emphasis should be on whether there was an abandonment or abrogation of contractual rights. In this case, the sums paid on termination of employment were found to be taxable for:

(i) the taxed sums were paid pursuant to the sums agreed in the service agreement.

(ii) the taxed sums were not payment for damages for the breach of the service agreement, nor were they paid in abrogation of the service agreement;

(iii) the taxed sums were paid to the taxpayer in return for acting as or being, or for becoming, an employee.

An *ex-gratia* payment paid upon a taxpayer's resignation and calculated by reference to the taxpayer's salary and length of service was regarded as a gratuity arising from the taxpayer's employment of profit with the company, and therefore as income from that employment subject to salaries tax in *D79/88* IRBRD Vol 4, 160. Similarly, in *Case* B39 (1992) 1 HKRC ¶80-200 (*D12/92*) an *ex-gratia* payment made to a taxpayer in view of the long and loyal service he had provided to his employer was an assessable gratuity. It was confirmed in that case that, as a matter of law, a payment which is not damages for breach of contract and which is not paid out of an approved provident fund or retirement scheme is subject to salaries tax if it is paid in respect of the services provided by the taxpayer to the employer. Neither the Commissioner nor the Board of Review has any discretion to allow a tax exemption in those circumstances.

An ex-gratia payment was held to be made in return for having acted as employee and arose from the employment which was not compensation for loss of employment (*Case* T6 (2010) HKRC ¶81-275 (*D58/08*)). Also see *Case* W15 (2013) HKRC ¶81-378 (*D30/12*); *Case* R26 (2008) HKRC ¶81-244 (*D41/07*); *Case* P23 (2006) HKRC ¶81-175 (*D19/06*); *Case* O53 (2005) HKRC ¶81-109 (*D4/05*); *Case* N63 (2004) HKRC ¶81-039 (*D80/03*); *Case* M99 (2003) HKRC ¶80-964 (*D74/02*); *Case* K48 (2001) HKRC ¶80-779 (*D88/00*); *Case* I88 (2000) HKRC ¶80-657 (*D25/99*); *Case* I73 (1999) HKRC ¶80-642 (*D2/99*); *Case* H11 (1998) HKRC ¶80-519 (*D24/97*); *Case* G63 (1997) HKRC ¶80-501 (*D90/96*); *Case* F50 (1996) HKRC ¶80-428 (*D97/95*); *Case* D25 (1994) 1 HKRC ¶80-275 (*D15/93*); *Case* C3 (1993) 1 HKRC ¶80-212 (*D25/92*); *Case* V28 (2012) HKRC ¶81-354 (*D40/11*)).

In *Case* O16 (2005) HKRC ¶81-072 (*D37/04*), the taxpayer suffered from cancer and her employment was subsequently terminated by her employer. Her employer agreed to pay a "Special Notice Payment" (computed on the basis of six times of the taxpayer's monthly salary) and a "Severance Payment" (computed on the basis of 12 times half of the taxpayer's monthly salary). The taxpayer

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argued that both sums should not be taxable for salaries tax purposes in that the Special Notice Payment was paid to her to cover the medical expenses that she would be able to claim if she was still working for the company, whereas the Severance Payment was paid to compensate her loss of office.

The Board noted that there were two approaches in resolving these questions. The wider approach was to consider whether the payments were sourced from the employment. The narrower approach was to decide whether the payments were for services rendered by the taxpayer. The Board adopted the narrower approach and held that the Severance Payment was income of the taxpayer. The sum was calculated with reference to the taxpayer's length of service, strongly indicating that the payment was in recognition of past services rendered by the taxpayer. The Board held that the Special Notice Payment was not part of the taxpayer's income, as it was paid in recognition of her physical predicament and her loss of coverage under the company's medical scheme but not her past services.

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Long service and severance payments

It is the Inland Revenue Department's practice to exempt from salaries tax severance payments and long service payments paid in accordance with the *Employment Ordinance* (*Case* D25 (*D15/93*)). For a severance payment to qualify, there must have been, among other things, an actual dismissal or lay-off. For long service payments, the statutory requirements are that an employee has been either: dismissed; certified as permanently unfit for the relevant work; or has terminated his or her employment at the age of 65 years. Furthermore, an employee must be employed by the employer for not less than 24 months to be eligible for a severance payment pursuant to sec 31B(1) of the *Employment Ordinance* (*Case* O59 (2005) HKRC ¶81-115 (*D17/05*).

The Commissioner in *Case* N3 (2004) HKRC ¶80-979 (*D107/02*) argued that the payment made to the taxpayer was an incentive payment rather than a severance payment. The employer in this case decided to close down its office and made two payments to the taxpayer that were in total equivalent to one-month's salary for each year of service. The Commissioner argued that the first payment was truly a severance payment while the second payment was not as the taxpayer would only be entitled to the second payment if he stayed on the employment until closure and performed his duties to the employer's satisfaction. However, the Board accepted the taxpayer's assertions that the second payment was made in response to the employees' request to increase the severance payment to one-month

¶2-2850 Identifying "employment"

Income is derived from "employment" if a relationship of master and servant exists between the taxpayer and the employer, in other words, where there is a "contract of service" as opposed to a "contract for services" (*Cassidy* v *Ministry of Health* (1951) 1 All ER 574 and *D19/78* IRBRD Vol 1, 323). Income derived by a self-employed taxpayer or an independent contractor does not attract salaries tax but is normally assessable to profits tax.

Control test

The original test for determining whether a master and servant relationship exists focuses on the amount of control exercised by the employer on the basis that "a servant is a person subject to the command of his master as to the manner in which he shall do his work" (*Yewens* v *Noakes* (1880) 1 TC 260, CA (quoted in DIPN No 25 (Revised))).

The extent to which a taxpayer is under the direction and control of another person is still an important consideration in determining whether a relationship of master and servant exists (*Narich Pty Ltd* v *Commissioner of Payroll Tax (NSW)* 84 ATC 4035). It does not always follow, however, that taxpayers who are engaged to do work are independent contractors simply because there is no control or because the control is insignificant or negligible (*D67/87* IRBRD Vol 3, 97).

See also *Case* H55 (1998) HKRC ¶80-563 (*D121/97*).

Economic reality test

The "economic reality" test was applied to determine whether the taxpayer was an employee or an independent contractor in *D67/87*. That test, as set out in *Market Investigations Ltd* v *Minister of Social Security* (1969) 2 QB 173, asks whether taxpayers who have been engaged to perform services, perform them as persons in business on their own account. If they do, the contract is a contract for services, and the taxpayers are not liable to salaries tax. If they do not perform services, or are not in business on their own account, the contract is one of employment and the taxpayers are liable to salaries tax (*Case* A85 (1991) 1 HKRC ¶80-085 (*D54/90*)).

Factors to be considered include:

- whether the person performing the services provides his or her own equipment;
- whether the taxpayer works from his or her own premises;
- whether the taxpayer hires his or her own helpers;

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- the degree of financial risk the taxpayer takes;
- the degree to which the taxpayer assumes responsibility for investment and management; and
- whether, and to what extent, the taxpayer has an opportunity of profiting from sound management in the performance of his or her task.

