香 港 稅 務 學 會
THE TAXATION INSTITUTE OF HONG KONG

CTA
註 冊 稅 務 師
Certified Tax Adviser

Hong Kong Tax Updates

New Legislation

Inland Revenue (Amendment) Bill (No.5)

This bill was passed on 14 Nov 2018. The new legislation:

(1) allows husband and wife to elect personal assessment separately;

(2) granting tax deduction for capital expenditure incurred for procuring environmental protection installations in full in one year instead of over five years; and

(3) enhancing tax exemption for debt instruments under the Qualifying Debt Instrument (QDI) Scheme.

Inland Revenue (Amendment) (No.7) Ordinance

The amendment ordinance was gazetted on 2 Nov 2018. For research and development expenses incurred on 1 Apr 2018 and thereafter, they are classified into Type A and Type B. Type A expenditure qualifies for 100% tax deduction. For Type B expenditure, the deduction is 300 per cent for the first $2 million of the aggregate amount of payments made to "designated local research institutions" for "qualifying R&D activities" and expenditures incurred by the enterprises for in-house qualifying R&D, and 200 per cent for the remaining amount. There is no cap on the amount of deduction.

Inland Revenue (Amendment) (No.6) Ordinance

Double taxation relief under salaries tax is amended:

(1) S.8(1A)(c) (exemption of income derived from services rendered in a country outside HK if the taxpayer can prove that he has paid tax in that country) does not apply to services rendered in a country which has a comprehensive double taxation agreement (CDTA) with HK ("DTA Country"). A taxpayer who has paid tax in a DTA Country can claim tax credit for HK tax purposes under s.50.

(2) Relief under s.8(1A)(c) or tax credit under s.50 must not exceed the relief that may be allowed to a taxpayer had the taxpayer taken reasonable steps to minimise his tax liability under the law of the foreign country or the CDTA concerned.

Inland Revenue (Amendment) Bill (No.4)

This bill was passed on 31 Oct 2018. The amendment allows deduction for salaries tax and personal assessment purposes to taxpayers who purchase eligible health insurance products for themselves or their spouses, children, parents, grandparents and siblings under a Voluntary Health Insurance Scheme (VHIS), starting from April 1, 2019. The deduction is up to $8,000 per person in respect of premiums paid.

Hong Kong Tax Cases

Koo Ming Kown & Murakami Tadao v CIR HCIA1/2017

A director who signed the returns of a company which were held to be incorrect was found by the High Court to be not liable to penalty under s.82A

As directors, Mr. Koo and Mr Murakami signed the tax returns of Nam Tai Trading Company Ltd ("the Company") in which the Company claimed deductions of management fees paid to its parent company. Upon a tax audit, the management fees were disallowed as failing to fulfill s.16 and s.17. The CIR also applied s.61 and s.61A to disallow the expenses. On appeal, the Board upheld the assessments (*D41/08)*. The Company failed to pay the tax and was wound up. The CIR assessed Mr. Koo and Mr. Murakami to additional tax under s.82A. The two directors appealed to the Board under s.82B. The Board dismissed their appeals and substituted a higher penalty than those imposed by the CIR (*D32/16* for Mr Koo *and D33/16* for Mr. Murakami):

140% of tax undercharged for Mr Koo:

(a) starting point 100% (relying on *D118/02*)

(b) 50% for setting up the tax avoidance scheme (non-remorseful and uncooperative)

(c) deduction of 5% for the accounting records which enabled identification of the issue

(d) deduction of 5% for the disclosure of the transactions with non-residents in the profits tax returns and tax computations.

90% for Mr Murakami:

(a) starting point 100% (relying on *D118/02*)

(b) deduction of 5% for the accounting records which enabled identification of the issue

(c) deduction of 5% for the disclosure of the transactions with non-residents in the profits tax returns and tax computations.

In addition, the Board ordered, for both directors, commercial interest compounded monthly on the tax undercharged.

Both directors appealed to the High Court, Court of First Instance on various questions of law. In summary, their challenges were:

(1) that a director who signed a return of the company which turns out to be incorrect is not liable to penalty under s.82A(1)(a) for submission of incorrect returns;

(2) that they could challenge the assessments against the Company notwithstanding s.70 which is only final and conclusive between the IRD and the Company, the director not being parties to the appeal proceedings. It was open to the directors to argue that the returns were not incorrect;

(3) that the directors have reasonable excuse;

(4) that the Board fettered its discretion by adopting and relying upon the Penalty Policy of IRD.

