Case No. D42/11

Extension of time – transmission of determination to authorized representative – sections 2, 66(1)(a) and 66(1A) of the Inland Revenue Ordinance ('IRO').

Profits tax – deduction – sections 16(1)(a) of the Inland Revenue Ordinance.

Panel: Cissy K S Lam (chairman), Lee Fen Brenda and Timothy Shen Ka Yip.

Dates of hearing: 15 April 2011 and 4 May 2011.
Date of decision: 20 December 2011.

The Taxpayer, a company incorporated in Hong Kong, appealed against the Determination which only allowed a portion of the bank loan interest to be deducted. The Determination was sent by registered post to (1) the Taxpayer's previous business address which was a mistake on the part of the Inland Revenue Department ('IRD') and (2) copy thereof to the Taxpayer's authorized representative. The proper notice of appeal was out of time and the issue was whether transmission of the Determination to the Taxpayer's authorized representative constituted transmission to the Taxpayer within the meaning of section 66(1) of the IRO. The substantive issue was whether a $2 million loan was borrowed for the purpose of producing profits. The Taxpayer asserted that the item 'Due from a director' was an error and did not accurately reflect the true position of the loan and sought to re-open its audited accounts.

Held:

1. The one month time limit for the appeal commenced when the Taxpayer's representative received the Determination. The Board did not find any reasonable cause within section 66(1A) and whilst the Board sympathized with the Taxpayer in that part of the reasons for the delay was a mistake on the part of the IRD, it has no discretion to extend the time limit.

2. The Board had serious doubts whether a taxpayer should be allowed to challenge its own accounts unless they can clearly be shown to be wrong. And the new accounts should also be properly audited and present a true and fair view of the company. Ms Leung of the IRD likewise accepted that the audited accounts here were not conclusive evidence and the Taxpayer can re-open them in case of error. In conclusion, the Board found no error in the audited accounts. The $2 million loan was taken out to enable Mr A, director of the Taxpayer, to pay off his personal liabilities and not for the purpose of

producing assessable profits in terms of section 16(1)(a) of the IRO and the interest thereon is not a deductible expense.

Appeal dismissed.

Cases referred to:

D124/97, IRBRD, vol 13, 78
D146/01, IRBRD, vol 17, 88
Chow Kwong Fai v CIR [2005] 4 HKLRD 687
D9/79, IRBRD, vol 1, 354
Chinachem Investment Co Ltd v CIR 2 HKTC 261

Mr J, Tax Director of Company K, for the Taxpayer.
Leung Wing Chi and Chan Siu Ying for the Commissioner of Inland Revenue.

Decision:

1. The Taxpayer appeals against the Determination of the Deputy Commissioner of Inland Revenue dated 3 November 2010 ('the Determination') by which the Deputy Commissioner refused to allow interest under a certain bank loan to be deducted as an item of expenditure.

2. Before dealing with the substantive merits of this appeal, we have to consider whether the appeal was out of time and if it was, whether leave should be given to extend the time of appeal. An important issue is whether transmission of the Determination to the Taxpayer's authorized representative constituted transmission to the Taxpayer within the meaning of section 66(1)(a) of the Inland Revenue Ordinance, Chapter 112 ('the IRO').

Whether the appeal was out of time

3. The relevant chronology of events is as follows:

(1) The Determination was sent under cover of a letter dated 3 November 2010 by registered post to (1) the Taxpayer and (2) copy thereof to the Taxpayer's authorized representative Company K.

(2) The copy Determination was delivered to and received by Company K on 4 November 2010.

(3) The Determination sent to the Taxpayer, however, was sent to the Taxpayer's previous business address. Ms Leung representing the Inland

Revenue Department ('the IRD') admitted that it was a mistake on the part of the IRD. It was eventually redirected to the Taxpayer at the correct address on 30 November 2010.

