

Case No. D48/09

Profits tax – assessable profits – deductions – consultancy agreement – artificial transaction – whether consultancy agreement has any commercial reality – sections 16(1) and 61 of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Chyvette Ip and Michael Liu Kin Wa.

Dates of hearing: 21 October and 12 November 2009.

Date of decision: 19 January 2010.

The Taxpayer was a limited company incorporated in Hong Kong. In 2003/04 and 2004/05 assessment years, the Taxpayer reported deductions of HK\$2,106,000 and HK\$234,000, pursuant to a consultancy agreement entered with Company H. The consultancy agreement was dated prior to the incorporation of the Taxpayer, in which the Taxpayer was required to pay US\$18,000 per month to Company H in 2002/04, and US\$15,000 per month in 2004/05. Company H was a shareholder of Company E, which in turn held 50% of shares in the Taxpayer. The Taxpayer's Vice-President (Mr J) was the brother of the Taxpayer's director. Mr J rendered services to the Taxpayer. Evidence showed that neither the Taxpayer's director nor Mr J was aware of the terms of the consultancy agreement. In addition, they could not explain how the fees were arrived at in the consultancy agreement, and the extent of the services Company H should provide. The Taxpayer paid a total of HK\$1,500,000 to Company H.

Held:

1. According to section 16(1) of the IRO, the Taxpayer could report an accrued liability yet to be discharged as deductions, i.e. the entire consultancy fee (Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] STC 366; D94/99, IRBRD, vol 14, 603, So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416 applied).
2. However, the Commissioner could disregard a transaction which would reduce the tax liability of the Taxpayer if it is artificial or fictitious. Artificial transaction includes one which is commercially unrealistic (Section 61 of the Ordinance; Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 733 at 788 applied).
3. In the present case, the consultancy agreement could not have been a contemporaneous document. Neither the Taxpayer nor Company H acted according to the terms of the consultancy agreement. Other supporting

invoices and documents were also not contemporaneously prepared. The payment by the Taxpayer to Company H had no correlation with the agreed fees under the consultancy agreement. Also, the evidence from the Taxpayer did not support such a large amount of consultancy fee to be paid to Company H.

4. Therefore, the consultancy agreement was an artificial and fictitious transaction for the purpose of section 61 of the IRO. The Taxpayer should be treated as not having entered into the consultancy agreement, and not having incurred any consultancy fees.
5. In the circumstances of the case, a costs order of \$5,000 was imposed.

Appeal dismissed and costs order in the amount of \$5,000 imposed.

Cases referred to:

Commissioner of Inland Revenue v Lo and Lo (a firm)[1984] STC 366
D94/99, IRBRD, vol 14, 603
So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 733

Taxpayer represented by its director.
Tam Tai Pang for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Company C ('the Taxpayer') in respect of an objection to the profits tax assessment for the year of assessment 2004/05 and the additional profits tax assessment for the years of assessment 2003/04 and 2004/05.
2. The Acting Deputy Commissioner for Inland Revenue ('the Acting Deputy Commissioner') by virtue of the Determination dated 25 June 2009 ('the Determination') upheld the relevant additional profits tax assessments and profits tax assessment for the relevant years.
3. The issue before the Board for our consideration was whether or not various consultancy fees in the sum of HK\$2,340,000 should be an amount for reduction in computing the Taxpayer's assessable profits for 2003/04 and 2004/05.
4. The Acting Deputy Commissioner took the view that the relevant consultancy

fees should not be deductible due to the fact that the Taxpayer had failed to adduce any cogent evidence to support its claim. In all circumstances, the Acting Deputy Commissioner took the view that the consultancy fees were not incurred in the production of the Taxpayer's chargeable profits.

Agreed facts

5. We now set out the relevant facts on which the parties were able to agree and we therefore find these facts as agreed facts:

(1) [Company C] ["the Company"] has objected to the Profits Tax assessment for the year of assessment 2004/05 and the Additional Profits Tax assessments for the years of assessment 2003/04 and 2004/05 raised on it. The Company claims that the assessments were excessive and that certain consultancy fees should be allowed for deduction.

(2) The Company was incorporated as a private company in Hong Kong on 13 September 2002.

