

## Due Diligence

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**B**usiness buyers particularly concern with the “potential investment value” of the business they invested and whether there are any particular issues being hidden or any representations made to them would turn out to be untrue and incorrect. Due diligence is to study, investigate and evaluate a potential business investment.

Due diligence usually starts when the parties to a deal have agreed that the business deal is feasible. The buyer and the seller may negotiate the terms and rules for due diligence in the letter of intent or in the transaction agreement.

The buyer shall be given with adequate opportunity to conduct inquiry and guaranteed right to access the personnel, documents and sites. The seller shall concern about confidentiality. The extent of disclosure may be agreed by both sides and a separate undertaking on confidentiality may also be required.

For small business, due diligence may involve a review on the financial statements, the titles of the assets, and contingent liabilities. For the sizable business, the

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process can be more complex, take more time to complete and may involve other independent valuation assignments.

To ensure an effective and win-win deal, the seller may also view the process from the buyers' perspective and have the necessary information ready for inspection.

Due diligence normally covers three main aspects: legal, financial and operational. Here are some typical areas:

- ◆ Business structure and ownership.
- ◆ Key management and personnel.
- ◆ Products, services and technology.
- ◆ Financial statements and cash flow projections.
- ◆ Trade liabilities, mortgage and lease details.
- ◆ Tangible assets and valuations.
- ◆ Intangibles, such as trademarks, patents, trade names and copyrights.
- ◆ Pricing policies, discounts and terms of trade.
- ◆ Marketing and promotion strategies and commitments.
- ◆ Contractual obligations e.g. franchises, supply contracts.
- ◆ Employment contracts and staff compensation schemes.
- ◆ Computer software and other IT information.
- ◆ Any outstanding legal or potential litigation issues.

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Curtis has extensive accounting and business management experience in multinational and listed corporations. He had been in legal practice for about 10 years and used to deliver lectures in tertiary education institutions and training courses to HKSAR Government Departments and various professions. He also got publications on law and accounting topics.

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## Errors or Omissions on Tax Return

BY ANNIE K.Y. CHEUNG ARA & ASSOCIATES CERTIFIED PUBLIC ACCOUNTANTS

Where there is a tax assessment raised by the Inland Revenue Department, the taxpayer, who disagreed with the assessment raised against him, must object to the assessments within the statutory one month period as stipulated by section 64 of the IRO. Otherwise, the tax assessment will become final and conclusive in terms of section 70 of the IRO.



In the case where the appellant has made an objection to an assessment, the assessment does not become final and conclusive until the determination of the objection (and if the determination is appealed against, until after the determination of the appeal).

When the tax assessment became final and conclusive, there is no right for the taxpayer to ask for re-open the assessment. (Though in certain cases, the Commissioner is still of the rights to raise additional assessments where circumstances are warranted.)

Despite an assessment had become final and conclusive, a taxpayer may invoke section 70A to deal with any "errors or omissions" of his assessment. According to D137/02, the wording of section 70A, "errors or omissions" are confined to:

- (a) an error or omission in any return; or
- (b) an error or omission in any statement submitted in respect thereof; or
- (c) any arithmetical error or omission in the calculation of the amount of the assessable income or profits assessed or in the amount of the tax charged.

The usual cases for the application of Section 70A are where the arithmetical error or omission in the calculation of the amount of the assessable income or profits in a return that results in an excessive tax charge. In D137/02, the Board was of the view that even the assessment was raised by a compromise reached with the Department, it did not exclude the operation of section 70A.

Bearing in mind that the narrow grounds of "errors or omissions" under Section 70A does not confer any right to the taxpayer to introduce further evidence to object or appeal the assessment.

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**China Tax Update:**

State Administration of Taxation released <<The Notice for Corporate Income Tax on the Payment of Service Fees among the Parent and Subsidiary Companies >> on 14 August 2008.

Parent and subsidiary companies belong to different independent legal persons and has to handle the service fees paid among themselves and to pay tax as follows:

1. The parent company shall charge its subsidiaries for the provision of a variety of services and costs incurred as an independent enterprise and on fair basis as a normal business dealings. Otherwise, the tax authorities may adjust as appropriate.
2. There shall be service contracts or agreements set out the provision of services and fees charged. Fees received by the parent company shall be declared as business income and fees paid by the subsidiary will be expenses for deduction.
3. If the parent company provides the same kind of services to a number of its subsidiaries, the services charge can be allocated by agreements or service-sharing agreements, and there can be a certain percentage of markup on the costs incurred as profit. Enterprise Income Tax Law Article 41, Paragraph 2, reasonable sharing provisions will also be applicable.
4. If service fee charged to a subsidiary by the parent company is in the form of management fee, the subsidiary, having paid accordingly, shall not entitle to deduct the fee as pre-tax deduction.
5. The subsidiary that had paid service fee to the parent company shall provide tax authorities the service contract or agreement and related matters. Otherwise, the amount will not be allowed for tax deduction.

**Hong Kong Tax Reminder: Profits Tax Returns****Due date**

31 Oct 2008	Deadline for submitting further extension list for "M" code current year loss cases. (i.e. "M" code cases refer to those Accounting year ended between 1 January 2008 - 31 March 2008)
15 Nov 2008	Extended due date for "M" code returns.
13 Feb 2009	Final extended due date for "M" code current year loss cases.

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