Case No. D62/05

Profits tax – additional assessment – onus wholly on the appellant to show the assessment excessive or incorrect on appeal – sections 16(1), 68(4) and 68(9) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), William Cheng Chuk Man and Andrew Li Shu Yuk.

Dates of hearing: 11 and 12 November 2005.
Date of decision: 19 December 2005.

In the year of assessment 1996/97, the appellant bought the Lifts from the Vendor and then sold the same to the Purchaser (an overseas company and by then 52% owned by the appellant) at a profit.

The Lifts were to be installed in a newly constructed building in an overseas city.

The appellant claimed that most of the purchasing work relating to the Lifts was in fact done by the Purchaser and a handling fee of $4,378,000 was incurred to the Purchaser.

The assessor disallowed the alleged handling fee and raised estimated (which was subsequently revised) additional assessment on the appellant.

The appellant appealed and during the hearing, applied for leave to add an additional ground of appeal that the profits earned in respect of the Lifts transaction was in fact offshore and should not be chargeable to Hong Kong profits tax.

Held:

1. There would be injustice to the respondent should leave be given to the appellant to add an additional ground of appeal:

    1.1 The offshore claim was never made by the appellant until October 2005.

    1.2 By October 2005, it was not possible for the respondent to investigate the practical hard matter of fact to ascertain the actual source of income of the

appellant.

2. The appellant failed to discharge its onus of proving that the revised additional assessment appealed against is excessive or incorrect:

2.1 The witness of the appellant did not have any personal knowledge about the Lifts transaction. He asserted only from what he had been told by the accountant.

2.2 There is no evidence as to when, how and by whom the alleged expense was incurred by the appellant in the production of profits during the relevant basis period.

Appeal dismissed and costs order in the sum of $5,000 imposed.

Cases referred to:

Lo & Lo v CIR [1984] 2 HKTC 34
CIR v National Mutual Centre (Hong Kong) Ltd [1998] 3 HKC 697
International Wood Products Ltd v CIR [1971] 1 HKTC 551
CIR v Hang Seng Bank Ltd [1991] 1 AC 306
CIR v HK-TVB International Ltd [1992] 2 AC 397
CIR v Magna Industrial Co Ltd [1996] 3 HKC 210
Consco Trading Company Ltd v CIR [2004] IRBRD, vol 18, 993
Baring Securities (Hong Kong) Limited, presently known as ING Baring Securities (Hong Kong) Limited v CIR [2005] HCIA 1/2003 unreported
D1/03, IRBRD, vol 18, 286
D76/03, IRBRD, vol 18, 738
CIR v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703
D28/86, IRBRD, vol 10, 220
D109/02, IRBRD, vol 18, 54
CIR v Orion Caribbean (in voluntary liquidation) [1997] HKLRD 924

Ng Kwok Yin Counsel instructed by Mr Mok Wai Kwong of Messrs Mok Wai Kwong & Co, Certified Public Accountants, for the taxpayer.
Ng Yuk Chun and Wong Siu Suk Han for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 29 July 2005 whereby the additional profits tax assessment for the year of assessment 1996/97 under charge number 1-1155102-97-3, dated 24 January 2003, showing additional assessable profits of $4,400,000 with additional tax payable thereon of $726,000 was reduced to additional assessable profits of $4,378,000 with additional tax payable thereon of $722,370.

The salient facts

2. The facts in the 'Facts upon which the Determination was arrived at' in the Determination were agreed by the parties and we find them as facts. For the purpose of this Decision, the salient facts are as follows.

3. The appellant objected to the additional profits tax assessment raised on it for the year of assessment 1996/97, arguing that the amount of assessable profits was excessive and not in accordance with the return submitted by it.

4. The appellant was incorporated as a private company in Hong Kong on 29 August 1991. At the relevant times, the nature of the appellant's principal activities was investment and general trading.