(3) (a) The Company's issued and paid-up capital was \$2 dividend into 2 shares of \$1 each. At the relevant times, [Ms D] and [Company E] were equal shareholders of the Company. The directors of the Company were as follows:

<u>Name</u>	<u>Appointed on</u>	<u>Resigned on</u>
[Ms D]	09.01.2003	
[Company E]	09.01.2003	01.06.2004
[Mr F]	01.06.2004	

(b) The Company commenced business on 1 January 2003 and it described its principal activity as engaging in the business of contractor.

(4) (a) In its Profits Tax return for the year of assessment 2003/04, the Company declared an Assessable Profit of \$224,089. The Assessable Profit was arrived at after deducting, inter alia, consultancy fee of \$2,106,000 ["Sum A"].

(b) On 1 April 2005, a Profits Tax return for the year of assessment 2004/05 was issued to the Company. The Company failed to submit a duly completed 2004/05 Profits Tax return in time.

(5) The Assessor raised on the Company the following Profits Tax assessments for the years of assessment 2003/04 and 2004/05:

<u>Year of assessment</u>	<u>2003/04</u>	<u>2004/05</u>
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Assessable Profit	<u>224,089</u> ^[1]	<u>230,000</u> ^[2]
Tax Payable thereon	<u>39,215</u>	<u>40,250</u>

Note: 1. Per tax return at Fact (4)(a).
 2. The assessment is an estimated assessment issued pursuant to section 59(3) of the Inland Revenue Ordinance [“the Ordinance”].

- (6) The Company objected, through [Company G] [“the Representative”], to the 2004/05 estimated Profits Tax assessment per Fact (5) on the ground that the assessment was excessive. To validate its objection, the Company filed a 2004/05 Profits Tax return in which it declared an Assessable Profit of \$14,302 after deducting, inter alia, consultancy fee of \$234,000 [“Sum B”].
- (7) (a) The Company closed its account on 31 March every year. The detailed profit and loss accounts of the Company attached to its Profits Tax Returns for the years of assessment 2003/04 and 2004/05 showed, inter alia, the following particulars:

<u>Year of assessment</u>	<u>2003/04</u>	<u>2004/05</u>
Basis period	13.09.02 – 31.03.04	1.4.04 – 31.3.05
	\$	\$
Contract income	9,650,317	2,979,460
<u>Less:</u>		
Purchases	(\$5,527,344)	(1,770,207)
Sub-contracting charges	(1,728,200)	(622,200)
Consultancy fee	(2,106,000)	(234,000)
Closing stock	-	<u>433,877</u>
Total cost of work	<u>(9,361,544)</u>	<u>(2,193,530)</u>
Gross profit	288,773	786,930
<u>Add:</u> Bank interest received	-	234
<u>Less:</u> General & admin. Expenses	<u>(64,058)</u>	<u>(700,077)</u>
Profit for the year	<u>224,715</u>	<u>87,087</u>

- (b) The Company’s balance sheets attached to its Profits Tax Returns for the years of assessment 2003/04 and 2004/05 showed, inter alia, the following particulars:

<u>Year of assessment</u>	<u>2003/04</u>	<u>2004/05</u>
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Basis period	13.09.02 – 31.03.04	1.4.04 – 31.3.05
	\$	\$
Non-current assets – Fixed assets	<u>8,400</u>	<u>322,422</u>
Current assets		
Cash and bank balances	46,458	1,058,193
Debtors, deposits and prepayment	719,612	760,776
Stock	-	433,877
Amount due from a director	<u>713,791</u>	<u>-</u>
	<u>(1,392,759)</u>	<u>(2,305,181)</u>
Current liabilities		
Trade creditors and accruals	(1,263,544)	(955,536)
Tax payable	(39,215)	(41,717)
Amount to a director	<u>-</u>	<u>(1,307,928)</u>
Non-current liabilities – Deferred tax	<u>(882)</u>	<u>(13,635)</u>
Net assets	<u>184,620</u>	<u>256,452</u>
Represented by:		
Share capital	2	2
Accumulated profit	<u>184,618</u>	<u>256,450</u>
	<u>184,620</u>	<u>256,452</u>

- (8) In response to the Assessor’s enquiries, the Representative put forth the following contents in respect of Sum A:
- (a) The name of recipient was [Company H] and its place of incorporation is the British Virgin Islands.
 - (b) [Company H] is one of the shareholders of [Company E], which held 50% the Company’s shares.
 - (c) “The services rendered were:
 - (i) Advisory and consultancy services in relation to purchases in Australia;