(4) Mr A, director of the Taxpayer, gave evidence that he did not receive the Determination and did not learn of it until Mr J of Company K called him on 26 November and asked him what he intended to do with the Determination. Mr A asked Mr J to fax him a copy of the Determination. Mr A then telephoned the tax assessor. He managed to talk to her on 28 November. He could not remember the conversation clearly but he remembered that she did mention to him that there was a deadline to meet.

(5) On 29 November, Mr A wrote to the Deputy Commissioner asking for an extension of time and for a Chinese translation of the Determination to enable him to understand the Deputy Commissioner's reasons for rejecting the Taxpayer's objection. The Chinese translation was sent to the Taxpayer on 5 January 2011. In the meantime, notice of appeal was received by the Board of Review ('the BOR') on 10 December 2010.

4. Ms Leung referred us to D124/97, IRBRD, vol 13, 78 at page 81 in which it was said that:

> '*In any event, the Commissioner's determination was sent to and received by the Taxpayers' authorised taxation representatives in the ordinary course of mail. Therefore, in all the circumstances before us, any non-receipt by the Taxpayers personally of the Commissioner's determination does not of itself provide any reasonable excuse within the terms of section 66(1A).'*

5. This was adopted in D146/01, IRBRD, vol 17, 88.

6. We note, however, that unlike the present case, in the above two cases although the taxpayer did not receive the determination because he had physically moved out of the address, the mistake was on the taxpayer in failing to notify the IRD of the change of address and not on the IRD in sending the determination to the last corresponding address. It was in such circumstances that the above dictum was said and adopted.

7. These cases are thus distinguishable from the present case. But we do not need to resort to any authority other than the definition of authorized representative in the IRO. Section 2 of the IRO defines 'authorized representative' (獲授權代表) as '*a person authorized in writing by any other person to act on his behalf for the purposes of this Ordinance.'*

8. This to us is very clear – Company K being the Taxpayer's authorized representative was entitled under the IRO to receive the Determination on behalf of the

Taxpayer. Transmission to Company K amounted to transmission to the Taxpayer.

9. We find that the one month time limit for the appeal commenced on 4 November 2010 when Company K received the Determination and expired on 3 December 2010. The proper notice of appeal was received by the BOR on 10 December 2010. There was a delay of about 7 days and the appeal was out of time.

Whether leave should be given to extend the time of appeal

10. The Board may extend the one month time limit under section 66(1A) *'if the Board is satisfied that an appellant was prevented by illness or absence from Hong Kong or other reasonable cause from giving notice of appeal in accordance with subsection (1)(a)'*.

11. In Chow Kwong Fai v CIR [2005] 4 HKLRD 687, Woo VP had this to say at paragraph 20:

> '*In my opinion, while a liberal interpretation must be given to the word "prevented" used in s. 66(1A), it should best be understood to bear the meaning of the term "未能" in the Chinese language version of the subsection (referred to in D176/98 cited above). The term means "unable to". The choice of this meaning not only has the advantage of reconciling the versions in the two languages, if any reconciliation is needed, but also provides a less stringent test than the word "prevent". On the other hand, "unable to" imposes a higher threshold than a mere excuse and would appear to give proper effect to the rigour of time limit imposed by a taxation statute.....*'

12. In D9/79, IRBRD, vol 1, 354 at page 355, the Board held: '.... *The word "prevented", as we see it, is opposed to a situation where an appellant is able to give notice but has failed to do so. In our view, therefore, neither laches nor ignorance of one's rights or of the steps to be taken is a ground upon which an extension may be granted.*'

13. Mr A was out of Hong Kong between 30 November and 4 December. But we do not consider that such short absence 'prevented' the Taxpayer from lodging the Notice of Appeal within time. Nor do we find any reasonable cause within section 66(1A).

