**Case No. D36/08**

**Profits tax** – whether determination can increase the assessment – sections 14(1), 20B, 21, 59(1), 59(3), 64(2) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Lee Lai Lan and Mark R C Sutherland.

Date of hearing: 12 August 2008.
Date of decision: 5 November 2008.

The appellant entered into an agreement with Company A to perform in Hong Kong. 50% of the total fee was to cover the rehearsal fees of the orchestra of Company A in Country D. The appellant filed a ' Notification of Arrival in Hong Kong of Non-resident Entertainer(s)/Sportsmen' in respect of Company A. The Agreement was attached to the Notification. The Determination by the Deputy Commissioner increased the assessable profit of Company A. The appellant on behalf of Company A took issue as to the correct amount of assessable profits to be charged.

**Held:**

1. The Deputy Commissioner is under a duty to administer the law to demand and receive whatever tax is due and payable from a taxpayer including the Society who is not entitled to confine the Deputy Commissioner' s determination of the objection only to the matters referred to in the initial assessment. The Board is of the view that if the initial assessment is considered by the Deputy Commissioner to be inadequate, he is able to increase the assessment pursuant to section 64(2) of the IRO.

2. The attempts to split the fee into two tranches each of an equal part and then to assert that 50% of the fee was for rehearsals in Country D was not supported by any evidence before the Board and was totally arbitrary in nature. The Board also takes the view that in the event that Company A did not perform in Hong Kong, then they would receive no monies whatsoever and therefore, their rehearsals in Country D would have been for nothing. This illustrates the fact that the rehearsals must have been an integral and the central part of performing in Hong Kong. Therefore, the Board concludes that the first payment really was only an advance payment of the overall fee.

**Appeal dismissed.**

Cases referred to:

CIR v The Hong Kong Bottlers Limited (1970) 1 HKTC 497
D36/07, (2007-08) IRBRD, vol 22, 826
CIR v HK-TVB International Limited (1992) 3 HKTC 468
Kwong Mile Services Ltd v CIR [2004] 3 HKLRD 168
ING Baring Securities (Hong Kong) Ltd v CIR [2008] 1 HKLRD 412

Taxpayer represented by its chairman.
Lai Wing Man and Chan Sze Wai for the Commissioner of Inland Revenue.

**Decision:**

**Introduction**

1. The appellant is registered under the Societies Ordinance and was set up in 1995 by a small group of music lovers ('the Society'). The objective of the Society was to promote the enjoyment of piano music of Composer G and of his contemporaries.

2. The Society entered into an agreement dated 15 August 2005 with Company A to perform for, and participate in Hong Kong in respect of Competition B ('the Agreement').

3. The Determination by the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') dated 24 April 2008 whereby the profits tax assessment for the year 2005/06 showing an assessable profit of HK$415,917 with tax payable thereon of HK$72,785 was increased to an assessable profit of HK$756,223 with tax payable in the sum of HK$132,339. The Society on behalf of Company A took issue as to the correct amount of assessable profits to be charged.

**Agreed facts**

4. At the hearing before us, the Society was represented by its Chairman, Mr C. The parties helpfully put before us agreed facts. At the hearing, Mr C again confirmed that these facts were agreeable. We find these facts as agreed and now set them out as follows:

(1) The Society has objected to the 2005/06 profits tax assessment raised on it for Company A. The Society claims that the assessment is excessive.

(2) Company A was incorporated in Country D on 25 May 2000.

(3) The Society organized an event called Competition B ['the Competition'] at Venue E during Date H to Date I.

(4) By a Contractual Agreement ['the Agreement'] dated 15 August 2005 between the Society and Company A, the Society engaged Company A to perform for the Competition. The Agreement contained, inter alia, the following terms and conditions:

(a) Engagement of services

(i) The Society would engage Company A to perform with the six finalists of the Competition, in three concerts, at Venue E on Date J, K and L. Each of the concerts would commence at X p.m. [Clause (1)(a)]

(ii) For the concerts on Date J, K and L, Company A would provide the services of musicians and administrative staff which would total thirty-seven persons ['the Orchestra Party']. [Clause (1)(b)]

(iii) Company A would provide a string quartet, the members of which would rehearse and perform with the eight semi-finalists of the Competition on Date M, N and O. [Clause (1)(d)]

(b) Fee payment

(i) The Society would pay Company A the sum of GBP 71,350 ['the Fee'] in accordance with the terms set out in Facts (4)(b)(iv) and (v). [Clause (2)(a)]

