

Commissioner of Inland Revenue *(Appellant)*

and

Yau Lai Man, Agnes trading as

L.M. Yau & Company *(Respondent)*

Court of First Instance

(Inland Revenue Appeal No. 3 of 2004)

Hon. Yam J

Date of Hearing: 7 September 2004

Date of Judgment: 7 September 2004

Date of Written Judgment: 24 June 2005

Inland Revenue Ordinance (Cap 112) – computation of loss – whether amounted to an “assessment” for the purpose of sections 60 and 70 – whether the “Reasonableness Test” should be applied in construing the proviso to section 70 – whether assessment validly issued

The Taxpayer commenced her practice as a certified public accountant in 1994. An assessor initially issued to the Taxpayer’s firm the computation of loss for each of the years of assessment 1995/96 and 1997/98. Subsequently the assessor considered

that certain management fees paid by the Taxpayer's firm to a company should not be allowable for deduction. The assessor therefore raised on the firm profits tax assessments for the years 1995/96, 1996/97 and 1997/98 to disallow the said management fees.

By a determination dated 2 May 2003, the Deputy Commissioner confirmed the profits tax assessments for the years 1995/96, 1996/97 and 1997/98 on the basis that the entire management fees paid by the firm were commercially unrealistic and were disregarded under section 61 of the IRO. The Taxpayer appealed to the Board of Review against the Commissioner's determination on two grounds, namely:

- (1) Section 61 of the IRO did not apply because the transactions were not artificial or fictitious; and
- (2) the profits tax assessments for the years of assessment 1995/96 and 1997/98 had been regarded as final and conclusive under section 70 of the IRO and should not be re-opened for the purpose of adjusting the management fees.

The Board rejected the Taxpayer's first ground of appeal on section 61. On the Taxpayer's second ground of appeal on section 70, the Board found that the 1995/96 assessment and the 1997/98 assessment were additional assessments and that the Revenue was not entitled to issue such assessments. The determination in respect of the assessments for these two years was accordingly set aside by the Board.

The Commissioner appealed to the Court of First Instance against the Board's decision to set aside the 1995/96 and 1997/98 assessments.

Held:-

- (1) There was no "assessment" if the taxpayer had suffered a loss and had no assessable income or profits.
- (2) There was therefore a distinction between a computation of loss and a notice of assessment. The computations of loss for the years 1995/96 and 1997/98 could not be notices of assessment.
- (3) Since a computation of loss could not constitute a notice of assessment which was defined in section 62, a taxpayer who received a computation of loss could not make any objection against that computation pursuant to section 64. However, he could object to a notice of assessment when it incorporated the "loss" of the previous year(s).
- (4) By virtue of section 63 of the IRO, the validity of the notices of assessment should not be affected by any mistake or defect in the tax computation.
- (5) The Board erred in law in applying the Reasonableness Test to construe the proviso to section 70.

- (6) Profits Tax and personal assessments were separate matters governed by different parts of the IRO. Personal assessment did not affect the making of a profits tax assessment.

Appeal allowed.

Mr Eugene Fung, instructed by the Department of Justice, for the Appellant.

Respondent in person.

Cases referred to in the judgment:

Medical Council of Hong Kong v. Chow Siu Shek [2000] 3 HKCFAR 144

The King v. Deputy Federal Commissioner of Taxation (SA), *ex parte* Hooper
[1926] 37 CLR 368

Littman v. Barrow [1951] Ch 993

D2/80 [1982] 1 IRBRD 410

D5/88 [1988] 3 IRBRD 144

Batagol v. Federal Commissioner of Taxation [1963] 109 CLR 243

Deputy Commissioner of Taxation v. Sheehan [1986] 18 ATR 194

Federal Commissioner of Taxation v. Ryan [2000] 201 CLR 109

Lloyds Bank Export Finance Ltd v. CIR [1991] 2 AC 427

CIR v. Malaysian Airline System Bhd [1992] 2 HKC 468

Scorer v. Olin Energy Systems Ltd [1985] AC 645

CIR v. Nina T.H. Wang [1993] 1 HKLR 7