See *Case* I71 (1999) HKRC ¶80-640 (*D178/98*); *Case* E58 (1995) 1 HKRC ¶80-355 (*D78/94*); *Case* B47 (1992) 1 HKRC ¶80-208 (*D22/92*); *Case* A108 (1991) 1 HKRC ¶80-108 (*D77/90*); *Case* A85 (1991) 1 HKRC ¶80-085 (*D54/90*); *Case* A32 (1991) 1 HKRC ¶80-032 (*D68/89*).

Integration test

This test asks whether a taxpayer was "part and parcel of the organisation" (per Denning LJ in *Bank voor Handel en Scheepvaart NV* v *Administrator of Hungarian Property* (1954) 35 TC 311 referred to in the *Market Investigation* case). If so, the taxpayer will be regarded as an employee and not an independent contractor. The integration test was applied and satisfied in *Case* D7 (1994) 1 HKRC ¶80-257 (*D24/93*). In that case, although the taxpayer claimed he was an independent contractor, he was entitled to medical expenses and paid leave from the company for which he performed services. The Board of Review said that although the provision of such benefits may not be absolutely incompatible with a contract for services, their inclusion must be very rare especially where the medical cover is provided through a scheme applicable to all employees as opposed to an *ad hoc* insurance taken out for an independent contractor working on a particular project. See also *Case* L48 (2002) HKRC ¶80-849 (*D61/01*).

Intention of parties, business registration and other factors

The intention of the parties involved is an additional factor for consideration, but is not conclusive on the question of whether a taxpayer is carrying on business on his or her own account (*Global Plant Ltd* v *Secretary of State for Social Services* (1971) 3 WLR 269). Similarly, whether or not the taxpayer has taken out a business registration is a matter to be considered but is not, in itself, decisive (*Case* B47 (1992) 1 HKRC ¶80-208 (*D22/92*); also see *Case* F34 (1996) HKRC ¶80-412 (*D70/95*) and *Case* F42 (1996) HKRC ¶80-420 (*D85/95*)).

Each case must be determined on its own particular facts, which must be weighed against each other to determine under which head of taxation the taxpayer is assessable. In some cases, factors may point in both directions. For example, in *Case* B28 (1992) 1 HKRC ¶80-189 (*D57/91*) a taxpayer who performed services as a "mamasan" in a nightclub was able to point to a number of factors indicating that she was running her own business. She recruited hostesses, kept

mother in this case would be entitled to a refund of the property tax she had paid.

¶5-1200 Evidence of ownership

Legal ownerhip

Registration with the Land Registry provides the strongest evidence of ownership. Ownership, however, does not depend upon such registration. A legally executed sale and purchase agreement, or in some circumstances an Instruction for Sale, may serve equally well.

Lack of documentary evidence can defeat a taxpayer's claim to legal ownership of a property. A director of a taxpayer company who let flats to tenants in a building which was constructed on the taxpayer's land, but paid for from his own personal account, unsuccessfully claimed that he was the legal owner of the flats (*D7/85* IRBRD Vol 2, 166). A condition of the taxpayer's purchase of the land had been that it should develop the lot by constructing a building. Subletting had to be registered. The Board of Review found that the taxpayer, not the director, was the legal owner of the building because there was no documentary evidence indicating that the taxpayer had leased the building to the director. The director, it was held, had only been acting as the agent of the taxpayer.

Equitable ownership

Persons having equitable interests in land or buildings may be property "owners" for property tax purposes. Tenants for life and beneficial owners, for instance, are specifically included in the definition of "owner" (see ¶5-1000).

If an equitable interest in land is created, or if land is held on trust, properly prepared documentation should be filed with the Land Registry. Equitable interests and declarations of trusts must be created and/or manifested in writing according to the *Conveyancing and Property Ordinance*. Failure to file the proper documents with the Land Registry can lead to complications in proving beneficial ownership.

The Inland Revenue Department will normally verify a claim that property belongs beneficially to a third person, rather than a registered owner, by checking the Land Registry's files. When no documentation can be found, the registered owner has the burden of proof to show that a valid, legally binding trust instrument or equitable interest has been executed or created. The registered owner may also be required to indicate why no documentation was lodged with the Registry.

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> **Example**
>
> If Mr P appoints Mr T as a trustee to hold a residential property for the life-long benefit of his daughter, Ms P, the owner of the property for property tax purposes will be Ms P. Although Mr T's name would appear in the Land Registry files as the registered owner of the property, the declaration of trust would record that Mr T is only holding the property on trust for the tenant for life, Ms P. As the equitable owner of the property Ms P would be liable for property tax on the net assessable value of the property.

¶5-1400 Change of ownership

Change of ownership is fundamentally a question of fact to be determined from the documents in each case. Ownership is generally said to have passed on the date specified in the sale and purchase agreement, even if the title is not actually transferred until a later date.

Liability to property tax is based on the consideration payable to the owner for the use of land and/or buildings. Consequently, even if purchasers fall within the definition of "owner" in sec 2(1) (see ¶5-1000), they are not liable to property tax until they are in possession and entitled to receive consideration.

¶5-1600 "Land and/or buildings"

The phrase "land and/or buildings" includes piers, wharves and other structures. The term "buildings" includes any part of a building (sec 7A).

In practice, the Commissioner separately assesses all parts of buildings which are separately rated under the *Rating Ordinance*. There is no provision for the consolidated assessment of separately rated land and/or buildings owned by the same taxpayer.

¶5-1800 Responsibilities of property owners

Keeping of rent records

To facilitate property tax assessment, the Inland Revenue Department issues returns to property owners and requires that statements of rent and any other consideration received in relation to the property during the previous year be lodged. This is in order that the assessable value of his or her property can be readily ascertained.

An owner is required to keep adequate records of the consideration payable to him or her, in money or money's worth, for the right of use of his or her property (sec 51D; see further ¶9-4500). The records

Wardley

In determining the source of the taxpayer's profits in *Wardley Investment Services (Hong Kong) Limited* v *Commissioner of Inland Revenue* (1993) 1 HKRC ¶90-068 the Court of Appeal emphasised the importance of the profit-producing activities of the taxpayer, as opposed to the overall operations giving rise to the profit.

The taxpayer in *Wardley* was a Hong Kong-based investment adviser engaged in the management of customers' investment portfolios under management contracts. In addition to management fees, the taxpayer was entitled to "additional remuneration as manager" under the contracts. Wardley received and was permitted to retain rebates and share commissions from stockbrokers which it employed to perform transactions. The Commissioner considered that the rebate commissions received by the taxpayer from overseas brokers were assessable Hong Kong-sourced profits.

In the first instance the Board of Review found that what the taxpayer was receiving was an actual share of the overseas agents' commission, which they had clearly earned overseas. The Board held that the income arose from the activities of overseas agents buying and selling investments overseas and did not arise in Hong Kong. This decision was made before *Hang Seng Bank* and *HK-TVB*. On further appeal, the Court of Appeal decided that the profit was Hong Kong-sourced.

Applying *Hang Seng Bank* and *HK-TVB*, and looking at what the taxpayer, rather than the overseas brokers, had done to earn the profit, the majority of the Court of Appeal found that the profit to the taxpayer was generated in Hong Kong from the management contracts. In the Court's view the taxpayer had done nothing abroad to earn the relevant profits.