(ii) The Fee excluded payment by the Society of all costs in connection with the international transportation of the Orchestra Party and its instruments, as well as all costs in Hong Kong in respect of local transportation and hotel accommodation, which the Society undertook to pay. [Clause (2)(a)(i)]

(iii) The Fee would be net of all Hong Kong taxes. [Clause (2)(a)(v)]

(iv) '…the Society has paid Company A in advance on: 26th May 05 by electronic bank transfer …, the sum of 35,675 GBP net (thirty five thousand, six hundred and seventy five pounds sterling), being 50% of the total fee, and meant to cover the rehearsal fees of the orchestra, all of the rehearsals to take place in [Country D] in order to minimize the costs, such as additional hotel etc. expenses, which the Society would have incurred if the rehearsals were to take place in Hong Kong.' [Clause (2)(b)(i)]

(v) '35,675 GBP (thirty five thousand, six hundred and seventy five pounds sterling) being the remaining balance of [the Fee], and representing the actual cost of performances in HK, will be paid by bank transfer by the Society to [Company A], to arrive in [Company A's] bank account on or before Monday [Date I], (immediately after the last performance of [Company A] in Hong Kong.)' [Clause (2)(b)(ii)]

(c) General conditions

(i) In the event that Company A was unable to perform by reason of illness or accident, the Society would not be liable to pay any fee or remuneration to Company A except for performances actually given by Company A. [Clause 11]

(ii) Should Company A fail to perform for reasons other than illness or accident, Company A should pay to the Society as and for liquidated damages the aggregate of (1) the excess of payment made to a replacement artist over the sum payable to Company A under the Agreement; and (2) other costs, damages and expenses incurred by the Society by reason of Company A's default. [Clause 13]

(iii) In the event that Company A cancelled the performances, any advance payment made by the Society to Company A should be refunded in full to the Society. [Clause 14]

(5) On 30 December 2005, the Society filed a 'Notification of Arrival in Hong Kong of Non-resident Entertainer(s)/ Sportsmen' ['the Notification', Appendix B] showing, inter alia, the following particulars in respect of Company A:

(a) The period of stay in Hong Kong was Date P to Q.

(b) The time and place of performances were as follows:

| | | |
|---|---|---|
| Time: | Date M, N and O | (String Quartets only) |
| | Date J, K and L at X:00 p.m. | (Full Orchestra) |
| Place: | Venue E | |

(c) The date and the amount of payment made to Company A were reported as follows:

| Date | Gross amount payable | Less: Amount deducted for tax payment | Net amount paid |
|---|---|---|---|
| 19-9-2005 | £ 35,675 | £ 3,567 | £ 35,675 |

In respect of the sum of GBP 3,567 deducted for tax payment, the Society made the following remarks:

'[Company A] insisted in being paid a fee without any deductions for Hong Kong Income Tax. As we would have been liable, in any case, for this tax we managed to negotiate with them a lower fee than they originally demanded, equal to about 10% of the original suggesred [sic] fee, thus allowing us to set aside the sum of GBP 3,567 to account for their tax liabilities. The sum declared here refers to the fees paid for the performances and tasks performed by [Company A] in Hong Kong only…..'

(d) The Society attached to the Notification an unsigned copy of the Agreement [that is, Appendix A].

(6) As the Agreement attached to the Notification was not signed, the Assessor, pursuant to sections 59(1) proviso, 59(3) and 20B of the Inland Revenue Ordinance ['IRO'], raised on Company A the following estimated profits tax assessment for the year of assessment 2005/06 in the name of the Society:

| | |
|---|---|
| Net amount paid to Company A (£ 35,675 [Fact (5)(c)] @14.0434*) | $500,998 |
| Add: | |
| Amount deducted for tax payment (£ 3,567 [Fact (5)(c)] @14.0434*) | 50,092 |
| Hong Kong profits tax borne by the Society | 72,785 |
| | 623,875 |

| | |
|---|---|
| Less: Expenses (estimated at 1/3 of $623,875) | (207,958) |
| Assessable profits | $415,917 |
| Tax payable thereon | $72,785 |

* This is the average exchange rate of pounds sterling to Hong Kong dollar for month R 2005.

(7) The Society objected to the assessment in Fact (6) on the ground that the sum of $72,785, representing the profits tax payable, was wrongly added in the calculation of assessable profits.

(8) To validate the objection, the Society filed the profits tax return for the year of assessment 2005/06 for Company A declaring an assessable profit of GBP 35,675.

(9) In response to the Assessor's enquiries, the Society supplied the following information and documents in connection with the Agreement:

(a) 'There was no further negotiation of any kind with Company A [in respect of the fee payment after 15 August 2005] and these payments fulfilled the contracted obligation of the Society.'

