INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D86/02

Salaries tax – whether artificial transaction – whether contract of service – section 61 of the Inland Revenue Ordinance ('IRO') – whether delay in taking action by the Commissioner.

Panel: Andrew Halkyard (chairman), Kenneth Ku Shu Kay and Michael Seto Chak Wah.

Dates of hearing: 18 April and 10 May 2002.
Date of decision: 15 November 2002.

At all material times, the appellant, through Company B, acted as Company A's principal and was in charge of Company A's insolvency department.

The appellant claims that he was not an employee of Company A and that the service fees paid by Company A to Company B should not be assessed to salaries tax as his employment income.

The appellant also claims that the Commissioner took up his case too late as Company B's books and record had been destroyed. Thus, there was a breach of natural justice.

Held:

1. The Board found that Company B was in the transaction only a receptacle into which the appellant's remuneration would be paid and as a vehicle for deriving very significant taxation advantages. Thus, this transaction is artificial within the terms of section 61 of the IRO and should be disregarded (Seramco Ltd Superannuation Fund Trustees v ITC (Jamaica) [1977] AC 287 and D69/98, IRBRD, vol 13, 412 applied).

2. The Board (the Chairman dissenting) found that the appellant had a disguised employment with Company A (Market Investigations v Minister of Social Security [1969] 2 QB 173 applied).

3. The Board found that there was no breach of natural justice in this case. There was no fault in the part of the Commissioner. The time lapse is regrettable but understandable.

Obiter:

Even if this transaction was not within the terms of section 61 of the IRO, it would be within the terms of section 61A of the IRO as it was carried out for the sole or dominant purpose of enabling the appellant to obtain a tax benefit.

Appeal dismissed.

Cases referred to:

Seramco Ltd Superannuation Fund Trustees v ITC (Jamaica) [1977] AC 287
D69/98, IRBRD, vol 13, 412
Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381
Cassidy v Ministry of Health [1951] 1 All ER 574
D19/78, IRBRD, vol 1, 323
Chan Kwok-kin v Mok Kwan-hing [1991] 1 HKLR 631
Lee Ting-sang v Chung Chi-keung [1990] 2 AC 374
Market Investigations v Minister of Social Security [1969] 2 QB 173
Ferguson v John Dawson & Partners (Contractors) Ltd [1976] 3 All ER 817
Hall v Lorimer [1994] STC 23
D47/00, IRBRD, vol 15, 422
D22/92, IRBRD, vol 7, 246
D103/96, IRBRD, vol 12, 49
D103/97, IRBRD, vol 12, 555

Ng Yuk Chun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the additional salaries tax assessments raised on the Appellant for the years of assessment 1992/93 to 1995/96 inclusive. The Appellant claims that he was not an employee of Company A and that the service fees paid by Company A to Company B should not be assessed to salaries tax as his employment income.

Agreed facts

2. The Appellant had previously been employed as a manager of Company C. His employment with Company C ceased in January 1991.

3. In the years of assessment 1992/93 to 1995/96, the Appellant declared the following income in his salaries tax returns or tax returns:

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$
Income from Company B	78,000	625,000	122,000	-
Income from Company D from 7-1995 to 3-1996	-	-	-	2,400,000
Total income	78,000	625,000	122,000	2,400,000

The Appellant declared in his salaries tax return for the year of assessment 1992/93 that Company B provided him with quarters for the year ended 31 March 1993.

4. Based upon the above returns the assessor raised the following salaries tax assessments on the Appellant:

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$
Net chargeable income	39,800	625,000	48,900	2,400,000
Tax payable thereon	2,182	93,750	3,001	360,000

The Appellant did not object to these assessments.

5. (a) Company B was incorporated in Hong Kong as a private company on 7 March 1991 with an issued and paid up capital of $2.

(b) At all relevant times the Appellant and his wife, Ms E, were Company B's only shareholders and directors. At all relevant times Company B's business address was the same as the Appellant's residential address.

(c) Company B closed its accounts annually on 30 June. The following income and expenditure was shown in its accounts from the date of incorporation to 30 June 1994:

Year ended	**30 June 1992**	**30 June 1993**	**30 June 1994**
	$	$	$
Income			
Consultancy income	888,259	1,245,350	805,000
Rental income	8,000	10,000	-
	896,259	1,255,350	805,000

Expenses			
Audit fee	6,000	7,000	7,000
Bank interest or charges	410	140	192
Cleaning	22,670	30,998	32,461
Consultancy fee	-	-	35,000
Depreciation	11,920	46,814	84,085
Directors' salaries	73,600	625,000	122,000
Entertainment	56,849	84,521	150,735
Medical expenses	22,989	22,013	10,883
Motor car expenses	-	14,203	56,587
Newspaper	3,264	10,945	7,635
Printing and stationery	430	205	3,513
Rent, rates etc	350,098	328,908	46,596
Repairs etc	-	4,489	8,120
Sundry expenses	9,843	6,405	3,976
Telephone and fax	11,565	26,438	15,519
Travelling	59,342	26,991	48,724
Tuition and education	11,050	6,400	-
Utilities	15,240	15,151	15,749
	655,270	1,256,621	648,775
Profit (Loss)	240,989	(1,271)	156,225

(d) Company B's fixed assets, on which depreciation was claimed, included a golf motor vehicle, domestic electrical appliances and domestic furniture.

(e) Company B has not submitted to the Inland Revenue Department ('IRD') its profits tax return for the year of assessment 1995/96 or accompanying accounts for the year ended 30 June 1995.

(f) By special resolution passed on 20 November 1997, it was resolved that Company B be wound up voluntarily. In a letter dated 21 January 1998 to the IRD, the liquidator of Company B stated that Company B had not traded and had no income of any sort since early 1995.

6. The agreed facts relating to the provision of service by the Appellant to Company A are:

(a) The Appellant commenced to provide service to Company A through Company B from 9 December 1991.

(b) The date of cessation of the Appellant's engagement with Company A was 15 June 1995.

(c) There was no written service contract entered into between Company A and Company B. Nor was there any written agreement between Company A and the Appellant.

(d) The Appellant acted as Company A's principal in charge of Company A's insolvency department.

(e) The following employees worked in the insolvency department when the Appellant headed the department: Ms F (secretary), Ms G (senior – joined 8 February 1993) and Mr H (senior – left 9 October 1993).[1]

(f) At all relevant times the Appellant used a name card that described him as 'Principal' for '[Company A] – Certified Public Accountants'. There is no reference on the card to Company B.

(g) Company A made the payments of service fees for the Appellant's work to Company B's bank account. The amounts were:

Year ended 31 March	**Amount**
1993	$655,000 (basic payment of $30,000 per month × 12 + variable payment[2] of $295,000)
1994	$710,000 (basic payment of $30,000 × 3 months + $35,000[3] × 9 months + variable payment of $305,000)
1995	$1,347,651 (basic payment of $35,000 × 3 months + $39,000[4] × 9 months + variable payment of $891,651)
1996	$417,847 (basic payment of $39,000 × 2 months + variable payment of $339,847)

(h) The Appellant was not required to employ his own assistant.

(i) A summary of reimbursement for entertainment expenses made by Company A to the Appellant during 1993 and 1994 and copies of the supporting vouchers are at appendices C1 and C2 to the determination.

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[1] Another employee, Mr I, was also employed during the first half of 1992 (see bundle A1, pages 1 to 3).
[2] This variable payment was calculated at 40% of the net profit generated by the insolvency department.
[3] Increased from $30,000 to $35,000 in July 1993.
[4] Increased from $35,000 to $39,000 in July 1994.

(j) The fees for the Appellant's appointment as receiver or liquidator were charged by Company A and were recorded as trading receipts of Company A. Those fees were included for the purposes of computing the amount of the variable payment made by Company A.

7. On divers dates the Commissioner raised on the Appellant the following additional salaries tax assessments under section 61A of the IRO:

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**
	$	$	$	$
Service fee paid by Company A to Company B	600,000	710,000	1,347,651	417,847
Income from Company D	-	-	-	2,400,000
Total income	600,000	710,000	1,347,651	2,817,847
Less: Charitable donation	-	-	1,100	-
Income already assessed	39,800	625,000	48,900	2,400,000
Additional assessable income	560,200	85,000	1,297,651	417,847
Additional tax payable	87,818	12,750	198,981	62,677

8. The Appellant objected to the assessments at paragraph 7 above.

9. In the determination issued by the Commissioner on 31 December 2001 relating to the Appellant's objections, the additional salaries tax assessments for the years of assessment 1993/94 to 1995/96 inclusive were confirmed and the additional salaries tax assessment for the year of assessment 1992/93 increased as follows:

Year of assessment	**1992/93**
	$
Service fee paid by Company A to Company B	655,000
Less: Income already assessed	39,800
Additional assessable income	615,200
Additional tax payable	96,068

In the determination the Commissioner considered that:

(a) the Appellant entered into a transaction (involving the interposition of Company B between the Appellant and Company A) that was artificial or fictitious within

the terms of section 61 of the IRO and should be disregarded. He considered that the income in question was in substance the Appellant's personal income chargeable to salaries tax; and

(b) in any event, this transaction was carried out for the sole or dominant purpose of enabling the Appellant to obtain a tax benefit within the terms of section 61A of the IRO. In the result, the Commissioner concluded that the service fees paid by Company A were in substance remuneration of the Appellant for the services rendered to Company A as an employee.