14. Mr J of Company K had been representing the Taxpayer in raising its objections before the IRD. He is the tax director of Company K. When Mr J received the Determination on 4 November, it was his duty to discuss with Mr A how to proceed with the Determination. Lack of communication between the Taxpayer and its authorized representative was a unilateral mistake on their parts and does not constitute a reasonable cause. Moreover, when they eventually communicated on 26 November there was still a week before the deadline. They could have proceeded with the appeal immediately. Mr J had had a number of correspondence with the IRD and had rehearsed the Taxpayer's position many times. The Notice of Appeal ultimately filed was a letter sent by Company K on behalf of the Taxpayer and contained two grounds of appeal which reiterated the Taxpayer's

position. Mr J being an experienced tax representative could have drafted the notice within a very short time. Even though Mr A was away from 30 November to 4 December, in this day and age with the use of email and fax, we do not accept that Mr J was 'prevented' from lodging the appeal for the Taxpayer before the deadline.

15. While we sympathize with the Taxpayer in that part of the reasons for the delay was a mistake on the part of the IRD, we have no discretion in the matter. We are not satisfied that section 66(1A) applies. As a result we have no power to extend the time for appeal and the appeal is dismissed.

16. Although this disposes of the appeal, we have heard the Taxpayer on the substantive merits and we give our decision below.

The substantive appeal

17. The Taxpayer is a private company incorporated in Hong Kong in 2001. The Taxpayer's directors are Mr A and his wife. The business of the Taxpayer is advertising and publishing. Mr A gave evidence on oath. He is the only witness at the hearing.

18. We are concerned with the following items in the Taxpayer's accounts:

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	7-2-2001 to 31-12-2001 $	1-1-2002 to 31-12-2002 $	1-1-2003 to 31-12-2003 $	1-1-2004 to 31-12-2004 $	1-1-2005 to 31-12-2005 $	1-1-2006 to 31-12-2006 $	1-1-2007 to 31-12-2007 $
Current assets – Due from a director	2,008,502	2,008,502	1,974,112	1,716,412	1,628,412	1,619,964	1,607,912
Non-current liabilities – $2 million fixed loan drawn down on 31-10-2001	1,850,273	1,710,483	1,565,740	1,414,107	1,418,247	1,289,795	1,124,733
Interest on the $2 million fixed loan	14,546	79,675	72,119	66,869	74,715	88,124	87,640

19. The assessments under dispute are the six years from 2002/03 to 2007/08. In each assessment, the Determination allowed only a portion of the bank loan interest to be deducted. The Taxpayer claims that the full sum should be allowed.

20. Section 16(1)(a) of the IRO allows interests on any money borrowed by a taxpayer for the purpose of producing profits in respect of which he is chargeable to tax to be deductible. The crucial issue in the present case is whether the $2 million loan was borrowed for the purpose of producing profits.

21. It is the IRD's case that the $2 million loan was borrowed to enable Mr A to repay debts he owed under a previous business. This is reflected in the item 'Due from a Director', which was stated in the accounts as an amount due from Mr A and was unsecured, non-interest bearing and had no fixed terms of payment.

22. The Taxpayer, on the other hand, asserts that the item 'Due from a director' was an error and did not accurately reflect the true position of the loan which was to enable the Taxpayer to take over the business of Mr A's previous company.

23. On page 3 of the Taxpayer's written closing submission, the Taxpayer explained that for the advertising and publishing business a lot of the expenses such as printing and packaging, etc, were incurred before any payment was received. But in the same paragraph it stated that no money was injected into the Taxpayer's business by the loan ('沒有新資金借給上訴人'). This confirms that the loan was not borrowed for the day to day running of the business. The Taxpayer's case is that the loan was borrowed to take over Mr A's previous business.

History of the Taxpayer

24. Business registration records show that:

(1) Mr A and his wife owned another business called Company B. It was incorporated in 1991. The nature of business was 'general trading'.

(2) In 1992, Company B registered the business Company C.

(3) In 1994, Company B registered another business under the name Company D.