The High Court judge ruled in favour of the Appellants on s.82A(1)(a):

(1) It was the Company which made the returns, not the directors albeit the making was done through physical steps undertaken by human beings i.e. the directors. Counsel for the directors relied on *Tesco Supermarkets Ltd v Nattrass* [1972] AC153 that the directors were acting as the Company and were an embodiment of the Company.

(2) Assuming that the returns were incorrect because they understated the assessable profits in respect of which the Company was "required" by s.51(1) of the IRO to make returns, the directors were not so "required". Although a director is answerable to do all acts required to be done by the company (s.57(1)), being made "answerable" is not equivalent to being required to make a return on behalf of another person for the purpose of s.82A(1)(a).

(3) Despite s.51(5) which deems a person signing a return to be cognizant of all matters therein, s.82A does not make such cognizance a condition of liability. The function of the second limb of s.51(5) is to relieve the CIR or the prosecution of having to prove such knowledge in the case of a criminal prosecution for tax evasion but does not thereby render the directors liable for penalty under s.82A(1)(a).

The High Court judge considered that the finality of s.70 only applies as between the IRD and the Company, not to the directors. Even if s.70 does apply to the directors, it means that the amounts of the assessable profits are binding on the directors, not the basis upon which they were arrived at. Since the CIR applies s.61A to disallow the expenses, it would still be legally open to the directors to argue that the tax returns were not incorrect i.e. the expenses were allowable under s.16 but for the exercise of s.61A.

On the question of reasonable excuse, both directors alleged that they relied on professionals in the Company and the external auditors for accuracy of the returns. The Board found that there was no evidence that at any time Mr Koo took any steps to check, confirm or ensure that the tax department of the external auditor had all the necessary instructions, information or documents to form a view as to the true nature of the fees in question. Without ensuring that for those working for him in the implementation and in the preparation of the tax computation, as well as for those external advisors involved in the tax return preparation, they all knew what actually took place and agreed that the structure as implemented actually works, there was no reasonable excuse to make the returns in question in the way they were made. The High Court judge did not overturn the view of the Board on this question.

On the quantum of penalty, the High Court judge also did not disturb the findings of the Board noting that the latter correctly reminded itself that it was not bound by the Penalty Policy. In essence the Board followed its decision in *D118/02*. the Board did not fetter its power by adopting or relying on the Penalty Policy.

CIR v Perfecta FAMV 56 and 57 of 2017

The Court of Appeal's decision was reported in July 2018 issue of TIHJK Newsletter. The Court of Final Appeal (CFA) grants leave, on the "or otherwise" basis, to the Taxpayer to contend that the majority of the Court of Appeal (CA) erred in concluding that the Taxpayer changed its intention as to the basis on which it held its property so that it disposed of the said property as a trading asset in the nature of a trade rather than selling the same as a capital asset.

The CFA also grants leave on the ground of great general or public importance to appeal on the question that in the event of a successful challenge to the majority decision of the Board of Review, can the Court substitute the finding of the minority decision for that of the Board or should the matter be remitted to the Board with the opinion of the Court for proper findings to be made free from the legal errors identified, unless it can be shown that the conclusion of the Minority Decision is the true and only reasonable conclusion.

The CFA refuses to grant leave to the CIR to cross-appeal.

China Mobile HK Co Ltd v CIR HCIA 2/2017

The Board's decision *D34/16* was reported in the Oct 2018 issue of the TIHK Newsletter.

The Taxpayer appealed to the High Court pursuant to s.69(1) IRO. The Taxpayer's Counsel posed a single overreaching question of law as to whether the said spectrum utilization fees are revenue or capital in nature. The Taxpayer's Counsel also provided a Statement of the Grounds of Appeal and Reasons why leave should be granted ("the Statement") in which 8 proposed grounds of appeal with detailed arguments in support of each ground were stated. The High Court judge considered that the single question of law is not a property question of law, because it merely turns the ultimate conclusion of the Board into a form of question. The Statement while it sets out the grounds of appeal, fails to identify and state precisely the question of law involved in each ground. The judge accepted that the Taxpayer's proposed appeal is reasonably arguable so he granted leave to the Taxpayer to file an amended Statement.

Francis Ngo HCIA1/2018

The Taxpayer was employed by CFHK as a broker in 2004. His position was changed to a director in 2009. The employment contracts provided that CFHK could pay part of his annual compensation by requiring him to take a Grand Award of CFLP, a limited partnership and the ultimate holding company, in lieu of cash from CFHK. CFLP awarded the Taxpayer various grants ("Grant Awards" consisting of :

(1) Grant units in CFLP ("Grant Units") and

(2) Amounts in the Grant Tax Payment Account.