10. On 31 January 2002 the Appellant appealed to the Board of Review against the Commissioner's determination. The grounds of appeal were:

(a) he was not an employee of Company A at any time and thus no salaries tax can be payable; and

(b) there was a breach of natural justice in the way in which this matter has been taken up long after the proper time for its consideration, which was well after Company B's books and records had legally been destroyed following its liquidation.[5]

The law

11. The overall issue for our decision is whether, and if so to what extent, the Commissioner's determination at paragraph 9 is correct. Our decision has been based upon consideration of sections 8(1), 9A, 12(1), 14, 16(1), 61, 61A and 68(4) of the IRO and the following propositions of law.

Section 61

12. In Seramco Ltd Superannuation Fund Trustees v ITC (Jamaica) [1977] AC 287 the Privy Council decided that the statutory terms 'artificial' and 'fictitious', appearing in a legislative provision very similar to section 61, are not legal terms of art and are capable of bearing a variety of meanings according to the context in which they are used. It was also held that 'artificial' has a wider meaning than 'fictitious' and that a commercially unrealistic transaction is considered 'artificial' (see also D69/98, IRBRD, vol 13, 412).

Section 61A

13. Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381 at 399B to H, per Rogers JA:

[5] The Appellant also contended that the IRD had failed to provide him with evidence on which it relied, namely the documents provided to it by Company A. Prior to the hearing, however, this documentation was provided both to the Appellant and to this Board and the Appellant did not pursue this matter at the hearing.

> *' ... the tests set out in s.61A have to be applied objectively.*
>
> *There are seven matters (a) to (g) to which the section requires that regard must be had. On a clear construction of the subsection, the section would not be relevant or the subject matter of consideration unless there was a tax benefit. ... On that basis, the various matters at (a) to (g) have to be considered and if upon that exercise, the conclusion would be arrived at that the person who entered into or carried out the transaction did so for the sole or dominant purpose of obtaining a tax benefit, the Assistant Commissioner may exercise one of the two powers set out in sub-s.(2).*
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> *In this Court, there was some discussion as to whether it is necessary for more than one item in matters (a) to (g) to indicate the sole or dominant purpose for it to be possible that that conclusion be arrived at. In my view, the posing of the question itself possibly indicates an erroneous approach to the section. Clearly, what must happen is that those matters must be considered and the strength or otherwise of the various resulting conclusions from considering those matters must be looked at globally. On the basis of that assessment, it must be decided whether the sole or dominant purpose was the obtaining of a tax benefit. It may be observed, for example, that one or other of the matters in (a) to (g) may be strongly or weakly suggestive of a purpose of obtaining a tax benefit or may be strongly or weakly suggestive of some other purpose. The Assistant Commissioner who undertakes such task has to use his own common sense and apply the results of his deliberations in respect of each matter and come to an overall conclusion.'*

Whether in substance the Appellant held an employment

14. An employment exists where there is a contract of service as opposed to a contract for services (Cassidy v Ministry of Health [1951] 1 All ER 574 and D19/78, IRBRD, vol 1, 323). In Chan Kwok-kin v Mok Kwan-hing [1991] 1 HKLR 631 the Court of Appeal decided that no single test determined whether a contract was one of service or for services, that ultimately this is a question of fact and that it is necessary to balance all relevant factors in deciding the overall classification of an individual (see also Halsbury's Laws of England 'Contract of Employment' volume 16, 4th edition, at pages 8 and 9). Generally, however, courts in Hong Kong have adopted the so-called 'work on own account' test to determine whether a worker was an employee or an independent contractor. The Privy Council approved this in Lee Ting-sang v Chung Chi-keung [1990] 2 AC 374; [1990] 1 HKLR 764 per Lord Griffiths:

> *' Their Lordships agree with the Court of Appeal when they said that the matter had never been better put than by Cooke J at pages 184 and 185 in Market Investigations v Minister of Social Security [1969] 2 QB 173:*
>
> *"The fundamental test to be applied is this:*
>
> *Is the person who has engaged himself to perform these services performing them as a person in business on his own account?"*
>
> *If the answer to that question is "Yes", then the contract is a contract for services. If the answer is "No", then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and the factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.'*

15. The way in which the parties themselves treat the contract and the way in which they describe and operate it are not decisive and may, if amounting to mere labelling, be wholly disregarded. What must be considered is the correct categorisation of the relationship objectively (Ferguson v John Dawson & Partners (Contractors) Ltd [1976] 3 All ER 817).

16. A number of useful general statements of principle also emerge from the English Court of Appeal decision in Hall v Lorimer [1994] STC 23. This case accepted that the test to be generally applied in determining whether an employment exists is that laid down in Market Investigations v Minister of Social Security [1969] 2 QB 173 quoted above. The court then went on to state:

> *'In order to decide whether a person carries on a business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a check list to see whether they are present in or absent from a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative, appreciation of the whole. It is a matter of*

evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another. The process involves painting a picture in each individual case.' ([1994] STC 23 per Nolan LJ at 29).

The hearing before us

17. The Appellant produced the following documents:

(a) Quarterly accounts of the insolvency department of Company A from 9 December 1991 to 31 March 1995.[6] These accounts showed the income derived from insolvency work, less staff salaries,[7] less overheads (after deducting charges made to other departments) and direct costs. From these calculations, a profit was generated and a 40% share thereof became payable to the Appellant (in addition to the basic monthly payment). At the end of each account was contained wording such as 'Share to [the Appellant]' and/or 'Payable to/(by) [the Appellant]'. No reference was made in those accounts to Company B. On two occasions for the three-month periods ended 30 June 1992 and 31 December 1993, the insolvency department generated a loss. The Appellant's share of the loss was calculated in the accounts at $9,398 and $25,278 respectively.

(b) Various pieces of internal office correspondence between the Appellant and Mr J, and between the Appellant and Company A's other partner, Ms K, relating to the calculations of the profits shown in the quarterly accounts for the insolvency department. It is fair to say that this correspondence shows that the profit calculations were contentious. Clearly there was vigorous debate between the parties as to the correct method for determining the profits, particularly on allocating salary costs[8] and inter-departmental charges. It is also fair to say that the terms of this correspondence shows that the Appellant was extremely frustrated over the lack of action by Mr J in agreeing his 'bonus calculations'.[9]

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[6] Accounts for the quarter ended 30 June 1994 were not produced.

[7] In each account the item for 'Salaries' included an entry for a fixed monthly sum payable for the Appellant's services. When asked in cross-examination why he should be paid a 'salary', the Appellant stated that a junior member of Company A's accounting staff (details not given) prepared the accounts.

[8] For example, the level of salary costs charged to the insolvency department for Mr I (see footnote 1 above) for the period December 1991 to May 1992 was ultimately agreed between Mr J and the Appellant only on 20 May 1992 (see bundle A1, page 2). It appears to us that Mr J made the initial decision to transfer Mr I to the insolvency department and to charge his salaries to the department.

[9] The documentation showed that although Company A paid periodically on account, for example, six payments were made for the period 9 December 1991 to 31 March 1993, only the first period figures were agreed by the time the 31 March 1993 account was prepared. At that time slightly more than one-third of the total amount payable (based upon those accounts) remained as 'Amount Now Due to [the Appellant]' (see bundle A1, page 8). On 13 May 1993, the Appellant wrote to Mr J asking for 'some action of concluding on my bonus calculations from 1 April last year to [31 March 1993]. This is fast reaching the point where it becomes a joke which I think is most unfair' (see bundle A1, page 9). By 31 March 1994, ten payments had been made on account and the 'Amount Now Due to [the Appellant]' was reduced to approximately 22% of the total amount payable (see bundle A1, page 16). The aggregate calculations referred to in this footnote deducted the 'loss' of $9,398 and $25,278 attributable to the insolvency department for the three months ended 30 June 1992 and 31 December 1993 respectively. On 25 October 1994, the Appellant wrote to Mr J stating 'A week has passed since I asked for breakdowns of several figures in the overheads calculation but I have not received any information at all. Please

(c) Various pieces of internal office correspondence and time sheets showing the direct amount of time spent by Mr J on insolvency client matters. It is fair to say these documents showed that this time was fairly negligible. For instance, in the year ended 31 March 1993 Mr J only billed a total of 60 hours and in the period 1 January to 30 June 1995 Mr J only billed a total of 1.9 hours.

(d) An aide memoire written by the Appellant on or around 16 May 1995 concerning a meeting held between the Appellant, Mr J and Ms K in which '[Mr J] expressed surprise at [the Appellant's] resignation'. During the meeting, the participants discussed which insolvency cases the Appellant would handle and which cases Company A would handle following the Appellant's resignation (see further (e) below).

(e) A schedule of the 'current and closed jobs [namely cases handled by the insolvency department] as at 26 May 1995' showing those cases for which Mr J would resign as liquidator and those cases for which the Appellant would resign. The schedule, produced under the Appellant's authorisation, also showed those jobs not yet commenced that would be retained by Company A and those that would be retained by the Appellant.

(f) Correspondence between the Appellant and Company A from August 1995 to October 1995 (a period after the Appellant's resignation from Company A) disclosing clear differences between the parties on the amount due to the Appellant from Company A. The differences mainly concerned the extent to which staff costs attributable to the insolvency department following the Appellant's departure should be taken into account.

