, the Commissioner made a determination and rejected the Taxpayer's objection. The Taxpayer has brought this appeal against such determination.

The facts

2. The Taxpayer is a company incorporated under the Laws of Hong Kong.

3. In its profits tax return for the year of assessment 1995/96 dated 20 September 1996, the Taxpayer declared that its assessable profits for that year of assessment were 'nil'. Submitted with the said profits tax return, there were the audited accounts of the Taxpayer for the period between 9 August 1994 and 31 March 1996 and a suggested tax computation.

4. In the said audited accounts, there is a note which reads as follows:

> '4. TAXATION
>
> No provision for Hong Kong profits tax has been made as in the opinion of the directors all the income of the company is derived from sources outside Hong Kong and is therefore not subject to Hong Kong profits tax.
>
> No provision for deferred taxation has been made as the effect of all timing differences is immaterial.'

5. In the said suggested profits tax computation for the period from 16 January 1995 (date of commencement) to 31 March 1996, it was suggested that the assessable profit should be nil. There is again a note which reads as follows:

> ' Note: The company operates and transacts its business outside Hong Kong. In the opinion of the directors, all sales and purchases of the company are treated as offshore transaction and the profit of the company is not subject to Hong Kong profits tax.'

6. By a letter dated 11 September 1996 addressed to the tax representatives of the Taxpayer, Messrs Chan Nip Sun Wong & Co (' the Representatives'), the assessor in charge of the Taxpayer' s file asked for the supply of certain information relating to the said audited accounts, including details of sales profits made by the Taxpayer. There was no reply to this letter.

7. By a letter dated 30 October 1996 addressed to the Taxpayer, the assessor gave formal notice under section 51(3) of the IRO requiring the Taxpayer to supply the information requested.

8. The Representatives thereafter by letters dated 16 December 1996, 30 January, 17 and 28 February, 1 April and 12 May 1997, requested by the Taxpayer for extensions of time for the supply of the information requested. An extension of time was given on each occasion as requested.

9. By a letter dated 17 June 1997, the Representatives requested for yet another extension of time. On this occasion, the assessor refused to entertain the request.

10. On 28 October 1997, the Taxpayer filed its profits tax return for the year of assessment 1996/97. In the accounts accompanying the same, the Taxpayer reported a loss of $304,483 for the year ended 31 March 1997 but did not claim it for profits tax purpose on the basis that the loss was offshore.

11. On 10 November 1997, the assessor raised on the Taxpayer the Assessment as follows:

'	$	$
Profits per accounts		1,276,747
Add : Depreciation charged	54,570	
Preliminary expenses	9,596	64,166
Assessable profits		1,340,913
Tax payable thereon		221,250

Assessor' s notes: Offshore claim not accepted as information requested in letters dated 11 September 1996 and 30 October 1996 not submitted.'

12. The assessor also issued to the Taxpayer the following loss computation for the year of assessment 1996/97:

'	$
Loss per accounts	304,483
Less : Depreciation charged	54,570
Adjusted loss	249,913'

13. There was no objection lodged by the Taxpayer against the Assessment.

14. Furthermore, the Taxpayer did not express any dissatisfaction with the loss computation for the year of assessment 1996/97.

15. By a letter dated 4 November 1998, the Representatives wrote to the assessor in the following terms:

> ' …we are …instructed by (the company) to apply for correction of the profits tax assessment for the year of assessment 1995/96 pursuant to section 70A of the Inland Revenue Ordinance on the basis that the income earned during the period from 9 August 1994 to 31 March 1996 was derived from offshore operation, accordingly, the profits arising therefrom should not be subject to profit tax.'

16. In the profits tax return for the year of assessment 1997/98 submitted on the same date, the Taxpayer reported having made a profit of $443,245 for the year ended 31 March 1998. As the Taxpayer considered the profits as offshore, this sum was not offered for assessment.

17. On 19 March 1999, the assessor wrote to the Representatives to advise them that the Assessment was raised to disallow the offshore claim as information requested on 11 September 1996 and 30 October 1996 had not been supplied. He further advised them that section 70A of the IRO did not apply as the Assessment was raised to disallow the offshore claim on purpose.