(b) Other than the payment of GBP35,675 on [Date L], the Society had made another payment of GBP35,675 to Company A on 27 May 2005, totalling GBP71,350 [that is, the Fee]. Copies of two telegraphic transfer slips were supplied to substantiate its reply.

(10) Based on the further information provided by the Society in Fact (9), the Assessor opined that the entire amount of the Fee should be subject to tax in Hong Kong. Section 64(2) of the IRO empowers the Commissioner to increase the assessment objected to. Accordingly, by letter dated 5 September 2006, the Assessor explained her views and proposed to revise the 2005/06 profits tax assessment raised on the Society for Company A as follows:

| | |
|---|---|
| Assessable Profits [( £ 71,350 [Fact (9)(b)] @14.0434 + $132,346) x 2/3] | $756,265 [Note] |
| Tax Payable thereon | $132,346 |

Note: The exact result of the stated formula should be $756,228.39. The minor discrepancy of $37 was due to rounding as follows:

[( £ 71,350 x 14.0434) + ( £ 71,350 x 14.0434 x 2/3 x 17.5% ÷ (1- (2/3 x 17.5%)))] x 2/3
=($1,001,996 x 0.6667) + ($1,001,996 x 0.6667 x 17.5% ÷ 0.88333 x 0.6667)
=$668,030 + $88,235
=$756,265

(11) In reply, the Society did not accept the proposed computation in Fact (10) and put forth the following contentions:

(a) Only half of the Fee paid to Company A was income arising from duties and performances in Hong Kong. The other half of the Fee was in respect of rehearsal duties performed by Company A in Country D which should not be subject to Hong Kong profits tax.

(b) Company A was specifically contracted to perform rehearsal in Country D and other duties in Hong Kong. The rehearsal was a separate part of their overall duties and was paid and negotiated separately.

(c) The Revenue reversed its previous decision, that is, accepted the division of income as showed in the assessment in Fact (6), which was not in dispute.

(d) 'We wish to emphasize that [the Revenue] accepted our original submission on the two separate payments, we promptly paid the tax due and raised an objection on a purely technical issue… Only then you decided to change your mind not on the basis of any new information, but because you decided to change your interpretation of the law! …'

(e) The Society would withdraw the objection and settle the case as per the assessment in Fact (6).

(12) By various letters, the Assessor explained to the Society that the estimated assessment in Fact (6) was made based on the information reported in the Notification because the Notification was accepted, at the time of lodgement, in good faith as being correct. This should not be taken as the Revenue had accepted the Society's claim that only half of the Fee should be subject to tax

in Hong Kong. The Assessor also informed the Society that she was unable to accept its withdrawal to settle the objection.

(13) In response, the Society reiterated its arguments in Fact (11) and further stated the following:

(a) 'The tasks that the [Company A] were asked to perform in Country D, namely paid rehearsals, form a completely separate part of their overall duties, are customarily negotiated separately and are not automatically included in their contractual obligations. The Society was correct in declaring them so. …'

(b) '…the Society feels that the [Revenue] failed to exercise due diligence and professionalism in this case as it accepted the Society's initial return, agreed to the division of tasks and accepted the tax payment. Only when the Society appealed on a purely numerical issue… did the [Revenue] change its mind. No explanation of any kind was offered as why the original submission and the supporting information was accepted and then rejected. …'

(14) The Assessor maintained the view that the entire amount of the Fee should be subject to tax in Hong Kong. However, to rectify the rounding difference in Fact (10), she now considers that the profits tax assessment for the year of assessment 2005/06 raised on the Society for Company A should be revised as follows:

| | |
|---|---|
| Net amount paid to Company A (£ 71,350 [Fact (9)(b)] x 14.0434) | $1,001,996 |
| Add: Hong Kong profits tax borne by the Society | 132,339 |
| | 1,134,335 |
| Less: Expenses (estimated at 1/3 of $1,134,335) | (378,112) |
| Assessable profits | $756,223 |
| | |
| Tax Payable thereon | $132,339 |

**The Taxpayer's case**

5. Mr C decided that he did not wish to give evidence nor did he wish to call any other witnesses to support the appeal. We reminded him that it was his right so to do.

6. Mr C submitted to us that the Society's position is that on 30 December 2005, they filed the relevant 'Notification of Arrival in Hong Kong of Non-resident Entertainer(s)/Sportsmen'

('the Notification'). In the Notification, he indicated that he attached an unsigned copy of the Agreement (subsequently the Society provided a signed signature page).