18. The Appellant also gave sworn evidence before us and was cross-examined. We summarise this evidence, which where appropriate refers to the documents produced before us by both parties, as follows:

(a) General background

He left Company C (for whom he had worked for several years) on 31 January 1991 to work independently as a consultant and to set up a number of small businesses. With the encouragement of Ms E, they purchased Company B (a shelf company) to accommodate his business income and any further income

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expedite this process as [Mr I] is not prepared to calculate my bonus calculation for the quarter ended 30 September 1994 until this is resolved. This in turn means that the money that I am owed is being held up indefinitely' (see bundle A1, page 21). By 16 May 1995, which was on or around the date the Appellant resigned from Company A, the Appellant still informed Mr J that he was 'unhappy with the fact that my bonus calculation was not agreed for over three years' worth' (see bundle A1, page 25).

Ms E may have.[10] At this time, he had no intention of joining Company A or using Company B as a means of obtaining a tax benefit on his remuneration from Company A. He intimated that, given Company C's involvement with the collapsed Group L, he was concerned with the issue of personal liability.

(b) Joining Company A

(i) Ms E introduced the Appellant to Mr J, a wealthy and generous individual. Mr J wished to engage his services to head Company A's insolvency department. The use of Company B was not agreed as part of the terms to procure his services to Company A and Mr J was interested in his personal service before they discussed any role to be played by Company B. For his part, the Appellant's intention was to use his contacts in the insolvency field to attract work, through Company A, which would involve his being appointed as liquidator or receiver of companies in financial difficulties. When the parties discussed the terms of the engagement, the Appellant negotiated to receive not only a fixed monthly sum, but also a share of the profits of the insolvency practice.

(ii) When the Appellant formally joined Company A on 9 December 1991 he did so through Company B as a consultant to Company A. He did so because (1) he anticipated (correctly) that he and Ms E would continue to have outside consultancy and other income that he would put through Company B, and (2) Company B afforded him the advantage of limited liability. Although the Appellant admitted that there were undoubtedly taxation advantages in arranging his affairs through Company B, he said it was certainly not the case that Company B contracted with Company A for the sole or dominant purpose of obtaining a tax benefit.

(c) Working in Company A and relationship with Mr J

(i) Upon commencing work, the Appellant acted as Company A's principal in charge of its insolvency department. Company A established the insolvency department upon his arrival. When he started work, he was provided with a secretary, Ms F, who was recruited by Company A. Mr H, an auditor who worked for Company A, was then also transferred to the insolvency department. Subsequently, the Appellant recruited Ms G, who joined the department in February 1993. Company A was not big enough to have a large, structured insolvency department. Thus, the work undertaken consisted of more technically challenging assignments.

[10] Although the Appellant claimed that Ms E earned income for Company B, he could not remember what that work was or how much income was involved. At all relevant times, Ms E held full-time employment with unrelated employers. The Appellant admitted under cross-examination that Ms E did not receive any director's fees or salaries from Company B.

Mr H and Ms G handled the more routine work, while the Appellant handled more demanding work.

(ii) The Appellant's name card described him as 'Principal' of Company A. He accepted that this term is often used in the accounting profession to describe someone with a position below that of partner and that he held himself out in this way.

(iii) In the affidavit of fitness for a person to be appointed by the court as liquidator or receiver, the Appellant agreed that he would have been described therein as 'Principal' of Company A rather than as 'Partner' or some other term. He stated, however, that how a person was described in the affidavit was of no relevance. He did not acknowledge that in the affidavit he was held out publicly as an employee of Company A.

(iv) The Appellant normally worked in Company A's offices on Hong Kong Island, although he sometimes worked at home. He often left the office to visit clients. Office hours were from 8:45 a.m. to 6:00 p.m., but he did not adhere to these.

(v) Company A provided the Appellant with his own office, a phone line, and postal and typing services, but no computer. In cross-examination upon Company A's letter to the assessor stating that he was not required to provide his own equipment and facilities, he intimated that accountants do not use much equipment, but that he did purchase and use his own pens, calculator and some textbooks.

(vi) The insolvency department was situated on a separate side of Company A's office. Sometimes the Appellant would not communicate with Mr J about insolvency matters for days, even weeks, on end. Indeed, it is clear from the documentation produced (footnotes 8 and 9 and related text above refer) that the Appellant had an appreciable amount of trouble and experienced no little frustration in arranging to see Mr J to settle the quarterly profit of the insolvency department.

(vii) The Appellant placed particular emphasis in his evidence to the effect that neither Mr J nor Ms K had any significant involvement in the activities of the insolvency department during the time he provided services to Company A. He stated that neither partner exercised any real control over him (and certainly no control over technical matters) and that he had near complete autonomy in running the insolvency department. Although admitting that sometimes he discussed insolvency matters with both

partners, he denied that, as a substantive matter, he was required to report to Mr J in terms of professional matters. In the Appellant's words 'there were no rules to obey and I was never given any'. The Appellant stated that Mr J did not decide on the work to be done by the insolvency department and his role was confined to executing certain documents (such as security bonds and letters of appointment that had to be signed by all liquidators), providing general commercial advice, and using his contacts to make work introductions. In the Appellant's words, Mr J's control over his activities was 'inconsequential'.[11]

(viii) The Appellant was cross-examined upon an office memorandum from Mr J addressed to all 'PICs & EICs' informing senior members of staff of Mr J's impending absence from Hong Kong (see bundle A1, page 13). The Appellant professed not to remember what 'PIC' meant. We infer that this acronym refers to 'Principal in Charge'.

(ix) The Appellant disagreed with Company A's statement to the assessor that there was no joint venture entered into with Company B or the Appellant and thus no joint venture accounts were prepared. He stated that he received a (relatively small) fixed monthly draw, plus a profit share that was only distributable upon collection. He said joint venture accounts were prepared (see footnotes 6 to 9 and related text above).

(x) The Appellant was cross-examined upon Company A's statement to the assessor that it reimbursed his outgoings and expenses, such as entertainment and travelling, incurred in the performance of his duties. He disagreed with this general statement. He stated that he did not recall Company A reimbursing him for any travel expenses. Although he recalled that Company A did reimburse some entertainment expenditure, this only covered part of a small percentage of the total. Initially he stated that these would mostly have been referable to a specific assignment and thus would be passed on as a claim against the estate.[12] Later the Appellant stated that he suspected that the reimbursed expenses might not have been directly concerned with the insolvency department but probably involved expenses that were more appropriately charged to other departments within Company A, such as the audit department. The

[11] It is clear, however, from the documentation produced to us that sometimes the Appellant did discuss difficult and large liquidation cases with Mr J (see, for example, bundle A1, page 19 concerning the liquidation of Company M; see also page 33 where both Mr J and Ms K recorded billable time for another company for which substantive liquidation work had not yet commenced). The precise nature of those discussions was not explained to us, although as a general matter the Appellant's evidence was to the effect that Mr J's billable hours related mostly to attendance at meetings and signing documentation and Ms K's involvement only related to company secretarial work.

[12] At the assessor's request, Company A supplied documentation for reimbursements for the period commencing April 1993 and ending October 1994 (paragraph 6(i) refers). Nearly all of the vouchers for which payments were made (only 12 in total) contained the annotation 'Charge to Insol/Insolvency Department'. On one occasion, the annotation was 'Charge to [Company A]'. On one occasion, the original annotation was scrubbed out and replaced by 'Charge to Insol Dept'.

Appellant described these expenses as being incurred for the purposes of 'cross selling'.[13] The Appellant also referred to Company B's accounts for the period from incorporation until 30 June 1994,[14] where appreciable amounts were claimed for both entertainment and travelling (as well as for medical and professional education or tuition expenses). In the Appellant's words 'The whole arrangement was a joint venture. If I had [a drink] with somebody, then that was Company B's contribution because Company B stood to gain from additional work.'

(xi) The Appellant was then cross-examined upon Company A's statement to the assessor that he received medical benefits from the firm. He replied that, to the best of his recollection, he did not receive medical benefits from Company A. He noted that, unlike Company A's reimbursement of entertainment expenses, Company A was not able to produce any copies of medical expense claims made by him. Moreover, the accounts of Company B showed that it incurred medical expenses for at least the first three years in dispute. He also noted that during this period Ms E worked for a multinational group in Hong Kong that provided both her and the Appellant with a good medical benefits scheme. The Appellant stated that he availed himself of this scheme.[15]

(xii) The Appellant also disagreed with Company A's claim to the assessor that he was entitled to annual leave of three calendar weeks per annum, and that he was required to report to one of Company A's partners for leave taken. He stated that there was no agreement as to holiday leave and, indeed, Company A had no leave records for him. In any event, he stated that he took more than three weeks leave each year. Whilst he was on leave, Company A continued to pay the fixed monthly sum.

(xiii) The Appellant agreed that each July he received an annual increase from Company A for the fixed monthly sum, but stated that there was no formal review mechanism for such increase.

(xiv) The Appellant disagreed with Company A's statement to the assessor that he was not liable for any debts incurred in the ordinary course of Company A's business during the period of the engagement. He noted that Company B did not receive any bonus until Company A received

[13] This explanation accords with the memorandum dated 20 May 1992 from Mr J to the Appellant stating 'All departments shall bear their own specific and identifiable entertainment expenses together with a share of [Mr J's] overall entertainment expenses' (see bundle A1, page 2).
[14] The Appellant noted that he could not produce specific vouchers for any unreimbursed entertainment and travelling expenditure because Company B's books and records had been destroyed.
[15] Company A's standard contract of employment provided that certain medical benefits would be made available to employees. The scope and terms of this coverage were not made available to us. There is no evidence before us as to the precise nature of the medical expenses charged in Company B's accounts and why they were not claimed from Company A, or indeed from Ms E's employer.

funds from its clients. Any bad debts would thus reduce the variable profit share payable under the arrangement. In cross-examination the Appellant did not agree with the suggestion that he did not actually have to make good bad debts. Although the Appellant admitted that he never discussed with Mr J what would happen if the insolvency department made a loss overall, he felt sure that any loss would have been carried forward and recouped when the department became profitable. We infer from the tenor of his evidence that he and Mr J never contemplated that the department would lose money nor considered what would happen if losses continued. He also stated that Company A did have to indemnify him as liquidator and receiver because of the nature of these personal appointments.