The decision in *Wardley* was applied in *Case* H29 (1998) HKRC ¶80-537 (*D71/97*). The Board of Review held that the businesses and operations of the taxpayer and overseas brokers should be viewed separately. The taxpayer received a share of brokerage fees in the form of rebates from the overseas brokers for having referred business to them from Hong Kong. These rebates were found to be sourced from Hong Kong and, hence, taxable.

Euro-Tech

The 1995 High Court decision in *Commissioner of Inland Revenue* v *Euro Tech (Far East) Limited* (1995) 1 HKRC ¶90-074 suggests that a taxpayer's profits may be regarded as being sourced in Hong Kong notwithstanding that the taxpayer's activities in Hong Kong are minimal and comprised of only routine administrative functions. The

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Court found that a taxpayer which simply processed orders and collected and made payments in and from Hong Kong was assessable to tax on the profits derived from its activities notwithstanding the low level of those activities.

However, this is another case in which the Court has arguably moved away from the principles enunciated in *Hang Seng Bank* by applying an operations test as well as the assumption that profits derived from a business carried on in Hong Kong are sourced in Hong Kong.

Magna Industrial Company Limited

In *Commissioner of Inland Revenue* v *Magna Industrial Company Limited* (1997) HKRC ¶90-082 the Court of Appeal confirmed that the Board of Review, applying an "operations test", had been correct in finding that profits derived by Magna from the sale of its products overseas, through a network of independent contractors, were not Hong Kong-sourced and therefore not assessable to profits tax.

Magna had carried on a trading business in Hong Kong. Its products were sourced from overseas manufacturers and stored in Hong Kong by its wholly-owned subsidiary, A Ltd. Overseas sales of the products were made by a network of export managers appointed in the taxpayer's overseas sales regions. The export managers appointed distributors and sales were made when the export managers signed contracts, as the taxpayer's agents, with the distributors as purchasers. When orders were received, the taxpayer would purchase products from A Ltd and stock would be shipped from A Ltd's warehouse to the overseas distributors. The taxpayer received payments in Hong Kong, profits from which were assessed to profits tax by the Inland Revenue.

At the first stage of appeal the Board of Review had adopted an "operations test" approach, looking at the "totality of facts" to determine whether Magna's profits arose in Hong Kong (see *Case* E63 (1995) 1 HKRC ¶80-360 (*D10/95*)). In its case stated, the Board indicated that in determining the *Magna* case, its deliberation included not only the purchase and sale of products but also all of the relevant facts. According to the Court of Appeal, no criticism could be made of that approach.

Based upon the total facts, the Board concluded that sale of products through the network of overseas contractors was the most important factor and the source from which the profit arose. Although certain activities took place in Hong Kong, such as invoicing, shipping, collecting payment, etc, they were ancillary and not the true source of the profit. The Court of Appeal upheld this finding as sustainable

The Inland Revenue Department assessed the profits arising from the taxpayer's lending transactions to tax. On appeal, however, the Board of Review found that what the taxpayer had done, to earn the profits in question, had been done in New York, Frankfurt and Tokyo, the places where the money was lent, and that, accordingly, the taxpayer's profits were not sourced in Hong Kong (see *Case* B46 (1992) 1 HKRC ¶80-207 (*D21/92*)). The Court of Appeal upheld this finding (see *Orion Caribbean Limited (in voluntary liquidation)* v *Commissioner of Inland Revenue* (1996) HKRC ¶90-077). However, on final appeal, the Privy Council found that the profits of the taxpayer in fact arose from or were derived from Hong Kong.

The taxpayer had relied on Lord Bridge's comments in *Hang Seng Bank*, contending that where income was interest on a loan the source of the loan was located in the place where the money was advanced. The Privy Council, however, rejected the taxpayer's interpretation and application of Lord Bridge's statement in the present case. There were several difficulties, including:

- First, the taxpayer's argument gave Lord Bridge's words a broader meaning than they naturally bore. His reference to "property assets" in relation to the lending of money might have been intended to refer simply to the exploitation of money owned by the taxpayer. If Lord Bridge was intending to cover a case, such as the taxpayer's, where money must be borrowed before it can be lent, it would be surprising if he were suggesting that regard should be had solely to the place of lending to the exclusion of the place of borrowing; and
- Second, the proposition that Lord Bridge was laying down a rule of law to the effect that, in the case of a loan of money, the source of the income was always located in the place where the money was lent, could not stand with his earlier statement that whether a profit arose in or was derived from a place was a question of fact.

The view of the Privy Council was that the taxpayer's business was the borrowing and on-lending of money with a view to a profit but the borrowings and on-lendings were carried out by its Hong Kong parent company, ORPL. What the taxpayer did to earn the profit was to allow itself to be interposed between ORPL and the ultimate borrowers by allowing itself to be used as a channel for funds raised or provided by ORPL and passed through to the ultimate borrowers. The present case was far removed from the simple loan transaction contemplated by Lord Bridge in the *Hang Seng Bank* case.

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Inland Revenue Department's assessing practices

DIPN No 21 (Revised) (para 53–54) sets out details of how the Inland Revenue Department views interest and related fee income of financial institutions for profits tax purposes.

Interest from loans:

- Offshore loans initiated, negotiated, approved and documented by an associated party outside Hong Kong and funded outside Hong Kong, albeit through or in the name of the Hong Kong institution — 100% non-taxable;
- Offshore loans initiated, etc by a Hong Kong institution and funded by it in or from Hong Kong — 100% taxable;
- Offshore loans initiated, etc by an associated party outside Hong Kong but funded by the Hong Kong institution — 50% taxable; and
- Offshore loans initiated, etc by a Hong Kong institution but funded by offshore associates (where the Hong Kong institution is starting up and has yet to establish a market presence) — 50% taxable.

When loans are funded by offshore associates two requirements must be fulfilled for an offshore claim to succeed:

(i) the Hong Kong institution should not have the authority to seek its own source of funds for the loans; and

(ii) there should be documentary evidence showing that the funds have been provided by an offshore associate even though they may have been routed through another vehicle in Hong Kong.

Interest on Certificates of Deposit (CDs)

CDs are treated similarly to deposit placements and are distinguishable from loans. Interest on CDs is 100% taxable on the basis that a Hong Kong institution would operate within previously approved parameters as to credit limits and prime banks with which it may operate.

Interest from securities other than CDs

It is treated similarly to interest from loans. If the interest is to be attributed to offshore intervention, the role of the Hong Kong institution must be that of a mere intermediary with no discretion in the matter of purchasing or selling securities. An exemption from tax is unlikely to be granted when the Hong Kong institution has active security-dealing capabilities.

In *Commissioner of Inland Revenue* v *Quitsubdue* (1999) HKRC ¶90-099, the Court of First Instance also found that the *Sharkey* rule did not apply. The taxpayer was a company that had purchased two properties. These were not disposed of, but were redeveloped into a new commercial building which was subsequently let out. During the redevelopment, the company underwent two changes in shareholdings.

The Commissioner ruled that there had been a change in intention, from that of holding the properties as trade stock to that of holding them as a long-term investment. The principle in *Sharkey* v *Wernher* (1955) 36 TC 275 was applied and an additional profits tax assessment was raised on the notional profit calculated as the difference between the cost and the market value of the properties as at the date of the change in intention.