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- (ii) To negotiate terms and prices with Australian suppliers; and
- (iii) To assist in quality check and product inspection.”
- (d) The total amount paid/payable was US\$270,000, which is equivalent to HK\$2,106,000 at the exchange rate of US\$1 = HK\$7.8.
- (e) “The basis of calculation is at monthly service fee of US\$18,000 each.”
- (f) “A total amount of HK\$1,500,000 was paid on March 8, 2004 by cheque and the balance of HK\$606,000 remains outstanding.”
- (g) “No minutes of directors’ meeting [authorizing the payment at Fact (8)(f)] have been prepared.”
- (9) (a) By letters dated 2 December 2005 and 30 December 2005, the Assessor requested for further information including a copy of the relevant service agreement to ascertain the deductibility of Sum A and Sum B [collectively referred to as “the Sums”].
- (b) Despite repeated reminders, the Assessor had not received any reply from the Company nor the Representative.
- (10) In the absence of the requisite information, the Assessor did not accept that the consultancy fees were deductible. He therefore raised on the Company the 2003/04 and 2004/05 Additional Profits Tax assessments as follows:

<u>Year of assessment</u>	<u>2003/04</u>	<u>2004/05</u>
	\$	\$
Profit per return [Facts (4)(a)&(6)]	224,089	14,302
<u>Add: Consultancy fee [i.e. the Sums]</u>	<u>2,106,000</u>	<u>234,000</u>
Assessable Profit	2,330,089	248,302
<u>Less: Profit already assessed [Fact (5)]</u>	<u>(224,089)</u>	<u>(230,000)</u>
Additional Assessment Profits	<u>2,106,000</u>	<u>18,302</u>
Tax Payable thereon	<u>368,550</u>	<u>3,202</u>

- (11) The Representative objected, on behalf of the Company, to the Additional Profits Tax assessments per Fact (10) on the grounds that the Sums should be deductible as it was incurred in the production of

chargeable profits.

(12) To support the Company's objection, the Representative forwarded the following contentions:

(a) The names and post of [Company H's] staff who were responsible for providing services to the Company were as follows:

<u>Name</u>	<u>Position/title</u>
[Mr I]	President/CEO of Australian Operation
[Mr J]	Vice-President (Australia)
[Ms K]	Manager (Australia)

(b) "All the [personnel in Fact (12)(a)] are non-resident of Hong Kong and all services were performed outside Hong Kong."

(c) "The basis of service fee was determined after due negotiation between [the Company] and [Company H]."

(d) "... [Company H] was responsible for initiating, structuring, negotiation and implementing the entire contract for [the Company] with the Australian Supplier for the [Site L Project]."

(e) "Services were performed throughout the two financial years from initiation of the [Site L Project] to final completion (and full implementation). Some of the details of services include:

~ Initial contact with Supplier – seeking information, etc for the preparation of the tender for the project;

~ Tender documentation etc, such as drawings etc were coordinated with [the Company] and the Supplier;

~ Arrangement for Prototype manufacture and mock-up etc;

~ Negotiation of terms and conditions, especially timing of payments etc;

~ Implementation of the entire project for the two years involved as well as any follow-up after the preliminary completion of the project;

~ Monitoring of progress of manufacturing, including changes required by the [Site L] Contractor, [Company M]."

(f) "The basis of calculation [of Sum B] was at US\$15,000 per month for

the months of April and May 2004 as follows:

April 2004	=	US\$ 15,000	
May 2004	=	<u>US\$ 15,000</u>	
Total	=	US\$ 30,000 (@HK\$7.8)	
		<u>HK\$234,000</u>	”

(g) Payments per Fact (12)(f) were still outstanding as at 12 September 2007.’

6. The hearing commenced on 21 October 2009. At that hearing, the Taxpayer was represented by Mr F. After considering various observations from the Board, he made an application for an adjournment to enable him to make arrangements to call witnesses that may be of assistance to the Board. The Board adjourned this matter to 12 November 2009.

The evidence

7. At the adjourned hearing, Mr F called two witnesses to give evidence before us. His sister, Ms D and his brother, Mr J.