(xv) The Appellant disagreed with Company A's statement to the assessor that he was not allowed to work for other organizations. At all relevant times, Company B earned extra income[16] derived from services rendered by him to parties other than Company A. Services included advice on setting up business ventures, and corporate investment. He could not recall whether these involved insolvency matters, although he did state that his intention was that Company A would be the entity through which he would perform his insolvency work, as distinct from general consultancy work. The Appellant explained that the reason for this was that although a liquidator is a personal appointment, the reality is that creditors expect to see substance, namely an accountancy or legal firm, behind it. He stated that if he took on an appointment as liquidator or receiver, he had to do so through a reputable organisation. That is why he had a relationship with Company A. The Appellant stated that virtually all the remuneration derived by the insolvency department came from executive appointments of himself and Mr J (jointly)[17] as liquidator or receiver and that virtually all the work for the department was introduced by himself or Company B, except for one or two jobs for individual clients introduced by Mr J. He confirmed that the fees for his appointment as receiver or liquidator were charged by Company A and were trading receipts of Company A.

(xvi) When he resigned from Company A, the Appellant and Mr J divided up the on-going jobs between themselves as to who would continue to act as liquidator. The Appellant stated that the normal practice in accounting

[16] In view of the different accounting year-end dates for Company A and Company B, it was not clear exactly how much extra income Company B earned apart from the remuneration received from Company A. It appears, however, that the amounts for the years ended 30 June were: $738,259 [less an undetermined amount for pre-Company A work] (1992), $590,350 (1993) and $95,000 (1994). The Appellant agreed that during the period in dispute he spent most of his time working in Company A's insolvency department.

[17] The Appellant stated that it is standard procedure in insolvency work for liquidators to be jointly appointed. Thus, when Company A undertook liquidation work, he was generally appointed jointly with Mr J and was only rarely appointed as the sole liquidator.

firms specialising in insolvency work is that when a partner or employee acting as liquidator leaves the firm, that person resigns as liquidator because he has taken the appointment on behalf of the firm. It is the firm that bills and derives the income. But in his case the normal practice did not apply. This was because he brought in the clients and thus when the on-going jobs were divided between him and Company A, Company A continued to act only in the simpler members' voluntary (that is, solvent) liquidations whereas he acted in the more complex creditors' and creditors' voluntary liquidations.[18] Jobs yet to be commenced (four in total) were also divided between the Appellant and Company A along similar lines. Company A also continued to represent clients in some more general non-liquidation matters. Upon leaving Company A, the Appellant joined a specialist insolvency firm who took over the jobs retained by him.

(d) Other matters

(i) The Appellant could not recall when Company B's books and records were destroyed, but he thought that this would have taken place some three months after the date of the final creditors' meeting. He noted that the destruction would have taken place before any dispute arose relating to his personal tax affairs. He intimated that this was why he could not now produce any documents relating to Company B's arrangements with Company A. He did not agree that he liquidated Company B because it was a service company that was used to mask a disguised employment, which, after August 1995, could have been attacked under the newly enacted section 9A of the IRO.

(ii) The Appellant could not adequately explain why Company B did not lodge its profits tax return for the year of assessment 1995/96 when requested to do so by the assessor, other than to say that Company B made no profit for the year and that there was no benefit to anyone in just ticking boxes. The Appellant stated that it never occurred to him that the IRD might regard the interposition of Company B between him and Company A as tax avoidance, amenable to attack under sections 61 and 61A.

[18] Of the ten resignation cases, the Appellant retained six, including the largest involving a company called Company M and Company A retained four, one of which was nearly complete and the remaining three being (although the Appellant admitted that he could not remember well) members' voluntary liquidations. The Appellant indicated that he took over the more complex cases after his departure in part because Company A did not have the technical expertise to discharge this work.

19. The evidence of Ms G

(a) Ms G gave sworn evidence on behalf of the Appellant. She joined Company A as an employee in February 1993. Although having some experience in insolvency matters, she was not a qualified accountant. The Appellant supervised her and gave her instructions. She supported the Appellant's assertions that he had complete control in running the insolvency department and that Mr J's involvement was negligible. She stated that Mr J was rarely in the office and she did not recall him ever having instructed her or the Appellant to do anything on any insolvency assignment. It appeared to her that Mr J had almost no knowledge of the day-to-day management of the assignments. She agreed that the Appellant was technically competent enough to head the insolvency department without any supervision from Mr J and that the Appellant would merely need to keep Mr J informed.

(b) Ms G's understanding of the term 'Principal' related to a person who ran a department.

The Appellant's contentions

20. Not an employee of Company A

(a) The Appellant's primary contention was that he was not an employee of Company A and thus the salaries tax assessments must fall away. By analogy, he adopted the six criteria of employment set out in section 9A(3) of the IRO and argued that none of these was met in his case.

(b) The Appellant reiterated that there was never any written contract of employment[19] and, in any event, it was common ground that Company B was the party contracting with Company A. The Appellant argued that his negotiations and dealings with Mr J were at all times conducted on the basis of being 'business partners'.

(c) Although admitting that most, but not all, of his time was spent working for Company B on matters relating to Company A, there were a number of specific characteristics of employment missing from the arrangement, such as provision

[19] The Appellant contrasted his position with that of a normal employee appointed under the terms of Company A's standard contract of employment (a copy of which was produced at bundle R1, page 21). Specifically, unlike a normal employee of Company A: he was not paid a monthly salary (his remuneration was unique within Company A), there was no agreed notice period (in fact the agreement came to an end much more quickly than the normal three month period), there were no agreed leave arrangements (in fact he did take leave, which he thought exceeded three weeks per year, but Company A had no records and this underscores the degree of informality present in this matter), he was however subject to a confidentiality obligation to Company A, he did not devote himself wholly to the work of Company A (Company B carried on other business), he cannot recall being given any office manual, and he was not obliged to observe normal office hours.

for holidays, sick leave, working hours, passage, pension entitlements and medical benefits.

(d) The Appellant also pointed to the fact that the relationship with Company A was not exclusive and that, at all relevant times, through his efforts Company B continued to derive other sources of income.

(e) In the Appellant's view, what was most significant in this case was the absence of control by Company A over himself as head of the insolvency department or over Company B that would be commonly exercised by an employer. He noted that Ms G had confirmed this. Indeed, any such control would have been inconsistent with his statutory role as liquidator and his contractual role as receiver. The Appellant argued that Company A could not terminate his position as liquidator or receiver of the companies to which he had been appointed and that he was jointly and severally liable for his actions in relation to these appointments. He contended that this is brought out very clearly by the fact that when Company B's and Company A's arrangements came to an end, he remained as liquidator or receiver of almost all of the companies and Mr J resigned as liquidator or receiver of almost all.

(f) In the Appellant's view, the starting point to determine the existence of an employment is always control and, in his case, the absence of supervision, direction, and Mr J's lack of involvement in the insolvency practice is conclusive against the existence of an employment. The Appellant stressed that Mr J did not have the expertise to control him in relation to running an insolvency practice, whatever control existed was negligible at best, the involvement of Company A's partners in running the insolvency department was minimal, and thus the facts are inconsistent with the existence of an employment relationship. The Appellant buttressed his argument by referring to his correspondence with Mr J (footnote 9 refers). He contended this shows that the flavour of their relationship was not one of employment, that Mr J had no influence over the work of the insolvency department, that Mr J rarely discussed insolvency matters with him and that Mr J spent very little billable time on insolvency matters.

(g) The Appellant noted that Company A was a firm of certified public accountants. It would well appreciate its taxation compliance obligations and it is noteworthy that it did not prepare any employer's return for him.

(h) Turning to his financial relationship with Company A, the Appellant noted that the insolvency department acted autonomously and was an independent profit centre. Company B received a profit share that was not calculated by reference

to his performance alone, but rather by the performance of the insolvency department as a whole. Company B's remuneration was not, in the main, paid or credited periodically but was calculated on a percentage of earnings basis that was not commonly used under a contract of employment. He noted that no other department head or staff member of Company A was entitled to a bonus calculated on a similar basis. This 'for profit' arrangement was, in the Appellant's view, inconsistent with a contract of employment. Although admitting that some employees are remunerated on a bonus or profit basis, the Appellant noted that normally the results on which the remuneration is based are either simply delivered to the employee confidentially, or that the basis used for computation is quite straightforward. In his case, the Appellant entered into protracted discussions regarding calculation matters; by way of contrast, employee bonus schemes do not allow employees to do this. The Appellant contended it was also significant that he did assume financial risk in the arrangement with Company A and this is illustrated by the fact that losses were incurred by the insolvency department and were carried forward in two quarterly periods. Thus, Company B did have a financial interest in its relationship with Company A, which the Appellant described as a 'joint venture'.

(i) The Appellant argued that Mr J had no power to remove him from his appointments as liquidator and receiver.