18. By a notice dated 19 April 1999, the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1997/98:

'	$
Profits per accounts	443,245
Add : Depreciation charged	54,571
	497,816

Less : Loss set-off	249,913
Net assessable profits	247,903
Tax payable thereon	36,813'

19. The Representatives objected against the 1997/98 assessment on the ground that the profits concerned should be regarded as offshore. They also requested the assessor to ' reconsider (the) Section 70A claim for the year of assessment 1995/96.'

20. On 5 May 1999, the offshore claim in relation to the 1997/98 assessment was accepted by the assessor and the assessable profits of the Taxpayer for the year of assessment 1997/98 were revised to ' NIL' .

21. Subsequently, the loss computation for the year of assessment 1996/97 was also revised to ' NIL' to give effect to the acceptance by the assessor of the offshore claim in relation to that year of assessment.

22. The Representatives, in a letter dated 10 May 1999, advanced the following contention in support of the section 70A claim in respect of the Assessment:

> ' In view that the profits for the year of assessment 1995/96 was derived from offshore, accordingly, the profits should not be subject to profits tax. As such, it is an error in assessing the subject profits to profits tax.
>
> With regard to our client' s section 70A claim, we consider that the view of the Board of Review in D23/96, IRBRD, vol 11, 369 as quoted below should be followed:
>
> "*If we were to find that the royalty payments were not within the ambit of section 15(1)(b) we would then consider this an appropriate case for the application of section 70A.*"
>
> On the basis that (the company' s) offshore claim has been accepted by your department as per revised 1997/98 assessment issued on 5 May 1999 and the view of the Board of Review as quoted above, we are of the opinion that (the company' s) claim should not be declined. We once again request you to consider (the company' s) claim.'

23 Subsequently, the assessor gave the notice of refusal dated 13 May 1999 refusing to correct the Assessment.

24. The Representatives lodged the notice of objection dated 24 May 1999 against the assessor's notice of refusal to correct the Assessment in the following terms:

> ' The objection is made on the following grounds:
>
> (i) that the tax charged for the year of assessment 1995/96 is excessive by reason of an omission in the return and statement submitted in respect thereof;
>
> (ii) that the profits of $1,340,913 arising from offshore operation should not be subject to profits tax;
>
> (iii) the suggested profits tax computation submitted to support the profits tax return for the year of assessment 1995/96 contained only a brief description of the operation claimed to be offshore. In the absence of detailed reasons together with relevant information and documents, the assessor considered that the profits in question was taxable;
>
> (iv) the offshore claim for the year of assessment 1997/98 was accepted by the assessor based on the information and documents in respect of the transactions carried out during the year of assessment 1995/96.

Summing up the above, the tax overcharged was due to the omission of the information and documents as described in (iii) in the return and statement for the year of assessment 1995/96 submitted. As a result, the assessor concluded that the profits of $1,340,913 was taxable. In our opinion, the assessment for the year of assessment 1995/96 should be corrected to exclude the offshore profits in question under section 70A.'

25. In response to the assessor's enquiry as to why application under section 70A was only lodged on 4 November 1998 and that the information requested on 11 September 1996 was only submitted on 26 April 1999, the Representatives explained by a letter dated 15 June 1999 that ' all the company's affairs were handled by its director, Mr A in City B, China and all the company's records were kept and maintained in the City B office (and therefore) considerable time were spend [*sic*] in awaiting for [*sic*] the documents and information to be supplied by the City B office.'