A. The evidence of Ms D

8. Ms D explained to us the circumstances that led to the Taxpayer being awarded a sub-contract in respect of a project at Site L. She informed us that she was working at an entity known as Company N with a friend of hers. Company N was involved in the installation and construction of shutters and gates. She learned from Authority P that the various shops at Site L required shutters. She made various enquiries as to the type of shutters that were needed. She obtained some information and then in turn, phoned her younger brother, Mr J, who is resident in Australia to see whether or not he was able to assist with the sourcing of the relevant shutters.

9. She indicated to us that she needed to obtain further information from Authority P and in turn, they needed to produce a Prototype which could then be utilized in the tender process. The tender process took some time, they needed to go back and forth with Authority P in order to obtain the relevant information. There were various alterations in respect of the specific verifications that were required.

10. Authority P told her that their project had been awarded to their main contractor, Company M and in turn, they asked her to deal with Company M directly. They had to start over again and reworked the Prototype in conjunction with Company M’s requirement.

11. She informed us that she herself never communicated directly with the factory in Australia because she could not speak English, therefore all communications were dealt with through Mr J.

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12. They were successful in their tender. Although they submitted various documents in the name of Company N, Company M indicated that they would only deal with a limited liability company. Therefore, she obtained a shelf company, the Taxpayer, which was incorporated on 13 September 2002 in order to ensure that they were able to successfully complete the documentation required in respect of the tender.

13. Mr J assisted and dealt with the process of quality control and dealt with all matters with the factory with regard to the production of the relevant shutters.

14. She took the view that without the assistance of Mr J, they would not have been instrumental in obtaining the successful tender and completing the relevant project. Mr J's role was to deal with the various manufacturers in Australia with regard to the production of the shutters to be installed in the relevant shops at Site L.

15. Ms D was aware as to the status of Company H and that Mr J worked for Company H. She also accepted that Company H is a related company of the Taxpayer. However, when asked whether or not she was able to ascertain the exact nature of the amounts that were being paid for the services performed by Company H, she advised that she did not have any 'strict standard'.

16. She took the view that if one looked at matters as a whole, Mr J carried out work in Australia and as such, he was entitled to earn money for the work he did. She drew to our attention that at first the factory in Australia required a far higher price and it was Mr J who was able to negotiate a lower figure.

17. When questioned about the monthly payments made to Company H by the Taxpayer, she was able to confirm that this was initially US\$18,000 a month from January 2003 to March 2004 and thereafter, between April and May 2004, the fee was US\$15,000 a month.

18. On cross-examination by Mr TAM Tai-ping representing the Inland Revenue Department ('IRD') ('Mr Tam') on 12 November 2009 Ms D could not recollect very much about the documentation she entered into with Company M. She said:

'frankly before I came here I did not really look into all documents, I did not read any, any one of the documents'.

19. She confirmed that she was not appointed a director of the Taxpayer until 9 January 2003. Her attention was drawn to the consultancy agreement between the Taxpayer and Company H which was dated 28 June 2002 ('the Consultancy Agreement'). She confirmed that she did not have the original of the agreement. However, she took the view that it may be at their office.

20. She confirmed that the agreement was signed by a Mr Q who is her husband. She stated that although she was aware of the agreement, she did not understand it.

21. When asked by Mr Tam whether or not Company H indeed actually sent any invoices to the Taxpayer, she took the view that they should have given her invoices, otherwise how she could make payments.

22. Mr Tam also drew her attention to Article 4 of the agreement which indicated quite clearly that this should take effect at the date of its signature by the parties. When asked how this agreement can take effect on a date before when the Taxpayer had not been incorporated, she said:

‘ We have an oral agreement beforehand so what is the problem?’.

23. She also confirmed that Company H was not remunerated for any services in connection with the project before January 2003.

24. Ms D was shown a cheque dated 6 March 2004 drawn on Bank R payable to Company H in the sum of HK\$1,500,000 and asked how she arrived at making payment in the sum of HK\$1,500,000 when the consultancy fee was payable in the sum of US\$18,000 each month. She told us that she took the view that this sum was due and that this was the only sum available at the time to effect payment.

B. The evidence of Mr J

25. He lived and worked in Sydney, Australia. He confirmed that in or around 2002, he talked to her sister, Ms D, and, Mr Q, and became involved in a tender project with regard to the shutters that would be installed at Site L. He was asked to look for and source various manufacturers who could produce the shutters for the relevant project.