(j) The Appellant argued that he was not held out to be an employee of Company A. The title of 'Principal' on his name card plainly indicates, in the Appellant's view, that his relationship with Company A was somewhat different to that of employer and employee and denotes nothing other than a partner or partner equivalent. He contended that the meaning of the term 'Principal' varied from firm to firm and that it could not be right to conclude that all principals are employees. The Appellant noted that he received no promotion in Company A: he started as 'Principal' running the insolvency department and finished as 'Principal'.

(k) The Appellant pointed to the fact that upon his resignation he retained his appointment as liquidator in the biggest and more complex cases. He contended that this is not indicative of his having an employment relationship with Company A.

(l) In conclusion, the Appellant contended that the facts clearly disclose that he had entered into a business venture (or joint venture) with Company A and that every dollar of remuneration was hard fought. Finally, he referred to Market Investigations v Minister of Social Security (above) and contended that the majority of the indicia for carrying on business on own account such as:

provision of own equipment, hiring his own helpers (Ms E), degree of financial risk he assumed, the degree of responsibility for investment and management he possessed, and whether and how far he had an opportunity of profiting from sound management in the performance of his task, were all present in his case.

21. Sections 61 and 61A

The Appellant contended that Company B was not established for tax avoidance purposes. Indeed, the Appellant argued the facts before us show that Company B predated the arrangement with Company A, it derived other income both prior to and during the arrangement with Company A and that Company B provided him with protection against unlimited personal liability.

22. Breach of natural justice

The Appellant argued that there was a breach of natural justice in the way this matter had been taken up long after the books and records of Company B had been validly and legally destroyed. He claimed that he had made full disclosure to the IRD and had no intention to hide any information from the assessor. Yet the first additional salaries tax assessment was issued after Company B was liquidated. According to the Appellant, many of Company B's documents that would have been relevant to his appeal are no longer available. For instance, he was not able to show the extent to which Company B worked for other clients after the arrangement with Company A was entered into, or show what holidays he took, because all the documents have been destroyed.

23. Double taxation

The Appellant's last argument was that there was an element of double taxation present, because Company B paid profits tax on income that had been assessed to him personally. He also noted that under the assessments raised, many legitimate expenses charged to Company B (such as travelling) would not be allowed. Finally, he noted that if he had been an employee of Company A, he would have received various employee fringe benefits (such as housing) that would have reduced his taxation liability.

The Commissioner's contentions

24. Ms Ng Yuk-chun represented the Commissioner and presented the following arguments.

25. Section 61A

(a) Ms Ng referred us to the following cases:

(i) Yick Fung Estates Ltd v CIR (above)

(ii) D47/00, IRBRD, vol 15, 422: a service company case where the evidence clearly showed the company to be the taxpayer's alter ego. By interposing the company, what would have been the taxpayer's salary had been presented to the Revenue as profits of the company. The taxpayer carried out this transaction for the sole or dominant purpose of obtaining a tax benefit. The tax benefit lay in the much greater amount of expenses available for deduction to the company for profits tax purposes compared with the restrictive rules applicable to the taxpayer under salaries tax.

(b) Ms Ng submitted that under section 61A(1) the relevant transaction in the present case consisted of the entering into an agreement between Company A and Company B as well as the interposition of Company B between Company A and the Appellant. Determined objectively and globally by reference to the criteria set out in section 61A(1)(a) to (g) (see Yick Fung Estates Ltd v CIR) it would be concluded that the Appellant entered into this transaction for the sole or dominant purpose of enabling him to obtain a tax benefit. The Commissioner had properly countered the tax benefit by raising the salaries tax assessments under appeal. Specifically, once the transaction was ignored, on the basis of the totality of facts before us, Ms Ng argued that the Appellant was not carrying on business on his own account but rather was an employee of Company A. In this regard, Ms Ng referred us to the following cases:

(i) Lee Ting-Sang v Chung Chi-keung (above)

(ii) Hall v Lorimer (above)

(iii) Chan Kwok-kin v Mok Kwan-hing (above): to determine whether a contract of employment exists, no single test is conclusive. The determination must be based upon the totality of facts.

(iv) D22/92, IRBRD, vol 7, 246: absence of control is not of itself decisive in determining whether an employment exists, particularly in the case of a professional person.

(v) D69/98, IRBRD, vol 13, 412: the nature of a contract of service is not altered merely because the taxpayer had received income from other paymasters.

(vi) D103/96, IRBRD, vol 12, 49: a case where the critical fact negating an employment was the taxpayer's financial risk, regardless of any personal

fault. Ms Ng argued it was significant that this factor was not present in the Appellant's case.

26. Section 61

Ms Ng referred us to the following cases, arguing that section 61 applied to this appeal:

(a) D69/98 (above)

(b) D103/97, IRBRD, vol 12, 555: a case where a taxpayer interposed a company between himself and his employer. The Board found that the interposed company was no more than a convenient receptacle for the emoluments that the taxpayer received from his employer and held that the transaction was artificial and fictitious.

27. Other matters

(a) Ms Ng argued that the Appellant was not prejudiced by the length of time taken to raise the assessments in dispute. She contended that assessments were made within a reasonable time after the assessor had become aware of all relevant information. Ms Ng stated that the matters complained of by the Appellant were not critical to our decision in this appeal. She also suggested that, in any event, the Appellant was the author of any misfortune given that the books and records of Company B had been destroyed before its profits tax affairs for the year of assessment 1995/96 were finalised.

(b) Finally, Ms Ng conceded that if the assessments in dispute were upheld, credit should be given for the tax paid by Company B on the remuneration it received from Company A. She suggested that this should be calculated on a yearly basis in accordance with the formula: Tax paid $\times$ Income from Company B / Total income of Company B. This formula should only apply to Company B's profit-making years (that is, not the loss-making 1993/94 year) and also not to the final 1995/96 year for which Company B had not paid any profits tax.

Analysis

Breach of natural justice

28. For reasons that will become apparent below, we consider it useful to first deal with this ground of appeal. According to the Appellant, natural justice was denied because the Commissioner took up his case long after the books and records of Company B had been validly and legally destroyed.

29. The reasons of the Chairman on this ground of appeal are as follows:

(a) This ground of appeal has given me pause for concern, but not in the way the Appellant intends. The time lapse in raising the assessments under appeal is, of course, regrettable – but understandable in terms of the complexity of this matter that involved detailed correspondence emanating from each of the assessor, Company A and the Appellant before all of the facts became known to the assessor. Be that as it may, the specific matters of which the Appellant has complained of being prejudiced by delay, namely details of work performed by Company B other than for Company A, leave taken, and expenses involving entertainment and travel incurred by Company A (all allegedly destroyed following Company B's liquidation), have not proved crucial to my decision in determining whether the Appellant had a disguised employment with Company A. Indeed, I accept the Appellant's claims on these matters, namely that Company B did derive significant sums of other income (although not from insolvency work), that his leave arrangements were flexible and that Company B did incur appreciable amounts of entertainment and travel expenditure.

(b) In the event, I find this ground of appeal to be misconceived, without substance, and I have no hesitation in dismissing it. What deeply concerns me, however, is Company's failure to lodge any profits tax return for the year of assessment 1995/96, notwithstanding the assessor's repeated requests, and the Appellant's explanations for this failure. However that may be, the affairs of Company B are not formally before us, and I resist the temptation to comment further.

30. The reasons of the Members on this ground of appeal are as follows:

(a) The facts surrounding the incorporation and activation of Company B, and the Appellant's evidence as to why he purchased the company are set out above. We will not repeat them here.

(b) The agreed facts relating to the Appellant's income derived from Company B in the years of assessment 1992/93 to 1995/96 are set out at paragraph 3 and the amount of service fees paid by Company A for the Appellant's work is set out at paragraph 6(g). From those facts it is clear that Company B's most income productive year was the year ended 30 June 1995 where a sum of $1,660,498 was received from Company A alone.[20] In his tax returns for the years ended 31 March 1995 and 1996, the Appellant declared that his only taxable income was from Company B ($122,000 for 1995 only) and from Company D (for 1996 only). It is trite, but pertinent, to note that the Appellant hardly received any

[20] $39,000 per month × 11 months + bonuses of $891,651 and $339,847.

monetary salary or fee from Company B in the financial year in which Company B easily earned its greatest amount of income.

(c) In a letter dated 10 March 2000 to the Appellant, the assessor stated, inter alia, that:

'Turning to the tax affairs of [Company B], the company was liquidated in July 1998. Prior to its liquidation, [Company B] was asked to file profits tax return for the years of assessment up to and including 1995/96. Despite our repeated reminders, the profits tax return for the year 1995/96 was not received, neither the Department was supplied with a copy of [Company B's] accounts for the year ended on 30.6.1995. According to our information, the remuneration from [Company A] during the relevant period amounted to $1,660,498. Hence neither you nor [Company B] had paid any tax on your income earned during this particular period.'

(d) According to the documents and evidence adduced before us, the Appellant on two occasions made representations regarding the tax affairs of Company B in respect of the year of assessment 1995/96. These two occasions were:

(i) In his reply to the assessor in a letter dated 12 April 2000, the Appellant stated:

'I consider it quite improper of you to mix the affairs of [Company B] and myself in the same letter and that indeed this is quite probably illegal. The affairs of [Company B] were conducted perfectly properly within the law and were dealt with by a liquidator who is an officer of the High Court of Hong Kong. Please refrain from mixing the affairs of two different taxpayers in one letter in future.'