His employment was terminated in 2011. He made a claim in the High Court against CFHK for commission in Grant Units and shortfall in payment in lieu of notice ("PILON") and annual leave. For the purpose of the legal action, he informed that the claims were in respect of wages. The legal action was settled by agreement whereby the Taxpayer would be paid:

(1) US$350,000 ("the First Sum") being abrogation of his remaining claims against CFHK and in consideration of the further agreements under the Settlement Agreement and the Partnership Separation Agreement'

(2) US$350,000 ("the Second Sum") being equivalent to the Taxpayer's capital contribution to CFLP (net of all applicable tax and withholding) in respect of his investment;

(3) US$188,500 by way of contribution to his legal fees and expenses.

IRD assessed to tax the First Sum less a proportion of the shortfall of the PILON.

On appeal to the Board of Review, the Board found that the First Sum was for settlement of the High Court Claims and was payment for his past services, not for abrogation or surrender of any of his pre-existing contractual rights nor, as argued by the Taxpayer, consideration for abrogating his rights under the partnership agreement (of CFLP) or consideration for restrictive covenants.

The Taxpayer sought leave to appeal against the Board's decision. The Board made its decision on 17 Dec 2017. The decision reached the address of the Taxpayer on 8 Jan 2018. The High Court judge ruled that the time limit for application to the High Court for leave under s 69(3)(a)(i) did not begin to run until 8 Jan 2018. The application must be made by summon served on the High Court. The Taxpayer must also serve a copy of the application with the CIR. He sent a copy of the summon to the CIR by email on 7 Feb 2018. Service by email is not recognised by the Rules of High Court. The Taxpayer only delivered a hard copy of the summon to the CIR on 23 Feb 2018. Thus the application was out of time. The High Court judge ruled that the Court has no jurisdiction to extend the time. The judge went on to rule that even if he has the power to extend the time, he would not exercise the power in the Taxpayer's favour. He could have instructed lawyers for advice. Nonetheless, the judge went on to consider the merit of his claim. The judge found that the Taxpayer did not raise any valid question of law. He supported the Board's decision. The Taxpayer argued at the High Court that the First Sum included interest for the delay in paying his compensation. He did not adduce any particular as to the amount of the said interest nor any evidence that the First Sum included interest.

Report on Published Board of Review Decisions

Volume 33

D32/16 and D33/16 - see Koo Ming Kown & Murakami Tadao v CIR *HCIA1/2017* above. The Board expressed their reservation on the Penalty Policy of IRD that there is no reason why commercial restitution (being interest at commercial rate on the tax understated) should, as a matter of law, form part of the component of the starting off point for quantum assessment before consideration of the aggravating and mitigating factors.

D4/17 *S.70A*

Since the Taxpayer failed to submit the Profits Tax Return for 2006/07, IRD raised an estimated assessment on an estimated profits of $1,376 million, charging tax of HK$221 million. The Taxpayer failed to object within the time limit. The CIR refused to grant time limit for late objection. His application for judicial review of the CIR's decision was rejected by the Court of Appeal. Subsequently he applied for correction of the assessment under the first limb of s.70A (error or omission in a tax return or a statement submitted in respect thereof) on the ground that a Company C had informed IRD by a letter that the company received HK$2,054 million from two companies so it was evident that it was Company C which received the income, not the Taxpayer. The Board rejected the claim under the first limb of s.70A since the statement was received by IRD after the issue of the assessment in question so that the assessable profits could not have been excessive by reason of the said letter.

To succeed in a s.70A claim, a taxpayer must prove the correct amount of assessable profits and tax payable. Then strong and clear evidence is required to prove that the "omission" is in respect of a "statement" submitted and the "omission" is in respect of the assessment (*Extramoney Ltd v CIR* and *D25/06*). The Board ruled that the letter of Company C was not a "statement" submitted in respect of the return. Further the Board ruled that the said letter of Company C could not have any "omission" within the ambit of s.70A. Regarding the second limb of s.70A claim, since the assessment was made by estimation, the Board thought that there was no "calculation" within the said second limb. Further the letter of

Company C was not before the Assessor when he made the estimation so it could not be said that something was "left out" or "excluded" when the estimation was made.

The Board considered that if there is discrepancy between the Chinese text and the English text of s.70A, the English version should prevail as the latter was enacted well before the Chinese version was produced.

Reported by Mr HO Chi Ming FTIHK, CTA

(This report is for general information and reference only and should not be regarded, used or adopted as professional advices. No warranty or guarantee, expressed or implied, is given as to the accuracy and completeness of the information contained therein. Neither the Taxation Institute of Hong Kong, the reporter, any contributor or the editors shall assume liability for any statement, opinion or advice contained in this report. In no event shall the Institute, the reporter, its members and council members be liable for any loss and damages arising from or related to the use of the contents of this report).