26. He worked full-time on this project. He started to look for various manufacturers by going through the Sydney Yellow Pages. He talked to various suppliers and found a company, Company S who was able to assist. In March 2002, he therefore started negotiating with Company S in respect of the supply of the shutters. He had to provide a sample and sent this to Company M for their review and consideration. Various changes were required and he had to go backwards and forwards with Company S in an attempt to ensure that they would be in a position to make a suitable tender.

27. He was informed by his sister that in order to tender, they needed to make use of a limited liability company.

28. The cost of the project was approximately A\$200,000. There were certain changes to the design of the shutters as well as various issues in respect of the glass that was going to be used that had to be dealt with.

29. He was aware as to the Consultancy Agreement signed between the Taxpayer and Company H in respect of various services which he performed in Australia. He confirmed that he was still working for Company H in respect of various projects in the People’s Republic of China. When asked as to who owns Company H, he confirmed that he

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has a 10% interest in Company H, and the other shareholders are Mr I and his brother, Mr F.

30. He confirmed that his annual salary in 2003 was US\$400,000 which was paid by Company H.

31. When asked as to the rationale and reasons for US\$18,000 per month being paid by Company H, he could not provide any reason other than the fact that he was conducting and carrying out work in Australia.

32. He confirmed that he went to University T and spent three years studying economics but did not graduate. He had no professional qualifications. He confirmed that Company H did have an office in Australia and gave the address at Address U. He confirmed that the office was approximately '22 squares'. He accepted that before embarking upon this project, he had no experience in installation of shutters or any construction work at a site like Site L. However, he had some experience working with regard to domestic gates. He confirmed that he never had any experience in the sourcing of shutters that were required for installation at a site like Site L. He accepted that Company H did not have any business presence in Hong Kong and did not maintain a bank account.

33. He informed Company S that he was working for Company H after the tender was obtained. He spent a considerable amount of time on the telephone with his sister dealing with all relevant matters arising out of his dealings with Company S. He accepted that there was no written contract between Company S and the Taxpayer in respect of supply of the relevant shutters.

34. His attention was drawn to the Consultancy Agreement. He confirmed that he had never seen this before. However, he was aware of the fact that his sister told him that an agreement may have very well been signed in 2002.

35. Mr Tam put to Mr J a series of invoices from Company H addressed to the Taxpayer. In particular, his attention was drawn to an invoice dated 31 January 2003. He accepted that his signature was on this invoice as well as the others. He confirmed that the address was given as Address V. His attention was also drawn to the fact that each invoice was entitled 'without prejudice' and his attention was drawn to the fact that the heading was consultancy fee as per the Consultancy Agreement. He accepted that he drafted these invoices and he remembered signing each and every one in Australia and dispatching these. The invoices were addressed to Mr Q.

36. On cross-examination, he confirmed that he did not know about the Consultancy Agreement. All he knew was that such an agreement was signed.

37. When asked how the figure of US\$18,000 was arrived at, he gave the answer:

'How did I arrive at? Because from, for what the work we work, and then we know that there will be with that sort of money'.

Additional documents

38. Mr F on behalf of the Taxpayer also produced for the Board's consideration a series of additional documents. These documents were in respect of further documentation vis-à-vis the tender exercise as well as invoices from Company H to the Taxpayer and a copy of various telephone bills. We note however that no original documents were produced. However, we have had the opportunity to consider and review these documents.

The relevant statutory provisions

39. Section 16(1) of the Inland Revenue Ordinance ('IRO') provides as follows:

'In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period'.

40. Section 17(1)(b) provides that for the purpose of ascertaining profits in respect of which a person is chargeable to tax under Part IV of the IRO, no deduction shall be allowed in respect of 'any disbursements or expenses not being money expended for the purpose of producing such profits'.

41. Section 68(4) provides that in an appeal to the Board of Review, the 'onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'.

The relevant principles in deciding deductibility of expenses

42. Deductible expenses are not limited to payments actually made. In Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] STC 366, Lord Brightman at page 370b said that:

'construing s 16, weight must be given to the fact that deductions are not confined to sums actually paid by the taxpayer. Such sums would be covered by the word "outgoings" standing alone'.

