

Court upholds Board's decision as taxpayer fails to discharge burden of proof

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In brief

On 26 March 2025, the Court of First Instance (CFI) handed down its judgment in *Samsung SDI (Hong Kong) Limited* (Taxpayer) v. *Commissioner of Inland Revenue* (Commissioner)¹, upholding the Board of Review's (Board) decision which was not published.

Remarkably, more than eight years after the hearing, the Board finally rendered its decision. The Board partially allowed the Taxpayer's appeal regarding certain profits² but confirmed the Commissioner's determination that the two types of profits derived from the sales of display device products (Disputed Profits) were sourced in Hong Kong, as the Taxpayer had not adduced sufficient evidence to discharge its burden of proof.

In its appeal to the CFI, the Taxpayer contended that the Board failed to consider relevant evidence and make a positive finding in its favour. However, the CFI concluded that the Board's decision, when assessed in its entirety, was fair and reasonable, and far from perverse as alleged by the Taxpayer. As such, the CFI upheld the Board's decision.

While the delay in the Board's decision was not grounds for dismissing the appeal, the CFI expressed concern and disapproval of the delay, noting that it negatively impacts the parties involved and the reputation of the legal system.

This news flash summarises the CFI's decision, along with our observations.

In detail

Background facts and the Board's decision

Below is a summary of the key facts based on those reproduced in the CFI's decision (the Board's decision was not published). Notably, it does not include any particulars on whether or how the Taxpayer's operations in Hong Kong relate to the Disputed Profits.

- The Taxpayer, a Hong Kong incorporated company, was a member of the Samsung SDI Group ultimately owned by Samsung SDI Company Limited (SDD Korea) in Korea. SDD Korea was one of the largest manufacturers of display device products.

- For the years of assessment 1998/99 to 2005/06, the Taxpayer contended that the following Disputed Profits were offshore sourced and not subject to profits tax:

Disputed Profits	Sales of display device products	Buyers	Amounts in dispute
(i) Factory Profits	Manufactured by a factory located in the Chinese mainland under a processing agreement	SDD Korea	HK\$600.7 million
(ii) Sales Profits	Purchased from the Taxpayer's subsidiaries in the Chinese mainland	Worldwide customers	HK\$524.3 million

- However, the Commissioner determined they were sourced in Hong Kong and taxable. Consequently, the Taxpayer appealed to the Board against the Commissioner's determination.
- Before the Board, the Taxpayer argued that the Disputed Profits arose from the relevant sale contracts pertaining to the Disputed Profits. As these sale contracts were effected in Korea, the Taxpayer considered that the Disputed Profits were offshore sourced and not taxable.
- The Commissioner argued that the Taxpayer earned the Disputed Profits by allowing itself to be interposed after each relevant transaction. Specifically, the Taxpayer earned the Factory Profits by serving as a signatory to the processing agreement and booking sales in Hong Kong. It earned the Sales Profits by acting as a re invoicing company in Hong Kong. Since all functions performed by the Taxpayer were carried out in Hong Kong, the Commissioner contended that the Disputed Profits were sourced in Hong Kong.
- After hearing the appeal in May 2014, the Board handed down its decision in July 2022 – more than eight years later. The Board found the evidence presented by the Taxpayer to be piecemeal and incomplete, preventing it from forming a comprehensive understanding of the Taxpayer's complex operations underlying the Disputed Profits. This lack of a full picture hindered the Board's ability to determine the effective cause of the Disputed Profits, i.e. the activities or transactions that directly produced the Disputed Profits.
- The Board was also not satisfied that the witnesses providing evidence on the Disputed Profits were in a position to give factual testimony about the parties involved in the transactions. Instead of offering factual evidence within their own sphere of knowledge, the witnesses tended to assert their understanding of customs and practices or assume that certain practices they encountered in their work applied universally. Such a tendency, in the Board's view, made their evidence unreliable.
- Against the above, the Board dismissed the Taxpayer's appeal on the grounds that the Taxpayer had not discharged the burden of proof required by the statute.
- For completeness, the Board went on to consider the interposition argument advanced by the Commissioner. However, due to the fragmented and incomplete evidence provided by the Taxpayer, which left the underlying facts uncertain, the Board could not determine if the interposition argument was the effective cause of the Disputed Profits. In other words, the Board did not conclude whether the Disputed Profits were sourced in Hong Kong.
- Dissatisfied with the Board's decision, the Taxpayer subsequently appealed to the CFI.

The CFI's judgment

The Board is a fact-finding tribunal, and its findings and decisions of facts are final pursuant to the Inland Revenue Ordinance (IRO). Therefore, an appeal to the courts against a Board's decision can only be made on a point of law. In this context, the Board's findings and decision that the Taxpayer had not discharged the burden of proof placed on it by the statute were primarily a matter of fact. Therefore, the Taxpayer's appeal to the CFI centred on the assertion that the Board had committed errors of law by failing to take proper account of relevant matters and by considering irrelevant matters.

The CFI's judgment is summarised below:

- The IRO provides that the taxpayer has the onus of proving that the assessment concerned is excessive or incorrect in an appeal to the Board. The CFI considered that where a Board is of the view that the taxpayer's evidence is insufficient for it to make the necessary findings in its favour, the Board is entitled to dismiss the appeal on the grounds that the taxpayer failed to discharge its onus of proof.