25. Mr A explained that he had some friends in Country E who wanted to import some products such as air conditioners and fire prevention equipments into China and wanted him to act as a middleman. He formed Company D for this particular purpose. Company D's role was to receive the goods and ship them to China and a commission was earned for each transaction. These transactions lasted for about two years from around 1995 to 1997.

26. We accept Mr A's evidence on Company D and do not find this part of Company B's business significant to our present consideration. We accept that the principal business of Company B was trading and advertising and publishing.

27. In 1991 Company B entered into a contract with a company in City F, Country E to publish a magazine for the company. It was a semi-annual publication with two issues per year and 200,000 copies per issue. Company B was responsible for the costs of publication and was entitled to receive fees for advertisements placed outside of Country E. That

contract was renewed in December 1996 for another period of five years.

28. A lot of emphasis has been placed on this contract, presumably because of its size. This contract might be the reason for Company B's substantial loss (see paragraph 29 below), but it was not the reason for the $2 million loan. As admitted, the loan was not borrowed for the day to day running of the business.

29. Audited accounts of Company B for 1997/98 and 1998/99 and its balance sheet as at 31 December 2000 were produced to the Board. These showed accumulated losses running over a million. As at 31 December 2000, the accumulated loss was $1,562,973.46.

30. It is Mr A's evidence that he formed the Taxpayer to take over the business of Company C in order to pool the resources and consolidate part of the business (集中資源). Since he was no longer doing any general trading, he wanted to continue the advertising and publishing business as a limited company. It would look more professional on his name card and letterhead that the business was a limited company. The Taxpayer produced to the Board a letter dated 20 June 2001 by which the Taxpayer gave notice that as a result of corporate restructuring the business would be operated under the name of the Taxpayer with the management and service team remaining unchanged. This is not accepted by the IRD (see paragraph 36 below).

History of Company B's and the Taxpayer's bank loans

31. According to Mr A, he has had a long-running business relationship with Bank G. A facility letter dated 8 August 2000 showed that Company B was granted the following facilities by Bank G:

Facilities	Amount	Interest
Overdraft (X-XXXXXX-X)	$1,100,000	Prime + 3%
Fixed Loan (X-XXXXXX-X)	$2,000,000 repayable by 120 monthly instalments with outstanding balance at $1,385,800	1% below prime
Term Loan (X-XXXXXX-X)	$600,000 repayable by 84 monthly instalments commencing on 2 September 2000.	1% over prime

32. These facilities were secured by (1) a mortgage on the family home of Mr A and his wife and (2) their personal guarantees.

33. As at 31 October 2001, the total amount outstanding under these facilities was 2,880,187.37.

34. After the incorporation of the Taxpayer, on 16 August 2001 facilities were granted to the Taxpayer by Bank G as follows:

Facilities	Amount	Interest
Overdraft	$300,000	Prime + 4%
Fixed Loan	$2,000,000 repayable by 144 monthly instalments	1% below prime

35. It is this $2 million fixed loan which forms the subject of dispute. These facilities were likewise secured by the family home of Mr A and his wife and their personal guarantees. As at 16 August 2001, the family home was valued at not less than $3,280,000.

36. Ms Leung drew our attention to the much reduced facilities granted to the Taxpayer and the less favourable interest rate. She suggested that it was a result of the poor repayment record of Company B as revealed by the bank statements. She suggested that Company B was in poor financial shape and Bank G was concerned with Company B's ability to repay. If Bank G withdrew the facilities and call for repayment, it put Mr A at risk of losing his family home. The solution for Mr A was to set up the Taxpayer and start a clean slate. Setting up a new company with no accumulated loss enabled Mr A to renew borrowing from Bank G albeit at reduced amounts and higher interests. She argued that this was the true reason behind the formation of the Taxpayer and not to consolidate the advertising business as claimed by Mr A.

37. The Board specifically asked Mr A whether Bank G ever told him that if Company B did not repay the outstanding sums, the bank would sell his property. He answered categorically in the negative. But he admitted that Bank G was concerned with Company B's repayment record and had urged him to repay as much as possible.