7. Based on the Notification, the Assessor pursuant to section 59(1) proviso of the Inland Revenue Ordinance ('IRO'), sections 59(3) and 20B of the IRO raised on Company A an estimated profits tax assessment for the year of assessment 2005/06 in the name of the Society. That assessment provided for tax payable in the sum of HK$72,785.

8. Mr C indicated to us that he in turn raised what he called a technical objection based on the fact that he was questioning the element of Hong Kong profits tax to be borne by the Society in the sum of HK$72,785.

9. Mr C's position was that at that time, the Assessor should have read the Agreement and had they read it, they would have clearly seen the various payments that were to be made.

10. Mr C, in order to validate the objection the Society, filed a profits tax return for the year of assessment 2005/06 for Company A declaring an assessable profit of £35,675. It was at that stage, the Assessor then had the opportunity to consider the Agreement in its entirety and took the view that the entire fee that was paid by the Society to Company A should be subject to tax.

11. In short, Mr C on behalf of the Society, indicated that their position was that the Deputy Commissioner must have known all the relevant facts since the Agreement was attached to the Notification and no explanation has been given to the Society as to why the Deputy Commissioner neither read nor took into account the terms of the Agreement. He takes the view that the Society was unfairly treated in that had he not raised what he called his 'technical objection' by virtue of his letter dated 26 April 2006, the Deputy Commissioner would have not taken this matter any further and the original assessment would have stood.

12. In a written notice of appeal dated 22 May 2008, the Society also maintained its position that the orchestra was performing the tasks at two different locations, that is, in City F (of Country D) and in Hong Kong. The Society asserted that the Deputy Commissioner missed the point that the Agreement included a clause whereby all fees were returnable if Company A did not perform in Hong Kong was to ensure their performance in Hong Kong. Therefore, if Company A did not perform in Hong Kong, their preparation in City F would have been for nothing.

**The relevant statutory provisions**

13. Section 14(1) of the IRO provides that:

> *'(1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of*

*his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'*

14. Section 20B of the IRO provides that:

*'(1) Without prejudice to section 20A, this section applies in respect of a non-resident person who is chargeable to tax in respect of-*

*(a) …..*

*(b) sums received in respect of, or which in any way derive directly or indirectly from, the performance in Hong Kong by a non-resident entertainer or sportsman (whether or not he is the non-resident person who is so chargeable) of an activity in his character as entertainer or sportsman on or in connection with a commercial occasion or event, including-*

*(i) any appearance of the entertainer or sportsman by way of or in connection with the promotion of any such occasion or event; and*

*(ii) any participation by the entertainer or sportsman in or for sound recording, films, videos, radio, television or other similar transmissions (whether live or recorded).*

*(2) Where this section applies, the non-resident person is chargeable to tax in respect of the sums described in subsection (1) in the name of any person in Hong Kong who paid or credited those sums to that or any other non-resident person, and the tax so charged shall be recoverable by all means provided in this Ordinance from that person in Hong Kong.*

*(3) Where a person in Hong Kong from whom tax is recoverable by virtue of this section pays or credits to a non-resident person (whether or not he is the non-resident person who is chargeable to tax) sums described in subsection (1) he shall, at the time he makes the payment or credit, deduct from those sums so much thereof as is sufficient to produce the amount of such tax, and he is hereby indemnified against any person in respect of his deduction of such sum.'*

15. Section 21 of the IRO provides that:

*'Where the true amount of the assessable profits arising in or derived from Hong Kong of a non-resident person in respect of a trade, profession or business carried on in Hong Kong cannot be readily ascertained, such assessable profits may be computed on a fair percentage of the turnover of that trade or business in Hong Kong.'*

16. Section 64(2) of the IRO provides that:

*'(2) On receipt of a valid notice of objection under subsection (1) the Commissioner shall consider the same and within a reasonable time may confirm, reduce, increase or annul the assessment objected to …..'*

17. Section 68(4) of the IRO provides that:

*'(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

18. The following cases were cited to us by Ms Lai Wing-man on behalf of the Deputy Commissioner:

(a) CIR v The Hong Kong Bottlers Limited (1970) 1 HKTC 497;
(b) D36/07, (2007-08) IRBRD, vol 22, 826;
(c) CIR v HK-TVB International Limited (1992) 3 HKTC 468;
(d) Kwong Mile Services Ltd v CIR [2004] 3 HKLRD 168; and
(e) ING Baring Securities (Hong Kong) Ltd v CIR [2008] 1 HKLRD 412.