(ii) When the Appellant gave evidence under oath before us, he could not adequately explain why Company B did not lodge its profits tax return for the year of assessment 1995/96 when requested to do so by the assessor, other than to say that Company B made no profit for the year and that there was no benefit to anyone in just ticking boxes.

(e) The Appellant is and was, at all material times, a qualified professional accountant specializing in liquidation or receivership matters. From the documents we have perused, the assessor had repeatedly reminded Company B and the Appellant before the liquidation of Company B to rectify the failure on the part of Company B or the directors of Company B to file with the IRD Company B's profits tax return for the year ended 30 June 1995. These

reminders were duly ignored. On the basis of those documents and evidence given by the Appellant before us, we find that the Appellant, without just cause and excuse, knowingly failed to cause Company B's profits tax return for the year of assessment ended 30 June 1995 to be duly prepared and then filed with the IRD before the books and accounts of Company B were alleged to have been destroyed.

(f) On the evidence before us, the Appellant was, at all material times, the only paid director of Company B. Given his expertise in liquidation and receivership matters, his receipt of repeated reminders from the IRD and in particular his receipt of the letter dated 30 December 1997 from the assessor referred to below, and our findings in relation thereto, the Appellant knew or ought reasonably to have known that the books and accounts of Company B should be fully and completely preserved until after the satisfactory finalization of all the tax affairs of Company B and/or the Appellant. For all these reasons, we totally reject the Appellant's allegations of breach of natural justice on the part of the Commissioner.

(g) In his letter dated 30 December 1997 to Company B care of Mr N, the liquidator of Company B, the assessor requested Company B to complete and thereafter submit the enclosed profits tax return for the year of assessment 1997/98 and duplicate profits tax return for the year of assessment 1996/97 to the IRD within one month. In this letter, the assessor expressly stated, inter alia:

'Pending the finalization of the Company's tax affairs, this Department must reserve its right to make a claim on the Company.'

Therefore, on 30 December 1997 the Appellant and Company B had due notice that:

(i) the tax affairs of Company B were still outstanding and pending finalization; and

(ii) the IRD had reserved its right to make a claim on Company B in respect of the tax affairs of Company B.

The liquidator of Company B responded to this letter on 21 January 1998 and enclosed therewith the profits tax returns for the years of assessment 1996/97 and 1997/98, duly completed and signed by him. In his reply the liquidator of Company B stated:

' Please note that [Company B] has not traded and has had no income of any sort since early 1995.'

(h) When the liquidator of Company B made this statement to the IRD, the books and records of Company B would still have been in existence and intact. The liquidation of Company B was still progressing at this time. The Appellant gave evidence that he could not recall when Company B's books and records were destroyed, but noted that the destruction would have taken place some three months after the date of the final creditors' meeting. He stated that the destruction had taken place before any dispute arose relating to his personal tax affairs. He intimated that this was why he could not now produce any documents relating to Company B's arrangements with Company A.

(i) According to the return of final winding-up meetings of members and creditors, the final creditors' meeting took place on 6 July 1998.[21] We do not believe that the books and accounts could have been destroyed before this date. In any event, according to the evidence given by the Appellant, the books and records of Company B should still have been in existence and intact until some three months after the date of the final winding-up meetings of members and creditors.

(j) We have no reason to doubt the integrity of the liquidator of Company B nor do we have reason to doubt his ability. The liquidator of Company B was a practicing solicitor at the time and accordingly was an officer of the High Court of Hong Kong. We also have no reason to suspect that when the liquidator of Company B wrote to the assessor on 21 January 1998, he had not verified it by conducting the necessary due diligence in respect thereof. All the books and accounts of Company B either should have been in the possession of the liquidator of Company B or should have been made available to him with unrestricted or unfettered access. We would expect that the liquidator of Company B would have examined the books and accounts of Company B before making the statements contained in this letter.

(k) Why did the liquidator of Company B state in his letter dated 21 January 1998 that '[Company B] has not traded and has had no income of any sort since early 1995'? What did he rely on in making this statement? Was it that the books and accounts of Company B did not contain entries in respect of the sums paid by Company A for the Appellant's work? We do not know, but will consider these matters below when examining the application of section 61 to this appeal.

(l) The books and accounts of Company B are, in our view, crucial in the determination of the appeal. Without them, we have been unable to see the full

[21] A copy of the return can be found at page 139 of bundle R1.

picture, including the true nature of the business of Company B and the relationship between Company A and the Appellant. But we have no hesitation in concluding that their absence is due to the Appellant's actions, and not the Commissioner's lack of action.

(m) We turn now to section 51C of the IRO, and sections 248 and 283 of the Companies Ordinance ('CO'), which in our view are relevant to the matters before us. Under section 51C(1) business records must be retained for not less than seven years after the completion of the transactions to which they relate. The provisos to section 51C(2) state that subsection (1) shall not require the preservation of any records (a) which the Commissioner has specified need not be preserved (clearly this was not applicable to the facts of this appeal); or (b) of a corporation which has been dissolved.

(n) When was Company B dissolved? Company B's winding up was a creditors' voluntary winding up, not a members' voluntary winding up. We also note that the return of final winding-up meetings of members and creditors together with the liquidator's statement of account[22] both dated 23 July 1998 and lodged with the Registrar of Companies were made pursuant to section 248 of the CO. We have also perused a copy of a 'Report on the Conduct of the Liquidation' signed by Mr N, also dated 23 July 1998.[23] According to section 248(4), Company B was dissolved on a date not earlier than three months from the registration of the return of Company B as defined therein. The return was dated 23 July 1998. Accordingly, Company B was dissolved by statutory definition on or shortly after 24 October 1998.

(o) The special resolution[24] to wind up Company B stated that liquidation was required:

(i) by reason of Company Bs liabilities that Company B cannot continue its business; and

(ii) it was advisable that Company B be wound up.

(p) What was the extent of Company B's liabilities and the nature thereof that rendered Company B unable to continue its business as alleged and therefore advisable for Company B to be wound up? According to the letter from the liquidator of Company B to the assessor dated 21 January 1998:

(i) Company B has not traded since early 1995; and

(ii) Company B had no income of any sort since early 1995.

[22] A copy of the liquidator's statement of account can be found at page 141 of bundle R1.
[23] A copy of the report can be found at page 140 of bundle R1.
[24] A copy of the special resolution to wind up Company B can be found at page 131 of bundle R1.

(q) From the tenor of the evidence before us, the liabilities of Company B must therefore have been incurred at or before early 1995, namely at the time when the Appellant was still providing services to Company A. Was it the tax liabilities of Company B for the year ended 30 June 1995? We do not know. We do not have the relevant evidence before us. The books and accounts of Company B have allegedly been destroyed. The audited accounts of Company B for the year ended 30 June 1995 have not been prepared. But we would repeat that, from the evidence before us, the financial year ended 30 June 1995 was the best business year for Company B in its whole lifetime in that Company A alone paid a total sum of $1,660,498 for the Appellant's work rendered during that period.

(r) We also note from the liquidator's statement of account dated 23 July 1998 that Company B's assets or receipts as at 21 November 1997 were nothing other than cash at bank in the sum of $3,978 and its liabilities or payments were, as at 21 November 1997, zero. We note from the liquidator's statement of account that, save and except the fees payable to the liquidator, Company B in fact did not thereafter incur any liabilities. Accordingly, Company B did not have any creditors at all. If it was true that Company B did not have any creditors, why did Company B choose to proceed with its winding up as a creditors' voluntary winding up?

(s) According to section 233 of the CO, where it is proposed to wind up a company voluntarily, the directors of the company may make a statutory declaration to the effect that they have made a full inquiry into the affairs of the company, and that, having so done, they have formed the opinion that the company will be able to pay its debts in full within such period not exceeding 12 months from commencement of the winding up as may be specified in the declaration ('declaration of solvency').

(t) According to section 233(4) a winding up in the case of which a declaration of solvency has been made and delivered under section 233 is referred to in the CO as 'a members' voluntary winding up' and a winding up in the case of which a declaration of solvency has not been made and delivered is referred to as 'a creditors' voluntary winding up'.

(u) We found earlier that the Appellant knew or ought reasonably to have known that Company B did not prepare and thereafter lodge with the IRD its profits tax return and the statutorily required audited accounts for the year ended 30 June 1995 prior to 20 November 1997. The Appellant therefore was not in a position to make a declaration of solvency. It was therefore necessary to

proceed with the winding up of Company B by way of a creditors' voluntary winding up.

(v) Section 283 of the CO provides:

' ***Disposal of books and papers of company***

(1) When a company has been wound up and is about to be dissolved, the books and papers of the company and of the liquidators may be disposed of as follows, that is to say –

(a) in the case of a winding up by the court ...;

(b) in the case of a members' voluntary winding up, in such way as the company by special resolution directs, and, in the case of a creditors' voluntary winding up, in such way as the committee of inspection or, if there is no such committee, as the creditors of the company, may direct.

(2) After 5 years from the dissolution of the company no responsibility shall rest on the company, the liquidators, or any person to whom the custody of the books and papers has been committed, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.'

(w) Since Company B did not have any creditors, we do not think that there was a committee of inspection in respect of the winding up of Company B. Then, who made the decision to dispose of the books and papers of Company B? We simply do not know. No evidence has been offered in respect thereto.