38. The $2 million fixed loan borrowed by the Taxpayer once drawn down was applied to repay outstanding amounts owed by Company B under its facilities. It was not sufficient to settle all outstanding amount, in addition Mr A through his solicitors deposited a total of $900,000 into Company B's accounts.

39. The solicitors have issued two receipts for this sum:

(1) On one receipt was attached copy of a cheque dated 29 October for $400,000 drawn by the Taxpayer in favour of the solicitors. The receipt stated that the cheque was received from Mr A 'being balance of redemption money in respect of the above property' referring to Mr A's family home.

(2) On the second receipt it stated that a sum of $500,000 being 'part of redemption money' re Mr A's family home was received from Mr A.

40. So instead of treating these sums as payment to Company B, Mr A's instructions to the solicitors were clearly that the sums were to discharge his personal liability, namely the redemption of the mortgage on his property.

41. The $2 million was drawn down on 31 October 2001 and together with the $900,000 deposited by Mr A applied as follows:

$2 million drawn down by the Taxpayer	2,000,000.00	
Money deposited through the solicitors	900,000.00	
Less	1,115,552.04	Overdraft (X-XXXXXX-X)
Less	1,215,025.29	Fixed Loan (X-XXXXXX-X)
Less	549,610.04	Term Loan (X-XXXXXX-X)
Balance	19,812.63	

42. It is material to note that on the credit advice depositing the sum of $1,115,552.04 into Company B's overdraft account X-XXXXXX-X, the payment was particularized as 'being the balance of the redemption money under' Mr A's property.

43. The balance of $19,812 was deposited into the Taxpayer's overdraft account and likewise the sum was particularized as 'being the balance of the redemption money under' Mr A's property.

44. In the written closing submission the Taxpayer explained that because the property was used as security for the new facilities, it had to be redeemed first before the new facilities could be granted and that was why the documents were written in this way. We do not see the logic of such an explanation and are not convinced by it. It is clear that both the bank and Mr A were treating the whole exercise as a redemption of the mortgage on Mr A's property, that is his personal liability.

45. In the audited accounts of the Taxpayer 2001/02, the $2 million together with miscellaneous sums due from Mr A amounting to $8,502 were put under the item 'Due from a director' in the total sum of $2,008,502. The same treatment was made in subsequent accounts. The auditor was there treating the $2 million as a loan to Mr A being used to redeem the mortgage on his property.

46. But Mr A now claims that the $2 million was not a loan to him but a sum used to acquire the business of Company B and that the accounts were in error.

Whether the Taxpayer is entitled to re-open its accounts

47. At the beginning of the hearing, this Board questioned whether the Taxpayer could be allowed to re-open its audited accounts in this manner. In a case where a taxpayer seeks to rely on his accounts whilst the revenue challenges them, it is easy to understand why the revenue and the courts are not bound by the accounts. In the present case, however, the Taxpayer challenges its own accounts. In most cases the IRD relies on a taxpayer's accounts in the computation of tax because the accounts have been audited by an auditor who has to form an independent opinion of 'the true and fair view of the state of' the company. If a taxpayer is allowed to amend its accounts whenever it suits them, it would make a farce of audited accounts. We have serious doubts whether a taxpayer should be allowed to challenge its own accounts unless they can clearly be shown to be wrong. And the new accounts should also be properly audited and present a true and fair view of the company.

48. We are bound by the authority of Chinachem Investment Co Ltd v CIR 2 HKTC 261. The issue in that case was whether certain properties were purchased for investment purpose or for trading. The taxpayer there alleged the former despite the fact that in its audited accounts they were entered as trading stock.