The case of the Taxpayer

26. The Taxpayer was represented at the hearing by Mr. Leung Seh-wing of the Representatives. He handed to the Board his written submission. In paragraph 1 thereof, he sets out the grounds of appeal as follows:

' (a) that the profits tax assessment issued by the Commissioner of Inland Revenue (' CIR') to the appellant as per his notice of assessment dated 10 November 1997 for the year of assessment 1995/96 is excessive by reason of error or omission in the return or statement submitted by the appellant in respect thereof in that the "so-called" assessable profits of $1,340,913 earned by the appellant were not derived from Hong Kong and therefore, these profits are not subject to profits tax assessment for the year of assessment 1995/96 or at all. Furthermore, the CIR and/or his assessor based on the incomplete information raised an assessment on the appellant as aforesaid amounts to an error or mistake of fact within the meaning of Section 70A of the Inland Revenue Ordinance;

(b) that the assessor' s refusal to correct the assessment which is an erroneous one referred to in his notice of refusal to the appellant dated 13 May 1999 is a wrongful act because the assessor ignored the facts and failed to consider contentions put forward by the appellant in its correspondence with the said assessor through its representatives, Messrs Chan Nip Sun Wong & Co (' the Representatives'); and

(c) that the DCIR failed to consider and ignore [*sic*] the main objects for the legislation of the provisions of section 70A of the Inland Revenue Ordinance and thus took the erroneous view misleading himself to reach a wrong conclusion in his determination to the appellant dated 26 September 2000.'

27. Mr Leung further called a Mr C, proprietor of the Representatives, to give evidence on oath. Mr C confirmed the truth of his written statement which had been handed to the Board previously.

28. The evidence relating to the failure to supply information to the assessor as requested can be summarised as follows:

(i) The Taxpayer has a permanent office in City B in China.

(ii) Upon being pressed by the IRD to supply further information, the Representatives in turn asked the City B office of the Taxpayer to supply the same.

(iii) The City B office did not respond to the request for further information, probably because the people there were generally afraid of being asked question by the Government.

iv) The Representatives, having received no instruction, in turn did not supply any of the further information asked for by the IRD and further decided not to lodge an objection against the Assessment.

The law

29. The IRO prescribes a fixed time limit of one month for the lodging of an objection by a taxpayer against an assessment. The relevant part of section 64(1) reads as follows:

> ' *64. Objections*
>
> *(1) Any person aggrieved by an assessment made under this Ordinance may, by notice in writing to the Commissioner, object to the assessment; but no such notice shall be valid unless it states precisely the grounds of objection to the assessment and, in the case of an assessment other than a provisional assessment, is received by the Commissioner within 1 month after the date of the notice of assessment:*
>
> *Provided that –*
>
> *(a) if the Commissioner is satisfied that owing to absence from Hong Kong, sickness or other reasonable cause, the person objecting to the assessment was prevented from giving such notice within such period, the Commissioner shall extend the period as may be reasonable in the circumstances;*
>
> *…'*

30. Despite the fact that a taxpayer has not lodged any objection against an assessment pursuant to section 64(1), it is open to him to apply for a correction of the assessment within six years pursuant to section 70 A of the IRO if ' *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 net assessable value* [within the meaning of section 5(1A)], *assessable income or profits assessed or in the amount of the tax charged'* (emphasis supplied).

31. As to the true interpretation of section 70A of the IRO, a number of decided cases have been cited to us in argument. Two of them are worthy of note.

32. In the case of Sun Yau Investment Co Limited v The Commissioner of Inland Revenue 2 HKTC 17, the taxpayer company failed to make a profits tax return and the assessor estimated

its liability for tax at $125,981. The taxpayer purported to lodge an objection against the assessment by letter but did not include with it any profits tax return or supporting audited accounts. The letter was not accepted by the Commissioner as a valid notice of objection because it was out of the one month time limit imposed by section 64 of the IRO. Subsequently, the taxpayer submitted a return for the relevant year together with the audited accounts. It then lodged an application under section 70A of the IRO to re-open the assessment on the basis that it was excessive by reason of an arithmetical error or omission in the calculation of the amount of the assessable profits. The assessor declined to correct the assessment and his refusal was upheld by the Commissioner. On appeal direct to the High Court, the case went before Mr Justice Mantell who decided that section 70A had no application because the assessor had not committed any error or arithmetical error simply because his estimated assessment did not coincide with a figure he would have reached had other information been available to him. At page 21, the learned Judge said the following:

> ' *In my judgment, the wording of 70A is perfectly clear. It covers the case when there has been a miscasting by the Assessor on the material available to him. The Assessor is not in error, let alone arithmetical error, simply because his assessment does not coincide with a figure he would have reached had other information been available to him…*
>
> *The object of the Ordinance is to achieve within the timetable and procedures laid down.*
>
> *Various safeguards and appeal procedures are provided. One of those safeguards is provided by section 70A where in a proper case, the assessor is required to correct his own arithmetical error. That is not this case. I agree not only with the findings of the Commissioner of Inland Revenue but also with his reasons. This appeal is dismissed with costs.'*

33. In the case of Extramoney Limited v Commissioner of Inland Revenue 4 HKTC 394, Mr Justice Patrick Chan (as he then was) gave a ruling on the meaning of the word ' error' . He said at page 429 as follows:

> ' *In my view, for the purpose of section 70A, the meaning of 'error' given in the Oxford English Dictionary (page 277) 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 advantageous 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.*

Hence, in the context of the present case, if there is a change of opinion of the auditors or accountants in respect of the accounts, the first opinion cannot be regarded as an error or omission within the section. Similarly if there is a change of mind of directors of the company in connection with how any part of the accounts should be made up, the previous decision will not be regarded as an error or omission. Nor is it an error or omission if it is merely a difference in the treatment of certain items in the accounts by those preparing or approving the accounts. If this were permitted, the director or officer of a company will be tempted at a later stage to try and 'improve' the company's accounts or change his own decisions if this is to his advantage. This would be contrary to the spirit of the Ordinance that there should be finality in taxation matters. The whole statutory scheme provided in the Ordinance simply cannot work.'

Our conclusion

34. We are of the view that in the present case, there was no 'error' or 'omission' or 'arithmetical error' or 'arithmetical omission' on the part of anybody within the meaning of section 70A of the IRO. It was a deliberate and conscious act on the part of the Taxpayer to claim that its profits made in the year of assessment 1995/96 were exempt from profits tax on the basis that such profits were made offshore. It was an equally deliberate and conscious act on the part of the assessor to reject such claim for exemption and to raise the Assessment after continuous failure on the part of the Taxpayer to supply the further information requested.

35. The fact that a similar claim for exemption in respect of subsequent years of assessment does not affect the situation because:

(i) each year of assessment must be looked at by itself in light of all the materials relevant thereto;

(ii) there is no sufficient material before us to prove that if the relevant further information requested had been supplied to the assessor, he would or should have allowed the exemption claimed;

(iii) the burden of proof is on the Taxpayer and it has not discharged such burden.

36. If the argument of the Taxpayer were to prevail, it would mean that any taxpayer could simply sit back and not file any tax return or supply any information requested by the IRD and wait for the Department to make an assessment and the taxpayer can then challenge the assessment on the basis that there has been 'an error or omission' or 'an arithmetical error or omission' within

the meaning of section 70A of the IRO as long as he makes his challenge within a period of six years. That simply cannot be correct.

37. In the submission of Mr Leung, he has referred us to an extract from a publication intituled ' Taxation in Hong Kong' by Ernst & Young. It is interesting to note that the extract at page 447 contains the following passage:

> ' *In the case of an estimated assessment made under either section 59(2)(b) or section 59(3) which is not based on any return or statement submitted by the taxpayer and a valid objection is not lodged, the assessment may not be re-opened under section 70A (1) even though the assessor's estimate of the tax liability is in excess of that which would have been assessed had the proper return been made available at the time of the assessment (Sun Yau Investment Co Ltd v CIR (1984) 2 HKTC 17). This is because there is no arithmetical error or omission committed by the assessor simply because his estimated assessment does not coincide with the figure he would have reached had other information been available to him.'*

38. In all the circumstances, the appeal by the Taxpayer must be dismissed.

39. As we take the view that the appeal is without merit and that there was a continuous breach of duty on the part of the Taxpayer to supply information to the assessor pursuant to requests made under section 51(3) of the IRO, we order that the Taxpayer should pay the costs of the appeal in the sum of $5,000.