**Our anlaysis**

19. We are of the view that the Inland Revenue Department ('IRD') had clearly made their position known to the Society by virtue of correspondence that has passed between the IRD and the Society. It is quite clear by virtue of the letter dated 7 November 2006, the IRD' s position was set out and carefully explained to the Society.

20. We accept the submission by the IRD that the tax reporting system in Hong Kong is an 'honour system'. We also accept that in order to streamline the assessing procedures for an efficient and effective revenue collection, the IRD does indeed rely on the taxpayers' returns and notifications for tax assessment purposes. We accept that at the early stage, in-depth examination of accounts or source documents, such as the Agreement in the present case, might not have been made by the Assessor at the relevant time.

21. In their submissions before us, the IRD made it perfectly clear that they regretted and indeed, apologized to the Society that the IRD neither gave careful consideration to, nor made a

review of the Agreement when this was first put to the IRD in respect of the return that was sent in dated 30 December 2005.

22. It was clear that at that time the IRD had neither given careful consideration of, nor indeed had even read, the Agreement. In turn, the IRD relied on the Notification and the return and it was only when the Society through Mr C put in their 'technical objection' that they were able to look into matters in greater depth.

23. We accept the IRD's submission that the Deputy Commissioner is under a duty to administer the law to demand and receive whatever tax is due and payable from a taxpayer including the Society. We also accept that the Society is not entitled to confine the Deputy Commissioner's determination of the objection only to the matters referred to in the initial assessment (CIR v The Hong Kong Botters Limited (1970) 1 HKTC 497).

24. We also are of the view that if the initial assessment is considered by the Deputy Commissioner to be inadequate, he is able to increase the assessment pursuant to section 64(2) of the IRO. In any event, Mr C during his oral submission urged upon us to consider that the Society had been treated unfairly and improperly by the fact that the IRD was prepared at one stage to accept an assessment but once they had the opportunity to consider the Agreement, they should not be able to go back on the initial position they had put forward.

25. We have no hesitation in rejecting such a submission which is contrary to the authorities and the relevant provisions of the IRO that we have already had cited above.

26. We now come to consider the second ground of the Society's appeal. Again, as we have previously indicated, the issue in dispute is whether the fee paid to Company A should be assessed in full. As we have previously indicated, Mr C on behalf of the Society decided to call no evidence after our inviting him so to do at the outset of the hearing.

27. Therefore, we are left in the dark as to what, if anything, Company A did, or did not, do in Country D with regard to any rehearsals. Therefore, any analysis of any such rehearsals would involve mere speculation on our part. However, it is quite clear that by virtue of the Agreement, the Society engaged Company A to perform for a competition that was held in Hong Kong at Venue E. The scope of the services to be rendered were stipulated and set out in the Agreement. Company A undertook to provide performances on certain dates and with six finalists of the competition in three concerts as well as rehearsing with the competitors on these relevant dates. There was nothing in Clause (1) of the Agreement that refers to any provision of rehearsals in Country D.

28. We have had the opportunity to carefully review and consider the Agreement and we accept the IRD's submissions that there was an agreement to pay Company A a total fee of £71,350 net of all Hong Kong taxes. It is quite clear that this fee was settled by two equal

instalments of £35,675 on 27 May 2005 and Date L. We also refer to Clause (2)(b) of the Agreement. The first payment was 'meant to cover the rehearsal fees of the orchestra'. The second payment represented 'the actual cost of performances in Hong Kong'. Indeed, there was no evidence before us by virtue of the Agreement or elsewhere to show that Company A was to be remunerated separately for two different tasks, that is, rehearsals in Country D and performances in Hong Kong. In any event, we accept the submission by the IRD that the rehearsals in Country D in our view were merely activities that were 'antecedent' to the various performances that took place in Hong Kong. We emphasize that there was no evidence called before us to show exactly what, if any, rehearsals took place in Country D as to when and how they were carried out. It is quite clear that the attempts to split the fee into two tranches each of an equal part and then to assert that 50% of the fee was for rehearsals in Country D was not supported by any evidence before us and was totally arbitrary in nature. The IRD accepted that their determination might have been different had further detailed evidence of rehearsals in Country D been submitted and that this would have been considered as a 'case by case' basis.

29. We also take the view that in the event that Company A did not perform in Hong Kong, then they would receive no monies whatsoever and therefore, their rehearsals in Country D would have been for nothing. Again, this illustrates the fact that the rehearsals must have been an integral and the central part of performing in Hong Kong. Therefore, we conclude that the first payment really was only an advance payment of the overall fee.

**Conclusion**

30. Having considered all matters carefully and having reviewed the agreed facts and the submissions put to us, we have no hesitation in dismissing the appeal and upholding the assessment.