The Court distinguished the circumstances of the case from those of *Sharkey v Wernher*. It pointed out a principle that a person cannot trade with himself and, therefore, cannot make a profit out of trading with himself. When a supplier supplies himself with a commodity, he is not trading with himself but is withdrawing commodity from his stock-in-trade. Instead of crediting the trading account with the market value of the commodity at the time of supply, the taxpayer should pay back whatever he deducted from his trading account as expenses for that commodity.

In *Nice Cheer Investment Limited* v *Commissioner of Inland Revenue* (2011) HKRC ¶90-240 (¶6-3030), the Court of First Instance interpreted the word "trade" of the charging section under sec 14(1) as "... buying and selling or exchange of commodities for profit between two parties to a commercial transaction". The judge considered that the Sharkey rule was not relevant since the idea that a person could trade with himself was inconsistent with the meaning of the word "trade" under the legislation. In a further appeal in *Commissioner of Inland Revenue* v *Nice Cheer Investment Limited* (2012) HKRC ¶90-248, the Judge of the Court of Appeal considered that the focus of the case is on the trading investment/securities retained by the taxpayers, not transacted and it is not necessary to discuss the application of the principle in *Sharkey v Wernher*. When the case was heard in the Court of Final Appeal, the issue was not raised and hence not discussed (*Nice Cheer Investment Limited v CIR* (2013) HKRC ¶90-252).

Sharkey rule not applicable to "transfer of offshore company" which was an adventure of trade

In *Case* L6 (2002) HKRC ¶80-807 (*D142/00*), the transaction in question involved the only issued share in an offshore company,

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Company J (the J Share). The taxpayer had sold the J Share for substantial consideration and the Commissioner sought to tax the net surplus on the basis that the acquisition and disposal of the J Share amounted to an adventure in the nature of trade.

The underlying transactions involved the B and D groups of companies which entered into a joint venture to purchase and redevelop several plots of land (the Site). The taxpayer belonged to the B Group. Company G was the joint venture company which purchased and owned the Site. Company G had two wholly issued shares. The taxpayer's subsidiary, Company H, held one of the Company G shares and Company C held the other for the D Group.

A few months later, the D Group took over 100% beneficial interest in the Site by acquiring the 50% beneficial interest of the B Group in the Site by a 'Transfer Mechanism'. This started by the taxpayer acquiring the J Share. Three events then followed. Firstly, Company G allotted to each of Company J and Company C 4,999 new shares at their par value of $1. Company H held one share in Company G. Secondly, Company H's single share in Company G was transferred at par value of $1 to Company J. Company J thus held 5,000 shares in Company G, which represented 50% of Company G's issued shares. Thirdly, there was a Disposal Agreement where the taxpayer transferred the J Share to Company C for a consideration of $141,352,731. The Revenue sought to tax the net surplus of $137,576,471. The taxpayer objected to the assessment. The Commissioner rejected the taxpayer's objection and confirmed the assessment. The taxpayer appealed to the Board of Review.

The issue for the Board was whether the net surplus of $137,576,471 from the sale of the J Share was assessable to the taxpayer.

Firstly, the taxpayer submitted that it did not trade in the J Share. Secondly, the taxpayer argued that even if it did trade, there was no profit. The taxpayer relied on the principle of *Sharkey v Wernher* and argued that the existing value of an investment had to be deducted in computing any taxable trading profit. In other words, the taxpayer submitted that the value of the 'gift' (of the 50% shareholding in Company G) given to Company J had substantially increased Company J's value and such value should be deductible from the assessable profit earned in the disposal of Company J. Alternatively, the taxpayer argued that the J Share was incapable of being traded or sold until it was made valuable by, essentially, the injection of the new Company G share allotments. Hence, at the time Company J became tradable, its increased value (the consideration paid for the transfer of the J Share) must be the starting point in the calculation of assessable profits. The taxpayer submitted that there was no

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¶6-4140 Methods for determining derived profits

Two commonly accepted methods for ascertaining a taxpayer's derived profits are:

(i) *The cash receipts basis*: under which income is regarded as having been derived when cash, or something capable of being turned to cash, has been received; and

(ii) *The accruals or earnings basis*: under which income is regarded as arising or being derived as it is earned. This is normally when the performance of the obligations which give rise to the income has been completed — eg when goods sold are delivered; when services have been performed; or when rent or interest is due.

The Inland Revenue Department normally requires the accruals or earnings basis to be applied when assessable derived profits are being computed. The cash basis method is only acceptable in special circumstances.

¶6-4180 Income from trade or the performance of services

Assessable income derived from trading or the performance of services is calculated on an accruals or earnings basis (see ¶6-4140). This means that a taxpayer's trading or service income only arises, and only becomes assessable, when all the events have occurred which fix the taxpayer's right to receive it — for example: when sale goods have been delivered by the taxpayer to a purchaser, or when the taxpayer has fulfilled the terms of a service contract (see *FC of T* v *Australian Gas Light Co & Anor* 83 ATC 4800).

Trading or service income does not need to have been received in order to have arisen or to have been derived by a taxpayer. It is enough that the payment in question has become due to the taxpayer. The opposite, however, does not apply. Trading or service income which is received by a taxpayer before it is due or earned, and is refundable, is not regarded as having been derived by the taxpayer and is consequently non-assessable (until the assessment period in which it becomes due). Thus, amounts received in advance for specific services or the supply of goods, are not assessable until such time as they are earned — that is, when the service is performed or the goods supplied (*Arthur Murray (NSW) Pty Ltd* v *FC of T* (1965) 14 ATD 98).

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¶6-4220 Professional income

It is a standard Inland Revenue Department practice to compute income derived from a profession on an accruals basis (see ¶6-4140). It is regarded as arising or as being derived as it is earned. The cash basis (see ¶6-4140) is applied in the special cases of barristers, who cannot sue for their fees, and professional practices which have previously been assessed on a cash basis.

¶6-4260 Gains from property sales

Profits from the sale of property, including those derived by a property developer, are normally regarded as arising when the contract can be completed by performance and the purchaser can be given possession, that is, when the occupation permit is issued. This is notwithstanding that payments may be received before the building is complete (DIPN No 1 (Revised), Pt B para 17).

This view is consistent with HK-INT 3 issued by the Hong Kong Institute of Certified Public Accountants in May 2005. For pre-completion contracts entered into prior to the effective date of HK-INT 3 and with profits already recognised under the stage of completion method, the developers could continue to account for these contracts using the percentage of completion method or by restating the prior year profits through equity accounts (DIPN No 1 (Revised), Pt B para 19).

The first method will not have any taxation consequence while the following assessing practice will apply regarding the second method (DIPN No 1 (Revised), Pt B para 20):

(a) Profits derecognised will not be allowed for deduction as expenses in the current year (profits derecognised are not expenses);

(b) Profits derecognition does not arise from a change of valuation of trading stock (the valuation remains the lower of cost or net realisable value);

(c) Back year assessments will not be reopened under sec 70A because back year returns did not contain any error or omission; and

(d) Profits assessed under the stage of completion method but derecognised on the adoption of HK-INT 3 will not be assessed again in subsequent years (presumption against double taxation).