5. In July 1997 the appellant submitted its 1996/97 profits tax return together with accounts for the year ended 31 December 1996 and proposed tax computations which showed, among others, sales of $19,000,000 and cost of goods sold of $18,620,000.

6. On 1 September 1997 the assessor raised on the appellant profits tax assessment for the year of assessment 1996/97 as per return.

7. The assessor subsequently conducted a review on the appellant's tax affairs. By letter dated 9 April 1998 the assessor asked the appellant to supply information and documents in relation to its accounts for the year ended 31 December 1996.

8. From the information and documents supplied by the appellant's then representatives, Messrs A, the assessor ascertained the following facts:

(a) The sales amount of $19,000,000 was derived from the sale to the Purchaser of 10 sets of lifts and four sets of escalators (collectively referred to as 'the Lifts') to be installed in a newly constructed building in an overseas city.

(b) The cost of goods sold amounting to $18,620,000 was made up of purchase consideration of $14,242,000 paid to the Vendor, and an amount of

$4,378,000 alleged to be handling fee paid to the Purchaser for transportation, installation and testing services relating to the Lifts.

9. At the relevant times and until 30 December 1996, the Purchaser, a company incorporated overseas, was a 52% owned subsidiary of the appellant

10. On 14 June 1997, that is, more than five months after the expiry of the basis period for the 1996/97 year of assessment, the Witness was appointed a director of the appellant.

11. On 22 December 1999 the Witness and Mr B of Messrs A (now of Messrs C) attended an interview with the assessors. During the interview, the Witness alleged, inter alia, that

(a) towards the end of 1995 the appellant imported some lifts for the residential project in the overseas city. According to the documents, the appellant acted as the middleman by buying the lifts from the Vendor and then sold the same to the Purchaser at a profit. The profit was booked in the accounts of the appellant;

(b) the purchase of those lifts was negotiated by the Purchaser directly with the overseas manufacturer and the appellant did not play any part in the transaction. As the Purchaser had encountered serious financial difficulties in 1997, the other shareholders of the Purchaser did not agree to the transaction; and

(c) in the circumstances, the Witness discussed the matter with Mr B and other related persons. All of them considered that the booked profit of the transaction had been exaggerated to a large extent. As the work relating to negotiation of the purchase of the lifts and financial arrangements was done mostly by the Purchaser, therefore they did not object to the return of a part of the profit by the appellant to the Purchaser in the form of management or consultancy fee.

12. The assessor did not accept the appellant's claim that the alleged handling fee could be allowable for deduction. On 24 January 2003 the assessor raised on the appellant the following estimated Additional Assessment for the year of assessment 1996/97:

Additional assessable profits	$4,400,000
Additional tax payable thereon	$726,000

13. On behalf of the appellant, Messrs C objected against the additional assessment on the ground that it was excessive.

14. By letter dated 31 August 2004 the assessor proposed to revise the 1996/97 Additional Profits Tax Assessment as follows:

Additional assessable profits	$4,378,000
Additional tax payable thereon	$722,370

15. The appellant did not accept the assessor's proposed revised assessment.

Grounds of appeal

16. Having failed in its objection, the appellant gave notice of appeal through Messrs C by letter dated 29 August 2005. In order not to inundate our Decision with '*sics*', we state that the following grounds of appeal are written exactly as they stand in the original:

> 'GROUNDS FOR APPEAL
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> 1. Inland Revenue Department [IRD] only based on the sales and purchases figures of the lifts transactions and believed that there should be a gross profit of $4,758,000, in fact handling fee was also an important part of series of trading transactions between [the appellant] and [the Purchaser], which making [the appellant] earned some profit from lift transactions and the handling fee earned by [the Purchaser] could be kept in Hong Kong. Our client hereby explains AGAIN that [the appellant] at that time could not take up such trading activities without the support from [the Purchaser]. [The appellant] had no technical staff, it could not deal with the supplier about the product details. Also [the appellant] was not financially strong to issue letter of credit [L/C] to the supplier if [the Purchaser] did not issue the L/C to [the appellant] earlier.
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> 2. [The appellant's] general ledger did not reflect the whole agreement between [the appellant] and [the Purchaser], as the director, [the Witness], explained to IRD that the previous directors suddenly left Hong Kong without hand over to the new management the accounting information, including the latest financial statements. IRD could not base on an incompleted accounting record and concluded the handling fee was only an afterthought aimed at improving the financial position of [the Purchaser].
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> 3. [The appellant] actually aimed at clarifying its real profit and loss figure and the related tax. [The appellant] will benefit nothing, even it wins or losses this case. [The appellant] has been at net liability value since the new management took over [the appellant].'

