

Case No. D44/05

Profits tax – whether initial signing fees and monthly bonus of insurance agents are advance payments – section 16(1) of the Inland Revenue Ordinance ('IRO').

Panel: Jat Sew Tong SC (chairman), Francis T K Ip and Kenny Suen Wai Cheung.

Date of hearing: 8 June 2005.

Date of decision: 14 September 2005.

The appellant carried on an insurance agency business under the name of 'Company B'. By a standard form contract ('LOU') entered into between the appellant and Company A, the appellant agreed to remain an insurance agent of Company A for a minimum of five years. The LOU contained express terms by which Company A agreed to pay the appellant, upon the meeting of certain conditions, an initial signing fee and a monthly bonus. The LOU also provided for the refund of the actual signing fee and monthly bonus paid in the event the contract was terminated.

The appellant fulfilled the conditions specified in the LOU and received from Company A the initial signing fee, the balance of signing fee and monthly bonuses. No ground for repayment of any part of the said fees and bonuses had arisen and no part of those sums had been repaid to Company A. There was no dispute that the above sums were chargeable for profits tax. The issue was whether the entirety of the sums should be so charged for a particular assessment year. The appellant contended that those sums were in the nature of advance payments or deposits covering five years of service with Company A and should therefore be spread over the five years for the purpose of determining her assessable profits.

Held:

1. The Board was of the view that pursuant to the clear terms of the LOU the signing fees and monthly bonus would only be repayable wholly or in part in the event of termination of the agent's contracts with Company A during the five years. The Board therefore concluded that any repayment obligation under the LOU was a contingent liability only, but the contingency had not arisen. If and when the contingency should arise subsequently, the amount that the agent would have to repay to Company A would be deductible in the assessment year when the repayment obligation arose under section 16(1) of the IRO.

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2. On the evidence the Board found that the Initial Signing Fee and the monthly bonus for a particular month were accrued or were deemed to have accrued to the agent in the previous assessment year and not during the year of assessment in question. The assessment for the year of assessment in question was reduced accordingly.

Appeal dismissed.

Case referred to:

B/R 131/04 (Decision reported D18/05, IRBRD, vol 20, 323)

Taxpayer in person.

Chan Man On and Tsui Nin Mei for the Commissioner of Inland Revenue.

Decision:

Introduction

1. In this appeal the Appellant taxpayer objected to the profits tax assessment and personal assessment for the year 2002/03 raised on her.

2. The facts of this appeal and the issue for determination are materially similar to those in decision B/R 131 of 2004 (D18/05, IRBRD, vol 20, 323), dated 25 May 2005. The Appellants in both cases are insurance agents of Company A. They received advanced payments upon commencing their service with Company A pursuant to standard form contracts. The sole issue for determination in this appeal, as in B/R 131 of 2004, is whether the advance payments received by the Appellant from Company A between 1 March 2002 and 1 March 2003 were chargeable for profits tax for the assessment year in full (as is contended by the Commissioner of Inland Revenue), or whether only 20% thereof should be so charged (as contended by the Appellant).

Relevant facts

3. The relevant facts (which are largely not in dispute) as found by the Board after taking into account all the documentary evidence and the oral evidence of the Appellant are as follows.

4. At all material times, the Appellant carried on an insurance agency business under the name of 'Company B'.

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5. By a standard form contract entitled ‘Letter of Understanding’ dated 15 November 2001 (‘the LOU’) entered into between (inter alios) the Appellant and Company A, the Appellant agreed to remain an insurance agent of Company A for a minimum of five years. The LOU contained the following express terms:

- ‘ 3. Subject to Clause 8 and Clause 9 below, after the Applicant [ie the Appellant] has (i) signed the Contracts [as defined in the LOU], (ii) registered with the Hong Kong Federation of Insurers as an agent of the Company [ie [Company A]] and (iii) commenced services as an agent of the Company (the “Commencement Date”), the Company agrees to pay the Applicant an Initial Signing Fee based on proof of income provided by the Applicant, amounting to HONG KONG DOLLARS four hundred fifty one thousand and five hundred and fifty four only (HK\$451,554.00)...
4. The Applicant agrees to faithfully perform all obligations of the Contracts and to remain as a bona fide insurance agent of the Company for a minimum of 60 months from the Commencement Date.
6. (a) Subject to Clause 8 and Clause 9 below, the Company agrees to pay to the Applicant the Balance of Signing Fee for Year 1 at the end of the twelve (12) month period immediately after the Commencement Date provided that this amount does not exceed 100% of the Initial Signing Fee.
7. Subject to Clause 8 and Clause 9 below, the Company will pay the Applicant a Monthly Bonus in the sum of Hong Kong Dollars thirty seven thousand and six hundred and thirty only (HK\$37,630.00) at the end of each month for a maximum period of 12 months subject to the Applicant’s meeting the following validation requirements in relation to the annualized first year premiums net after terminations for individual life and personal accident business written with the Company by the agency managed by and including the applicant at the end of the following dates (measured from the Commencement Date):

End of	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter
Percentage of the Amount	20%	45%	70%	100%

Payment of the Monthly bonus will cease immediately upon the Applicant’s failure to meet the above validation requirement on a timely basis for any reason...

8. In the event that any of the Contracts is terminated for any reason by either the Applicant or the Company within twelve (12) months after the Commencement Date, the applicant agrees to refund to the Company (i) the whole of the Actual Signing Fee paid in Clause 3 and Clause 6 above, and (ii) all of the Monthly

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Bonus paid in Clause 7 above from the Commencement Date up to the date of termination, immediately and unconditionally.

9. In the event that any of the Contracts is terminated for any reason by either the Applicant or the Company within the period from the first (1st) year to fifth (5th) year after the Commencement Date, the Applicant agrees to refund part of the Monthly Bonus paid and Actual Signing Fee as defined below to the Company immediately and unconditionally, as follows:

<u>Termination of Contracts after the Commencement Date</u>	<u>Percentage of Monthly Bonus and actual Signing Fee to be refunded</u>
Within the 2 nd year	80%
Within the 3 rd year	60%
Within the 4 th year	40%
Within the 5 th year	20%

The Actual Signing Fee shall mean the sum of the Initial Signing Fee and the Balance of Signing Fee for Year 1 if any.'

6. There is no dispute that the Appellant fulfilled the conditions specified in the LOU and commenced services as an insurance agent of Company A on 1 March 2002.

7. It is not disputed that the Appellant received from Company A by way of loan the sum of HK\$903,108 in about November 2001 (comprising the 'Initial Signing Fee' of HK\$451,554 and 'Balance of Signing Fee for Year 1' of HK\$451,554), and that such 'loan' was repaid by setting off the same sums paid or payable to the Appellant pursuant to the LOU.

8. Further, the Appellant received the Monthly Bonus of HK\$37,630 for the month of March 2002 at the end of that month. She then received in advance the Monthly Bonuses for April 2002 to February 2003 in around April or May 2002.

9. There is also no dispute that the Appellant satisfactorily completed her services with Company A for 'Year 1' starting on 1 March 2002, and remains an insurance agent of Company A to date. No ground for repayment of any part of the Initial Signing Fee, the Balance Signing Fee for Year 1 or the Monthly Bonuses for 'Year 1' has arisen and to date no part of those sums have been repaid to Company A.

10. Accordingly, the Board is of the view that the Appellant received or should be deemed to have received by way of trading receipts arising in or derived from her trade or business a total of HK\$1,354,668 on the following dates:

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- 10.1. 'Initial Signing Fee' of HK\$451,554 pursuant to clause 3 of the LOU on or about 1 March 2002;
- 10.2. 'Balance of Signing Fee for Year 1' of HK\$451,554 pursuant to clause 6(a) of the LOU on or about 28 February or 1 March 2003 (for the purposes of this appeal it is immaterial whether it was 28 February or 1 March 2003); and
- 10.3. 'Monthly Bonus' of HK\$451,560 pursuant to clause 7 of the LOU from 31 March 2002 to 28 February 2003 at HK\$37,630 per month.