In respect of the sale of properties under instalment terms, HKAS 18 provided that the developers may either recognise sales in full at the

on unusual terms. The taxpayer had been involved in providing finance to other members of a group of companies for purchasing properties. Among other things: loans were effectively given to the other companies, which never independently requested them; the relevant rate of interest was arbitrarily set by the director of the holding company of the group; and each loan constituted 100% of the purchase price of the relevant property. There was no continuity in the taxpayer's business transactions, no turnover of capital and the interest earned by the taxpayer was minimal.

For the relevant year of assessment the taxpayer had made provision for bad or doubtful debts based on the net-asset value of the borrowers' year-end assets. However, a deduction for the amount of bad debts was denied by the Inland Revenue and on appeal to the Board of Review the taxpayer was unsuccessful.

According to the Board, although the bad debts had been incurred in respect of money lent they were not deductible because: the loan transactions were not transactions that would have been carried out by a money-lender in the ordinary course of the business of lending money; and considering the various *indicia* of a money-lending business, the taxpayer had not in fact been carrying on that business in the years in question.

However, in *Case* 164 (1999) HKRC ¶80-633 (*D153/98*), the taxpayer held a money-lending business and had documentary evidence to support its advance to its related company whose business failed subsequently. The Board of Review held that the advance represented a genuine loan made in the course of money-lending. Therefore, the provision for bad debt is deductible.

Subsequent recovery of bad debt

When a deduction has been allowed for a bad debt and the bad debt is subsequently recovered, the sum recovered is assessable as a trade receipt in the period in which it was recovered (sec 16(1)(d), proviso (ii)).

DEDUCTION FOR REPAIR AND REPLACEMENT COSTS

¶6-5180 Repair expenditure

Expenditure incurred in the repair of any premises, plant, machinery, implement, utensil or article which is employed in the production of assessable profits is deductible (sec 16(1)(e)). The expenditure must have been incurred by the taxpayer. No deduction

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is available where repair costs are paid by another person (eg a tenant).

The meaning of "repair"

The Ordinance does not define the term "repair". It is necessary to refer to case law for interpretation of the concept. A distinction is drawn between repairs and improvements, additions or the reconstruction of premises or equipment in its entirety. Expenses incurred in undergoing the latter processes are capital in nature and, therefore, non-deductible (see ¶6-6120). Depreciation allowances, however, may be granted (refer to Chapter 7 at ¶7-0100ff).

The courts give "repair" an ordinary, rather than a technical meaning. The *Shorter Oxford English Dictionary* defines "repair" as follows:

> "To restore (a composite thing, structure etc) to good condition by renewal or replacement of decayed or damaged parts, or by refixing what has given way; to mend … To restore to a fresh or sound condition by making up in some way for previous loss, waste, decay or exhaustion …"

This definition identifies two central attributes of a "repair":

- the item must have been restored to its previous condition (improvement or expansion is not "repair"); and
- the relevant item must have been in need of restoration (work performed on sound premises or equipment is not "repair").

These are the attributes which courts normally look for when determining whether a taxpayer had incurred deductible expenditure on repairs.

In *W Thomas & Co Pty Ltd* v *FC of T* (1965) 115 CLR 58 it was stated that repair involves a restoration of a thing to a condition it formally had without changing its character. It was held that in the case of an item considered from the point of view of its use as distinct from its appearance, it is the restoration of efficiency in function, rather than the exact repetition of form or material, that is significant.

In *Lurcott* v *Wakely and Wheeler* (1911) 1 KB 905 the Court found that a repair involves replacement or renewal of a part of an item, not the entire item (the "entirety"). By "entirety" the Court meant not necessarily the whole item but *substantially* the whole subject matter under discussion. Other repair cases reflect this view. The replacement of substantially the whole of a slipway in a shipyard, for instance, was regarded as the replacement of an "entirety" and therefore not a "repair" in *Lindsay* v *FC of T* (1961) 12 ATD 505. The cost of the replacement was consequently non-deductible.

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If there is no active partner resident in Hong Kong, the Hong Kong manager or agent of the partnership must furnish the return.

¶6-7220 Determining tax liability of partnership

In normal circumstances the profits tax liability of a partnership is calculated by applying the standard tax rate (in the case of a partnership of individuals), or the corporate tax rate (when the partnership is comprised of corporations), to the total assessable profits of the partnership as calculated under Pt IV of the Ordinance and shown in the partnership's return.

When a partnership is comprised of both individuals and corporations (to which a higher tax rate applies), or if some partners have losses to carry forward from previous assessment years, the partnership's tax liability is calculated by determining the tax liability of each partner individually.

A partner's individual tax liability is calculated by:

(i) apportioning the partnership's assessable profits between each of the partners in the ratio in which the profits or losses of the basis period were divided (sec 22A(1));

(ii) deducting any losses carried forward from previous years under sec 19C (sec 22A(2)); and

(iii) applying the appropriate tax rate according to whether the relevant taxpayer is an individual or a corporation (see ¶6-9100 for tax rates).

An individual partner's share of a partnership's assessable profits must also be determined when that partner elects personal assessment. Again, the partner's share is determined by an apportionment of the partnership's assessable profits in the same ratio as the profits and losses were divided during the basis period.

No deductions can be made from a partnership's profits for:

(i) salaries or other remuneration paid to a partner or a partner's spouse;

(ii) interest payable on capital or loans provided by a partner or a partner's spouse (sec 17(2)); or

(iii) contributions in excess of the amount specified in Sch 3B of the *Inland Revenue Ordinance* paid to a mandatory provident fund scheme in respect of a partner or a partner's spouse (sec 16AA). The adjustment to monthly deduction is passed under *Inland Revenue (Amendment) Ordinance 2012*. The deduction ceiling for contributions made to recognised retirement

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schemes, including the Mandatory Provident Fund Schemes is as follow (Sch 3B):

For the years of assessment 2000/01 to 2011/12	HK$12,000
For the year of assessment 2012/13	HK$14,500
For the year of assessment 2013/14	HK$15,000
For the year of assessment 2014/15	HK$17,500
For the year of assessment 2015/16 and onwards	HK$18,000

These amounts therefore form part of a partnership's profits for tax purposes.

Restriction of limited partner loss relief

To limit tax avoidance, particularly through leveraged leasing arrangements (see further ¶7-4400), the amount of loss that a limited partner may set off against his or her assessable profits is restricted, notwithstanding sec 19C. The amount of loss which may be set off is limited to the lesser of:

- the amount of the loss; or
- the amount of the limited partner's contribution to the partnership at the end of the relevant assessment year, or at the time when he or she ceased being a partner, as the case may be (the "relevant sum") (sec 22B(3)).

Any excess loss which is not set off is carried forward in the partnership and may be set off against future assessable profits of the partnership: it is not available for set off against the limited partner's other assessable profits in subsequent years (DIPN No 15 (Revised), Pt A).

For the purposes of sec 22B, a "limited partner" is defined as a partner in a partnership carrying on a trade, profession or business in Hong Kong who is either:

- a limited partner in a partnership registered under the *Limited Partnerships Ordinance*;
- a general partner not involved in the partnership's management, but entitled to have the liabilities which he or she incurs in connection with the partnership wholly or partly discharged or reimbursed by another person; or
- a person who, under the law of a foreign territory, is not involved in the partnership's management and is not liable beyond a certain limit for debts or obligations incurred by the partnership (sec 22B(1)).