43. At page 370h, he went on to say that:

'"an expense incurred" is not confined to a disbursement, and must at least include a sum which there is an obligation to pay, that is to say an accrued liability which is undischarged.'

44. Our attention was also drawn to D94/99, IRBRD, vol 14, 603, So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416. In respect of deciding whether or not an expense is deductible, the Board must look at all surrounding circumstances and in

particular with regard to the relationship between the payor and the payee and all relevant circumstances arising out of that relationship.

Artificial or fictitious transaction

45. Section 61 of the IRO provides as follows:

‘ Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.’

46. We rely on the dicta of Woo JA in Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773 where he said at page 788 as follows:

‘ 40. The meaning of “artificial or fictitious” has been dealt with in Seramco Superannuation Fund Trustees v Income Tax Commissioners [1977] AC 287, where Lord Diplock giving the judgment of the Privy Council stated at p.298:

“Artificial” is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used Fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. “Artificial” as descriptive of a transaction is, in their Lordships’ view a word of wider import.’

47. Woo JA went on to say at paragraph 41 as follows:

‘ 41. The term “commercially unrealistic” appears in CIR v Howe (1977) 1 HKTC 936 at p.952 in the sense of “unrealistic from a business point of view”. We are of the view that whether a transaction which is commercially unrealistic must necessarily be regarded as being “artificial” depends on the circumstances of each particular case. We agree with the submission of Mr Cooney [counsel for the Commissioner], however, that commercial realism or otherwise can be one of the considerations for deciding artificiality.’

Discussion

48. The Consultancy Agreement was signed before the Taxpayer was incorporated. No convincing or reliable evidence was called before us as to how such an agreement could have been signed when the Taxpayer had not yet been incorporated. Indeed, no evidence was adduced as to how Mr Q signed the agreement and why a large part of page 2 of the

agreement was left in blank.

49. Ms D, however, in her evidence confirmed that the Taxpayer was simply bought from an accounting firm. She acquired her shares in the Taxpayer on 12 February 2003 and she did not dispute that she was appointed only as a director on 9 January 2003. It is important to note that at no time has the Taxpayer ever made any attempt to produce the original agreement for our review and consideration.

50. During the course of her evidence, Ms D relied significantly on the services of Mr J on behalf of Company H. However, we find that she knew nothing about the terms of the Consultancy Agreement. She confirmed that she does not speak nor read English and could not give any satisfactory explanation as to who was responsible for the Consultancy Agreement.

51. Mr J in his evidence said that he was not aware as to any of the details that led to the Consultancy Agreement being entered into.

52. We have no hesitation in coming to the conclusion that this purported Consultancy Agreement could never have been signed on 28 June 2002 and therefore, it was not a contemporaneous document. Indeed, the evidence we have heard clearly illustrates that neither the Taxpayer nor Company H intended to act according to the terms of the agreement. Therefore, we come to the conclusion that the copy agreement put before us was indeed a backdated document and it cannot be relied on.

53. We have to say that we take a very serious view of the attempt by the Taxpayer to put before the Board a document that clearly was not contemporaneously executed and then try to rely upon the Consultancy Agreement to support their position that the expenses should be deductible.

54. We have also had the opportunity to consider carefully the various invoices that were allegedly faxed by Company H to the Taxpayer. Again, no original invoices were ever produced before the Board for our inspection. There was no evidence to show that the invoices were contemporaneous documents. In particular, we note the following unusual and indeed peculiar features of the invoices:

- (a) A BVI address is given for Company H. However, Mr J in his evidence indicated to us that Company H did have an office in Sydney Australia where it carried on business.
- (b) The invoices had the words 'without prejudice'. Again, this is very unusual and no satisfactory explanation was given to us as to why the invoices referred to the Consultancy Agreement dated 28 June 2002. However, Mr J who prepared and signed the invoices confirmed to us in his evidence that he had never seen the Consultancy Agreement himself. He could not give us any convincing explanation as to why he would have this typed on the invoices.

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- (c) Neither Mr J nor Ms D could explain in their evidence to us as to how the monthly fees of US\$18,000 and US\$15,000 were arrived at.
- (d) The Taxpayer did not make payment according to the invoices rendered. Indeed, Ms D's evidence was that she considered that the Taxpayer could make payment whenever it liked to and in whatever amount she felt was owing to Mr J due to the services he rendered in Australia.