49. On appeal from the Board's decision, Macdougall J dealt with the accounts of the company at pages 281 to 282:

> '*With regard to the accounts of the Company and its own tax computations the situation is even less satisfactory. The Company stated in its audited financial statements and in its tax returns that all of its properties, including all of the units under appeal, were carried in its books as trading stock. This situation had continued year after year right up to the re-organisation in 1979 which gave rise to this appeal. The Company had over the years, without exception, offered and paid profits tax on the profits arising on the sale of any units in any of the buildings in question and there had never been any previous suggestion by the Company that any of the units previously sold had been capital assets. Furthermore the Company claimed none of the depreciation allowances which one would expect to find in the case of capital investments. The units to which this appeal related were treated in every way in the accounts as trading assets.*
>
> *Counsel for the Company asked the Board to accept that a mistake had been made in the preparation of the audited accounts and tax returns. This the Board cannot accept. There had been a change of auditors and tax representative and one firm of public accountants had handled the tax matters and audited accounts up to the period ended 31st March 1975. New auditors took over and handled the Company's audited accounts and tax matters from then onwards. Both firms of auditors certified the audited accounts and they were signed in some cases by one and in some cases by two directors. The declaration on the tax return was signed by a Director of the Company in each year. No representatives from either of the two firms of auditors were called to give*

evidence. The Director who made the declarations accompanying the tax returns also failed to give evidence. No explanations were given for this.

The principal witness was asked a number of questions in cross examination with regard to the audited accounts and tax declarations. Her answers were to the effect that she had no knowledge regarding the accounts or accounting matters. She said that she left it to the Company's accountant who was a company employee. This employee was not called to give evidence. The explanations given by the witness and Counsel for the Company regarding the failure for this employee to give evidence were confusing.

If a tax payer wishes to challenge the accuracy of its own audited statements and tax declarations made by a director it is not sufficient merely to say that either a mistake was made or that the accounts were kept in a particular form which was incorrect "for convenience". Evidence to substantiate the mistake must be given in the strongest terms. In this case no such evidence was given.'

50. Further at page 283:

'*.... The Inland Revenue Ordinance clearly places the onus of proof on the tax payer who disputes the Commissioner's determination. Where the taxpayer is also disputing its own documentary evidence in the form of audited accounts, tax declarations, tax computations and contemporary sales brochures the onus of proof is heavy.'*

51. At the Court of Appeal, Sir Alan Huggins, VP held at page 308:

'*It is accepted by the Commissioner that the accounts are not conclusive evidence of the matter in issue, and obviously that is rightly accepted. Nevertheless the accounts must remain important and call for credible explanation, because they are contemporaneous evidence of the Company's intention ….. I agree with the judge that "the way in which the properties have been treated in the accounts is by no means an insignificant factor"...'*

52. Ms Leung of the IRD likewise accepts that the audited accounts here are not conclusive evidence and the Taxpayer can re-open them in case of error, but she argues that the Taxpayer comes nowhere near discharging the very heavy burden of proof placed on them. We agree.

The purpose of the $2 million loan

53. Mr A has not provided us with any explanation as to how the error came to be made. According to him, he never told the auditors the purpose of the $2 million loan nor did the auditor ever ask him. He never produced the loan documents to the auditor. He never paid any attention to the item 'Due from a director' and did not know its significance

until this appeal. We find these assertions far from credible.

54. Company K was the auditors of both Company B and the Taxpayer. It was Mr H of Company K who signed the audited accounts of Company B and the first five audited accounts (that is 2001/02 to 2005/06) of the Taxpayer. In each of the audited accounts, Mr H stated in his report in standard terms that the financial statements gave 'a true and fair view of the state of' the company and that they had been properly prepared in accordance with the Hong Kong Companies Ordinance.

55. The Taxpayer is a small business with turnover of $1 to $2 million. The loan forms a substantial part of the Taxpayer's financial status. In carrying out the audits Mr H must have done the necessary investigations that a professional and responsible auditor was expected to do. He had a duty to form an independent opinion and he had to certify that the financial statement presented a true and fair view. As auditor of both Company B and the Taxpayer, he had knowledge of the poor financial state of Company B. He must have known the terms of Company B's facilities and that they were secured by Mr A's property. He must have known that the loan was used to redeem Mr A's property. We do not accept that the item 'Due from a director' was an error because the auditors did not know the true nature of the loan. We find the contrary to be true.