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(ii) the *Securities and Futures Ordinance* for the years of assessment commencing on or after 1 April 2003. A corporation licensed under Pt V sec 116 and 117 of the *Securities and Futures Ordinance* or an authorised financial institution registered under Pt V sec 119 of the *Securities and Futures Ordinance* to carry on the regulated activity of dealing in securities and advising on securities or asset management, will qualify.

If the required conditions set out below are satisfied, a broker or an approved investment adviser is deemed not to be an agent in respect of the profits arising from transactions carried out through the broker or approved investment adviser (referred to as "taxable profits").

Conditions required to be satisfied

The primary concern is that the parties involved are acting on an arm's length basis. The following conditions must be satisfied in order for a broker or an approved investment adviser to be deemed not to be a taxable agent in relation to "taxable profits" arising from a transaction carried out for a non-resident person:

(i) At the time of the transaction, the broker or approved investment adviser must have been carrying on the business of a broker or an approved investment adviser.

The person concerned need not be carrying on business exclusively as a broker or an approved investment adviser. It is acceptable for the relevant activities to form part of a wider business (DIPN No 30 (Revised), para 10(a), 12(a)).

(ii) The transaction must have been carried out for the non-resident person as part of the ordinary day-to-day business activities of the broker or approved investment adviser.

This requirement will not be satisfied if a transaction has unusual features which make it stand out from the common flow of business of the broker or approved investment adviser, or if it reflects a special relationship with a client. One such instance would be where a transaction is carried out in respect of a discretionary account.

It is not necessary for the broker or investment adviser to personally carry out the transaction. He or she may give instructions for it to be carried out by another broker (DIPN No 30 (Revised), para 10(b), 12(b)).

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In respect of the investment adviser:

(a) for the years of assessment up to and including 2002/03, the Revenue will accept that this requirement is satisfied where a transaction has been carried out in the course of or in relation to activity of a kind referred to in para (c) of the definition of investment adviser in the *Securities Ordinance* and the other requirements of sec 20AA(3) are satisfied;

(b) for the years of assessment commencing on or after 1 April 2003, the transaction must fall within Type 4 (advising on securities) or Type 9 (asset management) or Pt 1 of Sch 5 (Regulated Activities) of the *Securities and Futures Ordinance*. The meaning of asset management in that Schedule includes securities or futures contracts management.

(iii) The remuneration received by the broker or approved investment adviser for providing services to the non-resident person must have been calculated at a rate no less than the customary rate of remuneration for the class of business;

The Department will consider whether the remuneration arrangements are in line with those generally acceptable within the industry at the relevant time, given the nature of the transaction involved, to determine if this requirement has been met. Provided that the terms are not abnormal, incentive or performance fees are acceptable (DIPN No 30 (Revised), para 10(c), 12(c)).

(iv) The non-resident person must not have been treated as having the broker or approved investment adviser as his or her agent in relation to other chargeable profits.

This requirement would not be satisfied during the year of assessment under consideration if, apart from acting as a broker or an approved investment adviser, the person concerned also acted as an agent of the non-resident in some other capacity through which the non-resident derived chargeable profits.

However, the non-resident may derive chargeable profits through other agents in Hong Kong without it affecting the application of sec 20AA in respect of the broker or approved investment adviser (DIPN No 30 (Revised), para 10(d), 12(d)).

Where the relevant activities constitute only part of a business, sec 20AA is only applicable to that part as a separate

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BALANCING ALLOWANCES AND CHARGES

¶7-5000 Balancing allowances and charges

The aim of the capital allowances scheme set out in Pt VI of the Ordinance is to spread tax relief for capital expenditure incurred on the construction of an industrial or commercial building, or the provision of machinery or plant, over the life of the relevant asset until the residue of the capital expenditure originally incurred is exhausted.

To ensure that the depreciation allowances granted to a taxpayer in each year of assessment are related to a realistic residue of expenditure, balancing allowances are granted and balancing charges made. The former make up for shortfalls in allowances should a building, structure, plant or machinery be disposed of for an amount less than the residue. The latter adjusts the position when an asset is disposed of for an amount which exceeds the residue.

¶7-5100 Balancing allowances and charges for commercial or industrial buildings and structures

A balancing allowance or charge arises in relation to a commercial building or structure, or an industrial building or structure (see ¶7-0300 and ¶7-1200) when one of the following occurs:

- the relevant interest (see ¶7-0700 and ¶7-1200) in the building or structure is sold;
- the relevant interest is a leasehold interest which has come to an end otherwise than by the leaseholder acquiring the reversionary interest; or
- the building or structure is demolished or destroyed, or ceases to be used (sec 35(1)).

Balancing allowance

A balancing allowance arises when one of the above events occurs, and the residue of the capital expenditure incurred in constructing the building or structure exceeds the amount of money received from its sale, or from any insurance, salvage or compensation payments received (sec 35(2)).

The balancing allowance granted is equal to the excess and is deductible from the taxpayer's assessable profits (sec 18F). No balancing allowance is granted, however, if the relevant building or structure is demolished for purposes unconnected with, or not in the ordinary course of, the trade, profession or business for which it was used (proviso to sec 35(1)).

The Board held in *Case* M68 (2003) HKRC ¶80-933 (*D26/02*) that it is the dollar value of sale moneys that matters in sec 35(2) and 35(3) and the sale moneys referred to in these sections should have the same meaning as "sale price of such assets" in sec 38B. The Board also held that how the sale moneys are satisfied is not relevant and there is no requirement in sec 35 of the receipt of any sale moneys.

Balancing charge

A balancing charge arises when the amount of any sale, insurance, salvage or compensation money received by the taxpayer exceeds the amount of the residue of expenditure immediately before the sale or destruction of the building or structure occurred (sec 35(3)). The balancing charge imposed is normally equal to the excess. If the residue is nil, the charge is equal to the amount of money received. The amount of a balancing charge, however, may not exceed the aggregate of any initial or annual allowances already paid to the taxpayer for the building or structure (sec 35(3)(b)). Balancing charges are added to the taxpayer's assessable profits (sec 18F).

Example — Balancing allowances and charges for an industrial building or structure

Mr P owns an industrial building which he uses for his business. His accounts are made up to 31 December. The building was constructed by him in 2006 at a cost of $100,000. After the deduction of the 2013/14 annual depreciation allowance, the residue of the expenditure incurred on the construction of the building was $48,000. The total amount of allowances given for the property up to and including 2013/14 was $52,000 ($20,000 initial allowance; 8 × $4,000 annual allowance).

(i) If in 2014/15 the building is sold for $44,000, a balancing allowance would be granted as follows:

		$
Cost		100,000
LESS		
Allowances to 2013/14	–	52,000
EQUALS		

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information to determine their tax liability. Any person may be given notice by an assessor requiring them to furnish a return for:

- property tax;
- salaries tax;
- profits tax;
- provisional tax; or
- personal assessment (see further ¶9-0300ff).

Discretionary powers exercised by assessors, inspectors and assistant commissioners enable the Inland Revenue Department to obtain all the information it needs to determine a taxpayer's tax liability. Assessors have the power to require that fuller or further returns be furnished by a taxpayer when considered necessary (see ¶9-1300). An assistant commissioner is authorised to summon a person to attend examinations and answer questions about a taxpayer's liability (see ¶9-1400).