(x) It is our finding above that Company B was dissolved on or shortly after 24 October 1998. By virtue of the fact that Company B did not have any creditors and accordingly did not have a committee of inspection in respect of the winding up, it is our view that the books and accounts of Company B were destroyed contrary to section 283 of the CO. By reason of all of the matters aforesaid, we decline to extend any sympathy to the Appellant over his failure to produce a full set of documentation relating to Company B's arrangement with Company A. As did the Chairman, we find the ground of appeal relating to alleged denial of natural justice to be misconceived, without substance, and we have no hesitation in dismissing it.

Section 61

31. Clearly Company B was not incorporated with a view to reducing tax liability on the remuneration paid by Company A – it was incorporated well before the Appellant had any contact with Company A or Mr J. In our view, however, the subsequent transaction identified by the Commissioner, involving the interposition of Company B between Company A and the Appellant, can be attacked under the anti-avoidance provisions of section 61 as artificial and as not reflecting the genuine relationship between Company A and the Appellant.

32. Our analysis of the manner and substance of the transaction appears below. It is only necessary at this juncture to state our view that, after examining the facts relating to the interposition of Company B and the circumstances under which this was concluded and carried out, Company B had no role whatever in the transaction other than as a receptacle into which the Appellant's remuneration would be paid and as a vehicle for deriving very significant taxation advantages. In short, we have no doubt that this transaction is artificial in the sense that this term has been interpreted and applied by the Privy Council in Seramco Ltd Superannuation Fund Trustees v ITC (Jamaica) [1977] AC 287 and by this Board in D69/98, IRBRD, vol 13, 412.

33. We find additional support for our decision by referring to the statement of the liquidator of Company B in his letter to the assessor dated 21 January 1998 that '[Company B] has not traded and has had no income of any sort since early 1995'. At face value, the reference to 'early 1995' is well before the Appellant ceased providing services to Company A. No explanation was given at the hearing as to how this statement could be made if the Appellant continued to provide paid services to Company A through Company B until 15 June 1995 (paragraph 6(b) refers).

34. This is not, however, the end of the matter. The Appellant is correct in his assertion that even if the interposition of Company B between him and Company A were disregarded under section 61 (or indeed, section 61A), the assessments in dispute must fall away if it were not then revealed that he was an employee of Company A and that the use of Company B masked a disguised employment for which he would be liable to salaries tax. We deal with this issue extensively in our analysis of whether section 61A applies in this case.

Section 61A

35. If our conclusion on section 61 were wrong, it is then necessary to consider the application of section 61A, which can operate even where a transaction is not artificial or fictitious. In accordance with Yick Fung Estates Ltd v CIR, taking a global perspective and looking objectively at the seven factors set out in section 61A(1), we have concluded that the transaction identified above was entered into for the sole or dominant purpose of obtaining a tax benefit.

36. Application of section 61A(1)(a) to (g)

(a) The manner in which the transaction was entered into or carried out

(i) We take this criterion to refer to the background to the transaction and the various reasons that could properly be attributed to the parties involved. Our first finding is that when the Appellant and Mr J initially reached agreement, it was not a term of that agreement that Company B would be the party contracting with Company A. This only occurred subsequently and thus could not have been a significant factor in the Appellant's mind when he concluded negotiations with Mr J.

(ii) Of the reasons given by the Appellant for the interposition of Company B, the only one we accept was that he correctly anticipated he would continue to have outside consultancy and other income which he would put through Company B. However, that state of affairs could have continued even if Company B were not made a party to the agreement with Company A. Although the Appellant indicated that he wanted to put all his commercial activities under one commercial umbrella, Company B, why this matter was important to the Appellant becomes very clear when regard is had to criteria (c) to (f) below. In essence, the interposition of Company B was as a vehicle used by the Appellant to generate significant tax advantages, primarily through what appears to be an extraordinary level of expenditure booked in its accounts in the form of a myriad of employee or directors' fringe benefit deductions that were claimed and allowed in its profits tax returns. Virtually all, if not all, these expenses would not be allowed if assessments were raised on the Appellant personally.

(iii) Considered objectively, we reject the Appellant's claim that the interposition of Company B could have afforded him a significant advantage of limited liability. We also reject his evidence that this was a significant factor in his mind when he interposed Company B between himself and Company A. Under cross-examination the Appellant could not adequately explain how this could be achieved given that the major part of his work undertaken for Company A was executive in nature, namely acting as liquidator or receiver, for which he would in any event be personally liable. The Appellant could only reply that limited liability could be important for non-executive (consultancy) work, but in the event the work performed by the insolvency department gravitated more towards liquidation work. This contrasts with the Appellant's evidence in chief, which we accept in this regard, that his initial intention (which was indeed realised) was that Company A would be the vehicle for his carrying out insolvency work involving him in personal appointments as

liquidator or receiver of financially troubled companies. Non-executive work was objectively and in fact, at best a poor relation.

(iv) Turning to implementation of the transaction, it appears that apart from the payment of remuneration by Company A to Company B's bank account, Company B had no role whatever. It is telling that in the Appellant's bundle, which spoke clearly of his frustrations in being unable to meet Mr J and his difficulties of agreeing the remuneration payable, only one document (see page 17) referred to Company B. The import of this document headed 'To Whom It May Concern', and why it was produced, was never explained to us. All other documents referred to the Appellant only. They contained a plethora of references to the Appellant personally, to amounts due to the Appellant personally (and not Company B), and to the Appellant's (and not Company B's) bonus.

(v) At all relevant times the Appellant provided personal services to Company A as Company A's 'Principal' and the Appellant held himself out as such, with no reference to Company B. Under the agreement with Company A, it seems clear that he was the only one to provide the services to Company A and had no right of substitution. We reiterate that once the agreement was concluded, Company B had no role whatever other than as a receptacle into which the Appellant's remuneration would be paid and as a vehicle for deriving very significant taxation advantages.

(b) The form and substance of the transaction

(i) The form of the transaction is that an agreement was entered into between Company B and Company A for the provision of the Appellant's services at a set monthly remuneration, which became subject to annual review, plus a percentage of profits derived from the operation of Company A's insolvency department. Thereafter, as indicated above, Company B had no real function other than that of a fiscal nature.

(ii) The decision of the Chairman on this matter is as follows:

I now turn to the substance of the transaction and the facts relating to how it was carried out. Contrary to the Commissioner's argument, I am not able to conclude that it looks like, and operated as, a disguised employment. Rather, I consider that the substance of the matter was that the Appellant was in business on his own account, carrying on a business venture with Company A. I have reached this conclusion on balance,

having considered the totality of facts. Some of these indicate an employment, some do not. Amongst other things, I have taken into account the following matters.

- First, it is true that Company B entered into an agreement with Company A for personal services by the Appellant with no right of substitution. However, the Appellant's role was not simply to provide personal services; instead, he was charged with establishing the insolvency department, operating it virtually autonomously, and building up its business. It cannot be the case that an agreement for personal services must indicate an employment. It is certainly not the case that every individual professional appointment amounts to an employment.

- Second, I appreciate that Company A has informed the assessor that the Appellant did not have to purchase equipment to carry out his duties. I accept that he did purchase several items of equipment (including stationery, pens and calculator and some textbooks) to assist in performing his duties. Whether Company A provided him with other simple stationery (although the Appellant denies this, non-provision of basic stationery militates against common sense) does not seem germane. My overall impression is that the nature of the Appellant's work for Company A involved no major purchase of equipment necessary to perform his duties. I thus regard this factor as neutral. I also note that the Appellant was not required to employ any assistant and I reject his argument that occasional perusal of legal documentation by his wife, at his request, alters this.

- Third, the Appellant was neither entitled to, nor subject to, certain benefits and burdens commonly found in contracts of employment. In this regard, the contrast between his situation and Company A's standard terms of employment is quite marked. For instance, Company B's agreement with Company A contained no specific provision for termination, no need for exclusive work, and no agreed leave arrangements. More generally, the Appellant received no medical coverage, no agreed arrangements for sick leave and no provident fund. He was not subject to any restraint of trade clause (apart from a general duty of confidentiality). I accept that neither the availability nor non-availability of these benefits or burdens is conclusive. They do however form part of an overall picture.

- Fourth, the Appellant did, through Company B, carry on outside work and did not seek approval from Company B for such work. I

am not, however, prepared to find that the Appellant carried on outside insolvency work through Company B. Although he hinted at this during his evidence, I prefer to accept his statement that his original intention (which, as stated above, was realised) was to use Company A as a reputable vehicle through which he would carry on all his insolvency work by taking personal appointments as liquidator or receiver. I find that the use of Company B for work unrelated to insolvency appears to be more neutral than indicative of whether the Appellant carried on business on his own account.

- Fifth, I accept the Appellant's arguments that he had a very high degree of autonomy in running the insolvency department. It is encapsulated in the Appellant's evidence when he recounted the following conversation, when at an early stage Mr J said to him 'Come on board [the name of the Appellant], get on with it and make money for both or us'. Ms Ng accepts that the Appellant had a great deal of freedom in his work, but she did argue that Mr J had some (unspecified) role in running the department. The fact remains, however, that there is no direct evidence of *any* control being exercised by either of Company A's partners over the Appellant's work schedule and performance of his duties either professionally or as the person in charge of the insolvency department. Moreover, the unchallenged evidence of the Appellant is that neither partner gave him any directions and that their billable insolvency work was either secretarial in nature, or involved attendance at meetings and other tasks of a non-technical nature. The documents in the Appellant's bundle, as well as the evidence of Ms G, support this conclusion. They indicate that the great majority of the Appellant's dealings with Mr J involved discussions about profit share. I do not, however, agree with the Appellant that absence of control is conclusive that no employment existed (see D22/92 and cases cited therein). In my view control, or lack thereof, is merely one factor to be taken into account.