56. It is clear on the facts that Company B was indebted to Bank G to an extent of nearly $2.9 million. Company B was running at a loss and had no ability to repay. The family home was valued at $3,280,000 in August 2001. 2001 was one of those rare periods in Hong Kong when the property market was falling rather than rising. With a company that had a substantial accumulated loss and borrowings coming to the limit of their securities, it is easy to understand why Bank G should become concerned. Mr A admitted that the bank had shown concerns. Bank G had recourse against Mr A personally. Company B's liabilities to Bank G were in truth Mr A's personal liabilities. The fixed loan of $2 million enabled Mr A to discharge Company B's liabilities and thus his own liabilities. The sum was rightly treated as a loan to Mr A personally.

57. This was also consistent with Mr A's own understanding of the loan as revealed by his instructions to the solicitors and the credit slips discussed in paragraphs 39 to 43 above.

58. While we have no doubt that the Taxpayer took over the entire business of Company B including the City F contract and all other uncompleted contracts and its clientele, we do not accept that the $2 million was ever intended to be the purchase price.

59. If the HK$2 million was paid to acquire the business of Company B as the Taxpayer now asserts, Mr A had to produce to the auditors sufficient documents to satisfy the auditors that it was a genuine transaction and that the sum was a fair price for that business.

60. On the first day of the hearing this Board have asked Mr A and Mr J of Company K how they would amend the audited accounts if we were to accept that there was an error and allow them to re-open the accounts. They were asked to prepare a draft amendment for the Board's consideration. At the adjourned hearing, what was produced before the Board was:

Fixed assets 固定資產	XXXXXXX
Intangible assets 無形資產	XXXXXXX
Goodwill 商譽	XXXXXXX
	2,000,000

61. This is obviously not a proper amendment and the inability of the Taxpayer to draft a proper amendment further goes to show how artificial its assertions are. Company B was a loss-making business. The claim that the $2 million loan was made to purchase Company B's business is clearly an afterthought made in an attempt to resist taxation.

62. Moreover if the item 'Due from a director' was in fact a one-off payment made to acquire the business of Company B, it should remain constant in subsequent years. But it was not.

63. Mr A was asked to explain why the item was reduced every year after 2002 (see table at paragraph 18 above). He explained that he was advised to do so by Bank G. The Taxpayer had to submit its audited accounts to Bank G for review every year. Mr A was advised that the accounts did not look good with such a large debt due from a director. As a result he tried to pay off part of the debt with his salary.

64. The Board was puzzled by this explanation because surely the solution would be for him to tell Bank G that the accounts were in error, that he did not owe the company any money and for him to immediately instruct the auditors to rectify the accounts. When asked why he did not do these, he said it never occurred to him to do so.

65. Mr A's explanation was only consistent with it being a debt due from him to the Taxpayer. Otherwise we fail to see why he would choose to pay off the sum using his own salary and not ask the auditors to rectify the accounts.

66. In conclusion, we find no error in the audited accounts. The $2 million loan was taken out to enable Mr A to pay off his personal liabilities to Bank G. It was not borrowed for the purpose of producing assessable profits in terms of section 16(1)(a) of the IRO and the interest thereon is not a deductible expense.

67. The Deputy Commissioner in his Determination apportioned the interest using the formula.

Bank loan interest not allowed
= Bank loan interest x Amount due by director / Total assets

68. Mr J confirmed to the Board that he would not dispute this formula in the event the Board find against the Taxpayer. We find this formula reasonable and would adopt the calculations on page 9 of the Determination.

69. For the reasons above we dismiss the appeal and confirm the assessment made in the Determination.