The Commissioner is also given powers which assist in the gathering of full information. They include:

- the power to demand from a taxpayer a statement of assets, liabilities, expenditure and incoming sums (see ¶9-2000); and
- search powers under warrant (see ¶9-2300).

Taxpayers are required to provide certain information to the Department in addition to that furnished in their returns. They are obliged to inform the Department of their chargeability to tax and of certain changes in their individual circumstances (see ¶9-1000 and ¶9-1100). Employers and public officers are also obliged to furnish specified information to the Department (see ¶9-3000). Additionally, to further assist the Department in obtaining full information about an individual's or a company's tax affairs, records are required to be kept by every person who carries on a trade, profession or business in Hong Kong or who owns land or buildings (see ¶9-4500). Failure to keep proper records is an offence.

To ensure that the Ordinance is complied with by all taxpaying organisations and individuals, obligations are imposed upon specified persons, to be responsible for the furnishing of returns and information to the Department (see ¶9-3800). Persons who are responsible for ensuring that the Ordinance is complied with include:

- executors of deceased taxpayers' estates (see ¶9-3900);
- precedent partners of partnerships (see ¶9-4000); and
- principal officers of corporations (see ¶9-4200).

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Taxpayer's duty to furnish returns

¶9-0300 Notice to furnish return

An assessor may give a notice in writing to any person requiring them to furnish a tax return for property tax, salaries tax or profits tax, or a composite return for property tax, salaries tax and profits tax (sec 51(1)). A return may be required for final tax or provisional tax purposes. When the notice is received, a return must be lodged with the Inland Revenue Department within the time limit stated in the notice (see further ¶9-0500).

A completed tax return is not acceptable without attached documents if they are among the particulars required to be furnished with the return (*Commissioner of Inland Revenue* v *Mayland Woven Labels Factory Ltd* (1975) 1 HKTC 627).

See further ¶9-0400.

A return may be furnished in paper form using a printed form, in the form of electronic record, or by using a telefiling system. In any case, the return shall contain the particulars specified by the Board of Inland Revenue and in a form, template or system made available by the Commissioner (sec 51AA).

The Inland Revenue Department has decided to suspend the electronic form for profits tax after February 2005, but has launched the "Electronic Filing of Profits Tax Return" service on 1 April 2010 for taxpayers meeting certain criteria.

A taxpayer who has elected personal assessment is given a notice by an assessor requiring him or her to furnish a return of his or her total assessable income (sec 51(2A)). When a taxpayer who has elected personal assessment is married and is not living apart from his or her spouse, the notice is given to both the husband and wife. They are required to furnish a return of their joint total assessable income (sec 51(2B)).

> For more on personal assessment, refer to Chapter 4 at ¶4-0200ff.

Return requesting declaration of income not yet accrued

A return may request a taxpayer to state details of income that will accrue during a specified future period. Such a return is not invalid (*Case* D3 (1994) 1 HKRC ¶80-253 (*D12/93*)). What is expected is only the taxpayer's best estimation of the income that will accrue. The fact that details of income not yet accrued are sought does not mean that

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directly to the Court of First Instance, bypassing the Board of Review (see ¶11-5000).

Decisions of the Court of First Instance may be appealed in the Court of Appeal. Decisions of the Court of Appeal may be appealed before the Court of Final Appeal (see ¶11-6000).

Courts structure from 1 July 1997

Following the resumption of Chinese sovereignty over Hong Kong, the final appeal court for Hong Kong cases, including tax cases, is now the Court of Final Appeal. Hong Kong cases are no longer referred to the Privy Council.

See further ¶11-3000.

¶11-0350 Who may object?

An objection may be made by any taxpayer who is aggrieved with an assessment (sec 64(1)). Other persons who may object to an assessment include the following:

- the **executor** or **administrator** of a deceased taxpayer's estate may object to an assessment raised on the taxpayer;
- a **partner** may object to an assessment raised on the partnership;
- a **participant in a joint venture** may object to an assessment raised on the joint venture;
- an **agent** taxed on behalf of a non-resident under sec 20A (see ¶6-8300), or the **non-resident** taxpayer, may object to the assessment raised under that section;
- any **resident** taxed on behalf of a non-resident under sec 20B (see ¶6-8380), or the **non-resident** taxpayer, may object to the assessment raised under that section; and
- a **spouse** who has elected for joint assessment may object to the assessment of his or her contribution to the aggregate income.

Requirements for valid objection

¶11-0600 Requirements for a valid objection

Timing

A notice of objection must be received by the Commissioner within one month after the date of the notice of assessment (sec 64(1)). The Commissioner may extend the time limit for objection if the taxpayer

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was prevented from giving notice within the required period because of absence from Hong Kong, sickness or other reasonable cause (sec 64(1)(a)).

The Board of Review does not have the power to grant an extension of time to lodge an appeal against a penalty tax assessment issued under sec 82A (*Case* N75 (2004) HKRC ¶81-051 (*D105/03*); *Case* I41 (1999) HKRC ¶80-610 (*D98/98*) and *Case* H40 (1998) HKRC ¶80-548 (*D96/97*)).

Before the 1993/94 year of assessment, in the case of provisional assessments (see ¶9-8000), an assessment was required to have been confirmed by the Commissioner before the relevant taxpayer could object to it (former sec 59A). That requirement has been repealed.

In *Yee Aik Ee* v *Commissioner of Inland Revenue* (2005) HKRC ¶90-156, the taxpayer applied to judicially review the decisions of the Commissioner of Inland Revenue in refusing to re-consider his late objections to the tax assessments. The taxpayer was the sole proprietor of Jianli Vacuum Forming Company ("Jianli"). A tax audit was conducted by the Inland Revenue Department and additional tax assessments were raised. The taxpayer offered "an additional tax liability for the years of assessment 1997/98 to 2001/02 of $2,622,171" ("the Offer") in order to bring a conclusion to the field audit.

The taxpayer subsequently changed his tax representative and objected to the assessments raised on the basis that there was a fundamental error and omission in respect of the basis of the assessments. The error stated was that the sales discrepancy found by the Inland Revenue Department was excessive. The letter further stated that the former tax representative proposed to accept a discrepancy of assessable profits, not tax liabilities, for all the years of not more than $2.6 million. The taxpayer also submitted that the Commissioner acted unreasonably in refusing to entertain his late objection in that he should have accepted that the taxpayer was unable, by reason of the mistake, to lodge the objection within the one-month period. The Court did not accept that the taxpayer had made the Offer under a mistake based on the evidence available. Since the taxpayer's case of mistake was not made out, the grounds for the application and the challenge to the Commissioner's refusal to entertain the late objection also failed.

In *Moulin Global Eyecare Trading Limited (In Liquidation) v Commissioner of Inland Revenue* (2014) HKRC ¶90-255, upon liquidation in 2006, the taxpayer's liquidators attempted unsuccessfully to object to the assessments for the years of assessment 1998/99 to 2003/14 on the grounds that the taxpayer did

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Timing of additional tax assessment

According to the Board of Review in *Case* F35 (1996) HKRC ¶80-413 (*D72/95*), the terms of sec 82A do not require that an additional tax assessment must necessarily relate to the year of assessment in which an incorrect return, statement or information was made or given by the penalised taxpayer. The penalty may be imposed in a year of assessment subsequent to the year of default when a tax undercharge occurs, or would have occurred but for detection of the taxpayer's default.