11. There is no dispute that the above sums are chargeable for profits tax. The issue is whether the entirety of the sums should be so charged for the assessment year 2002/03. The Appellant contended before the Deputy Commissioner of Inland Revenue that those sums were in the nature of advance payments or deposits covering five years of service with Company A, and should therefore be spread over the five years for the purpose of determining her assessable profits.

12. By a determination dated 18 March 2005, the Deputy Commissioner of Inland Revenue determined that all three sums stated in paragraph 10 above should be fully assessed to profits tax in the assessment year 2002/03. From that determination the Appellant appeals to this Board.

13. In a well prepared presentation, the Appellant contended before this Board, as she did before the Deputy Commissioner, that the sum of HK\$1,354,668 should be charged for profits tax over five years.

The decision in B/R 131/04

14. In decision B/R 131/04, this Board (differently constituted) rejected a similar argument raised by the Appellant in that case that similar payments received from Company A under materially identical contractual terms were in the nature of a prepayment or deposit paid by Company A to the agent. The Board rejected the argument and held that:

- 14.1. Pursuant to the clear terms of clause 3 of the LOU, the Initial Signing Fee was payable to the agent upon the fulfillment of the conditions stated in that clause, which took place on 1 March 2002.
- 14.2. Further, the Balance of Signing Fee for Year 1 was payable to the agent pursuant to clause 6(a) of the LOU at the end of the 12th month of services with Company A, which occurred on 28 February 2003 or 1 March 2003.
- 14.3. Moreover, the Monthly Bonus did not form any part of the 'Initial Signing Fee' or 'Balance of Signing Fee for Year 1' as provided under clauses 3 and 6(a) of

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the LOU. It was the total sum payable to the agent under clause 7 of the LOU for the 12 months beginning 1 March 2002 on account of business generated during that period.

15. In so holding, the Board also rejected a construction of clauses 7, 8 and 9 of the LOU advanced by the Appellant in that case that the entire advance payments or portions thereof would be repayable to Company A in the event of the agent's failure to meet the minimum business requirements under the contracts with Company A for any of the minimum 5-year term. The Board was of the view that pursuant to the clear terms of clauses 8 and 9 of the LOU, the Signing Fees and Monthly Bonus would only be repayable wholly or in part in the event of termination of the agent's contracts with Company A during the five years.

16. The Board therefore concluded that any repayment obligation under the LOU was a contingent liability only, but the contingency had not arisen. If and when the contingency should arise subsequently, the amount that the agent would have to repay to Company A would be deductible in the assessment year when the repayment obligation arose under section 16(1) of the Ordinance.

17. The Board, however, considered that the 'Initial Signing Fee' accrued or was deemed to have accrued to the agent on 1 March 2002, and that the Monthly Bonus for March 2002 accrued or was deemed to have accrued to the agent on 31 March 2002. The relevant year of assessment being 2002/03, that is, the 12 months commencing 1 April 2002 and ending on 31 March 2003, those two sums did not accrue to the agent during the assessment year but the previous assessment year.

Decision

18. This Board finds no reason to depart from B/R 131 of 2004. Since the facts of the instant appeal are indistinguishable from those in B/R 131 of 2004, that is determinative of this appeal.

19. The representatives of the Commissioner did not dissent from the decision in B/R 131 of 2004 and accepted that in accordance with that decision, the Appellant's assessment for the assessment year 2002/03 should be reduced by deducting the entirety of the 'Initial Signing Fee' of HK\$451,554 and the 'Monthly Bonus' of HK\$37,630 for March 2002.

20. The assessment for the assessment year 2002/03 is reduced accordingly.