- The CFI considered that while the concept of 'source' is easy to understand, its application can be difficult and there is no universal test for ascertaining the source of profits. Depending on the facts of the case, apart from looking at what the taxpayer has done to earn the profits in question and where he has done it, it may be necessary to consider other factors in order to identify the effective cause and the source of the profits.
- The CFI agreed that the Board needed to identify the effective cause underlying the Disputed Profits, and that the Board had to understand all possible causes in order to do so. The CFI rejected the Taxpayer's assertion that the Board had taken account of irrelevant matters.
- Given that the present case is not a straightforward instance of purchase and sale, and considering the complexity of the operations underlying the Disputed Profits, the CFI highlighted that it may be unreasonable and artificial to attribute the source of the profits wholly to the sale, because the sale only turned previously unrealised profits in the goods into cash.
- The CFI rejected the Taxpayer's assertion that the Board had irrationally refused to accept the witnesses' evidence. The CFI found that the Board had specifically set out and considered the witnesses' evidence the Taxpayer relied upon and highlighted. In particular, the Board had set out the shortcomings of the witnesses' evidence, such as the areas on which they did not give evidence, their lack of awareness, knowledge or involvement regarding specific areas in dispute, and the absence of justifications for why they would have knowledge of certain matters in which they were not directly involved.
- In its view, the CFI considered that the Board had taken a nuanced approach and considered the totality of the evidence. Even when evidence was unchallenged, it was not automatically accepted; the Board still needed to scrutinise it for sufficiency and reliability. Based on the evidence presented by the Taxpayer, the CFI concluded that the Board's decision was fair and reasonable, and not perverse.
- While there was a substantial delay in the rendering of the Board's decision, the CFI considered (and the Taxpayer agreed) that the delay itself would not entitle the Taxpayer to a relief.

In light of the above, the CFI held that the Board had not committed any error of law and dismissed the Taxpayer's appeal.

Our observations:

- **Importance of taxpayers discharging their onus of proof**

It is well recognised that challenges to findings of fact only raise questions of law in very limited circumstances. These circumstances include situations where the finding of fact or inference from the facts is perverse or irrational, where there is no evidence to support it, or where it was made by reference to irrelevant factors or without regard to relevant factors. Consequently, a Board decision dismissing a claim because the taxpayer failed to discharge its burden of proof is rarely overturned on appeal.

One notable example is ING Baring Securities (Hong Kong) Ltd v. CIR (2007) 10 HKCFAR 417, where the Board dismissed the taxpayer's appeal on the grounds that it had not discharged its burden of proof regarding certain offshore income. Ultimately, the decision was reversed by the Court of Final Appeal (CFA), which criticised the Board for adopting a speculative approach to making its decisions and misapprehending the governing legal principles in their application to the facts of the case.

It appears that the present case may be distinguished from the ING Baring case, as the CFI was satisfied that the Board, correctly directed as to the law, had applied the proper fact-finding approach and that the Board's assessment of the evidence was overall fair and reasonable. Specifically, jurisprudence has indicated that determining the source of profits is contentious, with its effective cause closely tied to a taxpayer's operations.

This case also demonstrates that it is crucial for the taxpayer, who alone has the full understanding of its operations, to provide sufficient evidence to support its case when discharging the onus of proof placed on it by the statute. In particular, any witness called by the taxpayer should be directly involved in and thus have firsthand knowledge of the matters concerned in the dispute.

- **Substantial delay of the Board in rendering its decision**

Of note is that there was a very substantial delay of 8 years and 2 months by the Board in rendering its decision. While the delay by itself neither raises a question of law nor entitles the taxpayer to relief, the CFI expressed concern and disapproval over the delay involved, noting that the delay is by any standard 'entirely unacceptable' and could have potential serious implications on the parties involved as well as the overall judicial system.

Indeed, this was not the first time the courts have voiced concerns over the Board's delay in issuing decisions after hearings. Both the CFI in CIR v. Li & Fung (Trading) Ltd [2012] 3 HKLRD 8 and the CFA in the ING Baring case described the delays by the Board in the respective appeals – 3.5 years and 19 months – as 'unacceptable'.

The CFA in the ING Baring case apparently concluded that the issues with the Board are more about the structural challenges of the role itself, rather than the performance of the part-time Board chairman or members assigned to the case at issue. In this context, the CFA called for urgent consideration of whether the public interest of present-day Hong Kong would be better served if a new body composed of full-time personnel handles the more complex and burdensome appeals, or at least an overhaul is conducted of the way the Board is constituted and resourced.

The Government should seriously consider the repeated concerns raised by the courts regarding the constitution and resourcing of the Board. Overhauling these aspects is crucial for the timely delivery of judicial decisions, which in turn helps preserve the reputation of the legal system and ensures that the public interest of contemporary Hong Kong is better served.

The takeaway

The source of profits is a hard practical matter of fact. It is crucial for taxpayers to maintain contemporaneous documentation to support offshore claims. This would help substantiate their filing positions upon enquiry by the Inland Revenue Department and reduce the likelihood of disputes and subsequent appeals requiring their defence.

However, should a dispute arise, taxpayers considering bringing their disputes to the Board or the courts should seek assistance from tax and legal professionals early on to ensure that they can discharge the onus of proof properly by presenting comprehensive and convincing evidence. Careful considerations should be given to the reliability of the witnesses to be called, including whether the witnesses have direct knowledge and involvement in the relevant transactions to provide credible testimony.

Endnotes

1. The CFI's judgement can be accessed via this link:
https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=167345&currpage=T
2. The Board allowed the Taxpayer's appeal regarding commission income and losses on forward contracts. As such, the profits in dispute before the CFI were confined solely to the Disputed Profits.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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