In *Case F35* (*D72/95*) the taxpayer had overstated losses in its profits tax returns for 1990/91 and 1991/92. For the 1992/93 year of assessment, the taxpayer declared assessable profits and the Commissioner issued an additional assessment under sec 82A as a penalty for the incorrect returns lodged in the two previous years.

The taxpayer unsuccessfully argued that where an incorrect return has been lodged, the Commissioner has the power to raise a penalty tax assessment only for the year to which the return relates. The Board's view was that the taxpayer had made incorrect returns and, if those returns had been accepted, tax would have been undercharged in the 1992/93 year of assessment. In those circumstances, the Commissioner was justified in imposing a penalty in that year of assessment.

¶12-6500 Appeal against assessment to additional tax

To appeal against an additional "penalty" tax assessment, a notice of appeal must be made in writing to the Clerk of the Board of Review accompanied by:

- a copy of the notice of assessment;
- a statement of the grounds of appeal;
- a copy of any notice to assess additional tax; and
- a copy of any written representations made (sec 82B(1)).

If the Board is satisfied that an appellant was prevented by illness, absence from Hong Kong or other reasonable cause from giving the notice of appeal, the Board may extend, for such period as it thinks fit, the time within which the notice of appeal may be given (sec 82B(1A)).

A notice of appeal which did not enclose a copy of the notice of intention to assess additional tax under sec 82A(4) was held to be invalidly given and out of time in *Case* O78 (2005) HKRC ¶81-134

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(*D48/05*). The Board considered that on the true construction of sec 82B(1), a valid notice of appeal must be accompanied by all the requisite documents under the section. A failure to comply with the section was not a mere irregularity but would render a notice of appeal ineffective. The Board was also not satisfied that the taxpayer was prevented by any reasonable cause from giving the notice of appeal in accordance with sec 82B(1A). The Board in *Case* R10 (2008) HKRC ¶81-228 (*D16/07*) disagreed with the Board in *Case O78* on jurisdiction and held that the Board had the jurisdiction to extend time for a taxpayer to submit the specified accompanying documents under sec 82B(1).

It is open to the taxpayer to argue:

- that he or she is not liable to additional tax;
- that the amount of additional tax exceeds the amount for which he or she is liable under sec 82A (more than treble the tax undercharged; see ¶12-5800); or
- that the amount of additional tax, although within that chargeable under sec 82A, is excessive having regard to the circumstances (sec 82B(2)).

The Board of Review has no power to review the Commissioner's decision to invoke sec 82A and impose additional tax. A taxpayer, appealing against an additional assessment, raised against him for the late submission of a return, submitted to the Board that the Commissioner had rarely invoked sec 82A to penalise late returns. It was claimed that the taxpayer had a reasonable expectation that only an administrative penalty would be imposed. The Board, in rejecting the taxpayer's arguments, stated that the Board of Review has no power to review the exercise of the Commissioner's discretion (*Case* A89 (1991) 1 HKRC ¶80-089 (*D58/90*)). Also, the Board has no jurisdiction over the payment terms of additional tax (ie instalments or a lump sum) (*Case* K40 (2001) HKRC ¶80-771 (*D75/00*)).

In *Case* I65 (1999) HKRC ¶80-634 (*D154/98*), the Commissioner issued a second assessment for additional tax after the Board of Review held that the first penalty assessment was invalid. The taxpayer appealed to this and the Board held that the decision to the earlier appeal was final and not permissible for the Commissioner to penalise the taxpayer for the same fact.

The rights of appeal to the Board of Review and to the courts (see ¶11-3000ff) also apply to additional tax assessments (sec 82B(3)).

Public officers and bodies corporate are prohibited to file, register, or in any way act upon an instrument which has not been duly stamped or endorsed by the Collector. Persons who fail to comply with this prohibition incur a level 2 penalty (see ¶600) which is recoverable by the Collector as a civil debt (sec 15(2)). When a public officer is required to act upon, file, or register a copy or duplicate of such an instrument, the officer is empowered to call for the original, or other evidence, to show that the original has been duly stamped (sec 15(4)).

SPOILED, MISUSED OR UNWANTED STAMPS

¶14-5500 Allowance for spoiled stamps

Subject to the production of the necessary evidence, the Collector is obliged to make an allowance for inadvertently spoiled stamps or stamp certificate rendered unfit for the purpose intended in the following circumstances:

- where a stamp on any material is spoiled, obliterated or otherwise rendered unfit for use before the material bears a signature, or before any instrument written on it has been executed (sec 48(1)(a));
- where an adhesive stamp is spoiled or rendered unfit for use and has not been affixed to any material (sec 48(1)(b));
- where a stamp is used for, or a stamp certificate is issued in respect of, an executed instrument which afterwards:
  - is found to have been absolutely void from the beginning;
  - is found to be unfit for the purpose intended due to an error or mistake therein;
  - has not been made use of, and due to the inability or refusal of a necessary party to sign the instrument or to complete the transaction according to the instrument, is incomplete and insufficient for the purpose for which it was intended;
  - fails or becomes void due to the refusal of any person to act under the instrument, or for want of registration thereof within the time required by law;
  - is inadvertently spoiled and in lieu thereof another instrument is made between the same parties, executed, and duly stamped; and
  - becomes useless as a consequence of the relevant transaction being effected by some other duly stamped instrument (sec 48(1)(c)).

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In order to qualify for an allowance, an application must be made within two years after the stamp has become spoiled or unfit for use (sec 48(2)(a)). An allowance is only granted, in the case of an executed instrument, if no legal proceeding has been commenced in which the instrument could, or would have been offered in evidence. Additionally, if the Collector so requires, the instrument must be given up to be cancelled (sec 48(2)(b)).

¶14-5580 Allowance for misused stamps

When an instrument has been stamped or issued with a stamp certificate but is not chargeable with stamp duty, or an instrument has been inadvertently stamped or issued with a stamp certificate for a greater value than required, the stamp may be cancelled and allowed as spoiled, and an allowance may be made by the Collector under sec 48 (see ¶14-5500). The person who first executed the relevant instrument must apply to the Collector for the allowance within two years after the date of its execution (sec 49).

An application in respect of a stamp certificate inadvertently issued shall be made by the person who can prove to the satisfaction of the Collector that the stamp duty to which the stamp certificate relates was paid by him or her.

¶14-5660 Allowance for unwanted adhesive stamps

The Collector may, upon application, make an allowance for adhesive stamps purchased from the Collector's office and returned unused, provided that the stamps are not spoiled or rendered useless (sec 50). An allowance is only made if:

- the adhesive stamp is delivered to the Collector; and
- the Collector is satisfied that the adhesive stamp was purchased at the Collector's office no more than two years earlier with the *bona fide* intention that it would be used (sec 50(a) and (b)).

¶14-5740 Making allowance for spoiled, misused or unwanted stamps

Where an allowance is made for stamps, adhesive stamps or stamp certificates, the Collector, may:

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