The appeal hearing

17. At the hearing of the appeal, the appellant was represented by Mr Ng Kwok-yin, counsel, and the respondent was represented by Ms Ng yuk-chun, acting chief assessor.

18. Mr Ng Kwok-yin furnished the Board with a bundle of the following authorities prior to the hearing of the appeal:

(a) Lo & Lo v CIR [1984] 2 HKTC 34

(b) CIR v National Mutual Centre (Hong Kong) Ltd [1998] 3 HKC 697

(c) International Wood Products Ltd v CIR [1971] 1 HKTC 551

(d) CIR v Hang Seng Bank Ltd [1991] 1 AC 306

(e) CIR v HK-TVB International Ltd [1992] 2 AC 397

(f) CIR v Magna Industrial Co Ltd [1996] 3 HKC 210

(g) Consco Trading Company Ltd v CIR [2004] IRBRD, vol 18, 993

(h) Baring Securities (Hong Kong) Limited, presently known as ING Baring Securities (Hong Kong) Limited v CIR [2005] HCIA 1/2003 unreported

(i) D1/03, IRBRD, vol 18, 286

(j) D76/03, IRBRD vol 18, 738

(k) **稅務局釋義及執行指引第** 21 **號(修訂本)**1998 – **利潤的來源地**

(l) 1996 **中華人民共和國進出口關稅條例含第** 417 **及** 418 **頁:法律出版社**

19. We do not know why Mr Ng Kwok-yin cited the decision of the High Court in CIR v Magna Industrial Co Ltd [1996] 3 HKC 210, without citing the judgment of the Court of Appeal which reversed the judgment of the judge. The judgment of the Court of Appeal is reported in [1997] HKLRD 173 and was cited in items (g) and (j) of his list of authorities. Nor do we understand his citation of a DIPN issued in 1998 when the relevant basis period ended on 31 December 1996.

20. Ms Ng yuk-chun furnished the Board with a bundle of the following authorities prior to the hearing of the appeal:

(a) Extracts of the Inland Revenue Ordinance, Chapter 112

(b) CIR v Wardley Investment Services (Hong Kong) Limited 3 HKTC 703

(c) Board of Review Decision D28/86, IRBRD, vol 10, 220

(d) Board of Review Decision D109/02, IRBRD, vol 18, 54

21. Mr Ng Kwok-yin applied for leave to add the following additional ground of appeal:

> ' that the profits earned by the Appellant from the sale and installation of the 10 lifts and 4 escalators [' the Lift Profits'] were derived from a source or sources outside Hong Kong and hence the Lift Profits so earned should not be chargeable to Hong Kong Profits Tax'.

22. Ms Ng Yuk-chun opposed the application.

23. Having heard the parties, we told them that our decision on this application will be given in the Decision.

24. After Mr Ng Kwok-yin had opened his case, he hummed and hawed. He told us that the Witness had many business matters to attend to and could not attend the hearing by 5:15 pm. We told Mr Ng Kwok-yin that the appellant had been given ample notice of the hearing of the appeal.

25. Mr Ng Kwok-yin then told us that he had another witness. When questioned on the absence of a witness statement, Mr Ng Kwok-yin said the witness would give the same evidence as per the witness statement of the Witness.

26. We told him that asking any Tom, Dick and Harry to say what a lawyer or accountant wrote out in a document called a witness statement would serve no purpose except to waste the Board' s time.