55. We have come to the conclusion that the invoices that were produced before us were not contemporaneous and again this was another attempt to mislead the Board.

56. We have also had the opportunity to consider the payment of HK\$1,500,000. Again, as stated above, no evidence has been adduced to us to reconcile this payment with the various consultancy fees allegedly charged under the invoices that were rendered. Indeed, no evidence was put to us as to why a sum in Hong Kong dollars was paid as opposed to US dollars. Indeed, the Taxpayer had failed to establish any evidence before us as to why a payment of HK\$1,500,000 was a payment of the so called consultancy fees. Indeed, on the Taxpayer's own case, the balance of the fees, HK\$840,000 remained outstanding since the completion of the project in 2004.

57. We also need to consider whether the consultancy fees if incurred were incurred in the production of the Taxpayer's chargeable profit.

58. Indeed, it is very unclear as to how much the Taxpayer did earn from the relevant project and in what capacity the Taxpayer was involved in the project and indeed, when it did become involved.

59. The evidence relating to the time at which the Taxpayer was involved in the project was unclear. It is clear from the evidence of Ms D and Mr J that the Taxpayer really only came into the picture when the deal with Company M was completed, that is, on or around 16 December 2002 and in turn, when the Taxpayer received instructions from Company M on 6 January 2003. We also have regard to the fact that Mr J in his evidence made it clear that Company S obtained a sum of A\$200,000. The extent of his involvement in the whole process of this project was also somewhat unclear. In her evidence in chief, Ms D stated that Mr J handled all documentation for the project. However, Mr J in his cross-examination said that he did not see any documents and he was not responsible for the tender documentation. He confirmed that he was only responsible for work carried out in Australia.

60. We accept that under such background, the consultancy fees of HK\$2,340,000 were hardly justified in the light of the activities that were carried out.

61. Indeed, we accept that a substantial amount of activities carried out by Mr J in Australia took place before the Taxpayer was incorporated.

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62. We have also had the opportunity to look at the letter dated 5 November 2009 from Company S addressed to 'To Whom It may Concern'. We note that no one from Company S appeared before the Board to give evidence. The letter states that Mr J on behalf of Company H provided a whole range of services for the benefit of the Taxpayer including initiation and negotiation, initial contact, manufacture, supply of an initial mark-up 'sample' to the Taxpayer with delivery in March 2002, co-ordination of tender documentation, arrangement with manufacturer of the Prototype unit, etc. However in Mr J's evidence before us, he said that in his initial contacts with the potential suppliers, he did not even mention he was acting on behalf Company H. It is clear that the Taxpayer only came into the picture when the deal was done and the installation of the sample of Prototypes took place before that date. This was supported by Ms D. It was also clear that Mr J was not involved in the tender documentation. Therefore, we have no hesitation in coming to the conclusion that Company S was attempting to put before the Board something that was not within their own actual knowledge. Hence, we cannot rely on this letter.

63. Having considered very carefully all the evidence and having reviewed the documents and the submissions of both parties before us, we have no hesitation in concluding that the Consultancy Agreement between the Taxpayer and Company H and the consulting fees that were paid was an artificial and fictitious transaction for the purpose of section 61 of the IRO. In particular, we have come to the conclusion that the Consultancy Agreement was not a contemporaneous document and we have also taken the view that the invoices submitted to us for our view and consideration were clearly not contemporaneous documents. As stated above, there is a lack of justification in respect of the substantial amounts of fees payable, whereas the fees are close to the profits of the Taxpayer for the relevant periods (before deduction of such fees).

64. There was also a clear lack of evidence of the services rendered by Company H on behalf of the Taxpayer. Regard should also be had between the relationship between the Taxpayer and Company H.

65. We have no hesitation in concluding that the transaction being impugned lacks commercial reality. We accept the submission of Mr Tam that the Taxpayer should be treated as (a) not having entered into any consultancy service agreement with Company H and (b) not having incurred any consultancy service fees.

66. Having considered all the evidence before us and the written submissions and the documents, we have no hesitation in coming to the conclusion that this appeal must be dismissed and we uphold the Determination made by the Acting Deputy Commissioner on 25 June 2009. Having regard to the way in which the Taxpayer conducted this appeal, we order pursuant to section 68(9) of the IRO that the Taxpayer do pay the sum of HK\$5,000 as costs.