

Tax

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Hong Kong Tax Analysis

Court of First Instance upholds Board of Review's decision on taxpayer's burden of proof

A recent tax court case, *Samsung SDI (Hong Kong) Limited v. Commissioner of Inland Revenue* [2025 HKCFI 1282], has been finalized. The Hong Kong Court of First Instance (CFI) upheld the Board of Review's (BoR) decision that the taxpayer failed to discharge its burden of proof in demonstrating that the disputed profits were offshore-sourced and dismissed the appeal.

Case background

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

The taxpayer derived profits from the sales of display device products, which were manufactured in a Mainland factory under a processing agreement and its Mainland subsidiaries, to SDD Korea and worldwide customers respectively.

The dispute

The taxpayer claimed that the profits were offshore-sourced, as the sales were arranged and agreed outside Hong Kong. However, the Inland Revenue Department (IRD) determined that the profits were onshore-sourced. Specifically, the IRD contended that the taxpayer was interposed after each relevant transaction. What the taxpayer did to earn the profits was its service as a signatory to the processing agreement, its presence in Hong Kong and therefore booking the sales in Hong Kong, and acting as a re invoicing company in Hong Kong. As all these functions were performed in Hong Kong, the profits were onshore-sourced.

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The decisions

The taxpayer appealed to the BoR which dismissed the appeal on the grounds that the taxpayer failed to discharge its burden of proof. The taxpayer further appealed to the CFI which upheld the BoR's decision. This case became final and conclusive.

Onus of proof

In the context of tax appeals, the onus of proof lies with the taxpayer to demonstrate that the assessment appealed against is excessive or incorrect. This means the taxpayer is obliged to provide sufficient evidence to support their claims. The IRD does not need to prove that the assessment is correct, and the BoR is not bound to make any finding of fact one way or the other. If the taxpayer fails to discharge the burden of proof, or if the evidence is disbelieved, the appeal will be dismissed, and the assessment will stand.

In the present case, the BoR found that the taxpayer failed to provide sufficient evidence to prove that the IRD's assessment was incorrect. The BoR commented that the taxpayer had chosen to present piecemeal and selective evidence and the underlying facts were too uncertain. Although the taxpayer called 7 witnesses to the BoR, the BoR found the witnesses' evidence unreliable, as they tended to assert their assumed or understanding of practices rather than providing factual evidence based on direct knowledge.

The CFI considered that the BoR's assessment of the evidence was fair and reasonable. The BoR, being a fact-finding tribunal, had considered the witness evidence appropriately and had valid reasons for its reservations about its reliability and completeness.

Effective cause

The taxpayer tried to argue that the BoR enquired into information that was irrelevant in determining the source of profits. The CFI commented that there is no universal test for ascertaining the source of profits. The broad guiding principles do not exclude the relevance of other factors which the BoR or court may need to consider. The CFI agreed that the BoR was entitled to consider all factors in identifying the effective cause of the disputed profits, especially given the complexity of the operations, which were not straightforward purchase and sale transactions.

As the taxpayer did not present the full picture to the BoR, the BoR was not in a position to reach a conclusion as to what was happening for the taxpayer to have earned the income and determine the effective cause of the disputed profits.

Given that the statutory burden of proof lies with the taxpayer, the CFI considered that the BoR did not make an error in dismissing the appeal as the evidence presented by the taxpayer was insufficient for it to make a finding.

Delay

The BoR took over 8 years to hand down its decision, ultimately dismissing the taxpayer's appeal. While acknowledging that the Board might want to be detailed and careful in preparing the decision in view of the complexity of facts and the substantial amount of tax involved, the CFI commented that such a significant delay is entirely unacceptable. Nevertheless, the delay alone could not be a ground of appeal and would not entitle the taxpayer to relief.

Our observation

This case underscores the importance for taxpayers to provide sufficient, comprehensive, and convincing evidence, including credible witness testimony from individuals with direct knowledge, to support their claims, especially for offshore profits. Failing to meet this burden of proof can result in the dismissal of an appeal.

Taxpayers are advised to maintain contemporaneous documentation to support their tax filing positions and seek professional assistance when disputes arise. In addition, taxpayers should carefully review the facts agreed with the IRD to avoid any misinterpretation.

Additionally, the CFI's criticism of the significant delay by the BoR in rendering its decision highlights potential negative impacts on the parties and the legal system's reputation. Given that this is not the first time courts have raised concerns about the BoR's delays, it may be time for the Government to review the BoR's structure and resources and consider the need for reforms.

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