27. We also told Mr Ng Kwok-yin that his instructing accountant should have gone out of the Board room to make a telephone call to the Witness quite some time ago. Mr MOK Wai-kwong then left the Board room. On his return, we were told by Mr Ng Kwok-yin that the Witness was on his way to attend the hearing. We granted the application by Mr Ng Kwok-yin for a 15-minute adjournment.

28. The Witness turned up after more than 20 minutes later and gave evidence. He was the only witnessed called by Mr Ng Kwok-yin.

29. Ms Ng Yuk-chun did not call any witness.

The Board's decision

Decision on application to add ground of appeal

30. As the Privy Council said in CIR v Orion Caribbean (in voluntary liquidation) [1997] HKLRD 924 at page 931:

> *'... the ascertaining of the actual source of income is a "practical hard matter of fact", to use words employed, again by Lord Atkin, in Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes [1940] AC 774 at page 789'.*

31. The appellant had all along expressly stated that it was not making any offshore claim. The 'Summary of facts regarding the year of assessment 1996/97' attached by Messrs C to their letter dated 29 August, 2005 stated, inter alia, that:

> ' 7 November 2002 ... One additional question was odd, [the appellant] was asked reasons that the profit so derived (lift transactions) was not chargeable to Hong Kong Profits Tax. In fact, [the appellant] had never claimed such exemption.
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> 31 December 2002 [The appellant] extracted from the reply letter by [Messrs A] dated May 25, 1998 and replied. Also [the appellant] informed IRD that the company had never claimed the profit from the ' lift transactions' was not chargeable to Hong Kong Profits Tax.'

32. The offshore claim was made for the first time in the letter dated 21 October 2005 from Messrs C.

33. By October 2005, it was not possible for the respondent to investigate what is 'a practical hard matter of fact'. The disclosure of documents by the appellant, despite the assessor's written requests, has been woefully incomplete. The appellant claimed that all the directors in 1996 had left all of a sudden.

34. We are satisfied that there is injustice to the respondent if leave to amend should be given in the circumstances of this case. In the exercise of our discretion, we dismiss the appellant's application for leave to amend.

The relevant provisions

35. Section 68(4) of the Inland Revenue Ordinance, Chapter 112, provides that 'the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'.

36. Section 16(1) provides that in 'ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period'.

Decision on the deduction claim

37. We attach no weight to the evidence of the Witness. He was not appointed a director until 14 June 1997. According to his own testimony, his first contact with the appellant was in June or July 1997 and it was in August or September 1997 that he had any information about the newly constructed building where the Lifts were to be installed. Ground 2 of the grounds of appeal asserts that 'the previous directors suddenly left Hong Kong without hand over to the new management the accounting information, including the latest financial statements'. Clearly, the witness had no personal knowledge about the relevant sale and purchase transactions at all. Despite this, he made numerous factual assertions on matters not within his personal knowledge, without disclosing his source of information or ground for belief. When asked how he came to know about a matter which he asserted, he said that he was told by the accountant.

38. There is no evidence when, how and by whom the alleged expense was incurred. There is no evidence that the alleged expense was incurred during the relevant basis period, that is, from 1 January 1996 to 31 December 1996. There is no evidence that the alleged expense was incurred by the appellant in the production of profits.

39. In any event, on the appellant' s own case as summarised in paragraph 11 above, the alleged expense could not have been incurred during the relevant basis period and could not have been incurred for the production of the profits which the appellant had already earned by the end of the relevant basis period.

40. The appellant has failed to discharge its onus of proving that the assessment appealed against is excessive or incorrect and the appeal fails.

Disposition

41. We dismiss the appeal and confirm the assessment appealed against as reduced by the Deputy Commissioner.

Costs order

42. This is a case where, if the appellant had been given proper accounting and legal advice and if the appellant had accepted such advice, the Board's time would not have been wasted by this hopeless appeal.

43. Pursuant to section 68(9), 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.