- Sixth, I find that, although the Appellant had normal fixed hours of work, as would the employees of Company A, he did not necessarily adhere to these. Naturally he arranged his time in and out of the office as professional service demanded. His principal working place was at Company A's offices. Regarding his leave arrangements, the Appellant's evidence shows that he was entitled to leave, but clearly the extent and timing of that leave was not set in stone and would doubtless have depended upon the exigencies of the insolvency practice. During any period of leave taken, Company A continued to

pay the fixed monthly sum. I regard these factors as generally indicative of employment, although in the circumstances of this case not strongly so.

- Seventh, I accept the Commissioner's argument that the evidence shows a certain degree of integration by the Appellant into Company A's business, although I appreciate that the Appellant established the insolvency department and that it had not existed previously. The secretary and staff working in the insolvency department were all employees of Company A and, apart from Ms G, were recruited by Company A. I also note Mr J's role in transferring Mr I to the department, which was apparently decided without the Appellant's involvement. The evidence relating to the Appellant describing himself as 'Principal' for Company A and holding himself out to clients in this manner, whilst not being determinative, also militates against his claim that he was simply a joint venturer with Company A. I make the same comment about the contents of the affidavit for fitness of appointment as liquidator, in which the Appellant was described in the same style. The use of the term 'Principal', however, appears to me to be neutral. It may denote either an employee or a partner equivalent, depending upon the facts of each individual case. The fees for the Appellant's appointment as liquidator or receiver were billed by Company A and were treated as trading receipts of Company A. Those receipts were, however, also recorded in the quarterly accounts of the insolvency department, the profits of which were divided between Company A and the Appellant in a 60/40 ratio after vigorous and prolonged debate.

- Eighth, I appreciate that Company A has indicated to the assessor that the Appellant would be reimbursed for his entertainment and travel expenses incurred in the performance of his duties. However, the Appellant's evidence (which I accept in this regard and which is bolstered by Company B's accounts produced in the Revenue's bundle) is that he was not reimbursed for travelling expenses and that the great majority of his entertainment expenses were not reimbursed. I find that, as part of the agreement reached with Company A, an amount of the Appellant's travelling and entertainment expenditure (which in the absence of Company B's records cannot be computed with certainty) charged through Company B was his contribution to the business development of the insolvency department.

Finally, I come to three matters that, in my view, tip the balance in favour of the Appellant not being an employee.

- Ninth, it is true that Company A paid remuneration to Company B of a fixed monthly sum, which was reviewed annually by Company A with no input or negotiation on the part of the Appellant. However, the greater part of the remuneration was paid in the form of a most peculiar 'bonus', which I regard more correctly as being a profit share. I agree with the Appellant's arguments that this part of the remuneration is not only highly unusual for an employee to receive (being determined not just by reference to his activities alone but rather by reference to the profitability of the insolvency department as a whole), but also the tone of the communications between the Appellant and Mr J and the level of dispute about the extent of his entitlement (which lasted for as long as the agreement operated) was simply not indicative of an employment relationship. Quarterly accounts for the insolvency department were prepared and although these only specifically referred to the Appellant's share of profits, it must follow that the remaining share belonged to Company A.

- Tenth, the Appellant's work for Company A did involve him assuming a degree of financial risk and, conversely, being able to profit from sound management in carrying out his tasks. The Appellant admitted that he did not directly discuss, let alone reach agreement, with Mr J on what would happen if the insolvency department made a loss. I also appreciate the force of Ms Ng's argument that the agreement with Company A envisaged a remuneration of a mixed monthly fee plus a profit share; not plus or minus a profit or loss share. I note also that those losses were not deducted from the fixed monthly pay. But the fact remains that the insolvency department *did* make losses for two quarters and all relevant documents in the Appellant's bundle as well as the Appellant's evidence indicate that the Appellant was allocated, and had to bear, a share of those losses. I thus accept that he did assume a degree of financial risk (including bad debts which would affect the profitability of the insolvency department) and this is simply inimical to the existence of an employment relationship. The Appellant certainly profited from sound management as he built up the insolvency department from zero to the point where the major part of the remuneration was profit share (which I reiterate looks and operated nothing like a typical employee bonus or profit sharing arrangement). And finally, the unreimbursed travel and entertainment

expenses shows an element of financial commitment on the part of the Appellant that is more indicative than not that he ventured into business on his own account with all the attendant risks.

- Eleventh, at the termination of his work with Company A, the Appellant took with him all of the major contested insolvency work. I accept his evidence generally regarding this matter, and also his argument that this fact is inconsistent with an employment relation with Company A and is much more consistent with the fact that these were all cases which he brought into the business and could be regarded as his clients. It is also significant that he was not subject to any restraint of trade clause, other than a general duty to maintain confidentiality.

In the event, I cannot agree with Ms Ng that, based upon the totality of facts before us, the indicia showing the existence of an employment-type relationship outweigh those showing the Appellant to be carrying on business on his own account. As stated in Hall v Lorimer, I have reminded myself that assessment of the facts 'is not a mechanical exercise of running through items on a check list to see whether they are present in or absent from a given situation. The object of the exercise is to paint a picture from the accumulation of detail'. Looked at globally, and on balance, I am satisfied that during all relevant times the carrying out of services by the Appellant to Company A was made under an agreement that was in substance a business venture with Company A. I do not find that the Appellant was an employee. The preponderance of facts points the other way.

(iii) The decision of the Members on this matter is as follows:

In the Appellant's view, what was most significant in this case was the absence of control by Company A over himself as head of the insolvency department or over Company B that would be commonly exercised by an employer.

We are, however, of the view that the alleged absence of control by Company A over the Appellant as head of the insolvency department or over Company B is insignificant given the business nature of the insolvency department of Company A. In this respect we rely on the Appellant's own admission in his letter dated 14 February 2000 addressed to the IRD where he stated:

'[Company B]/I was not subject to the control or supervision which would be commonly exercised by an employer, indeed as I have noted above **this would have been inconsistent with my statutory role as liquidator and my contractual role as receiver**.' (emphasis added)

In the same letter, the Appellant also stated:

'[Mr J] had known my wife for many years. He was attracted to the prospect of my setting up an insolvency practice (I had previously worked for [Company C] for several years in their Insolvency Department). Discussions began on these lines in, from memory, something like October 1991. **The idea was that I would operate an entirely new division**, effectively as a joint venture. …

[Company B]/I had near complete autonomy in the running of the **insolvency practice**. …

I do not recall what the arrangements were for leave but I am pretty sure that they were fairly flexible. … I certainly did not have to seek permission to take leave, **I took leave when it made sense to in the context of any matters being worked on at the time** (with [Company A] or otherwise). …

[Company B]/I ran the new insolvency division. While I discussed matters with [Mr J], and very occasionally his colleague and later partner, [Ms K], there was certainly no reporting in terms of professional matters and I was left to do all things in a way consistent with someone jointly responsible through my appointment as receiver or liquidator. …

I do not have in my possession a copy of any document which brought my involvement with [Company A] to an end but my **employment** was not, from my recollection, terminated. I **resigned** some time before 15th June 1995 because I had negotiated an arrangement with the firm for which I now work, [Company D], several months earlier. I do not recall the exact timing but I am aware that I signed a shareholders agreement with the partners of [Company D] on 15th May 1995, at least a month prior to my departure from [Company A].' (emphasis added in bold type)

We also note that the Appellant was reimbursed by Company A in respect of his purchase of a set of computer software, namely Lotus 123 Release 4.[25]

Various other matters have, on balance, persuaded us to accept Ms Ng's argument that in substance the Appellant had a disguised employment with Company A. These include: the description by Company A in the quarterly accounts of the amount payable to the Appellant as 'Salaries' (see footnote 7 and related text); the fact that it was Mr J alone who made the initial decision to transfer Mr I to the insolvency department; the fact that no real contemplation was given by Mr J and the Appellant as to whether losses would be incurred by the insolvency department and, if so, how they would be dealt with; the fact that even though losses were incurred they were not deducted from the fixed monthly pay; the fact that the fixed monthly pay was increased annually and unilaterally by Company A; the fact that Company A had total dominion and control over all money matters relating to the insolvency department (the evidence showed that the Appellant could not touch a single cent until Mr J approved; there was even internal control exercised over the Appellant's claims for reimbursement of entertainment expenditure); the fact that Mr J controlled distribution of the profits of the insolvency department and that this took place only after money was received from the clients; the inference from the Appellant's evidence that he took over the more complex insolvency cases upon leaving Company A in part because Company A did not have the technical expertise to discharge the work; the fact that a profit sharing arrangement is not an unusual occurrence for employees in professional firms; and the fact that although the Appellant had no formal holiday arrangement with Company A, he nevertheless did take leave and that during this period he continued to be entitled to receive the fixed monthly sum.

This is the Appellant's appeal and accordingly the burden is on him to show cause why the decision of the Commissioner was wrong. The Appellant has failed to produce full documentation relating to Company B's arrangement with Company A and in this respect he put the blame on the IRD by stating that the destruction of the books and accounts took place before any dispute arose relating to his personal tax affairs. As stated above, we find that the Appellant knew or ought reasonably to have known that the books and accounts of Company B ought to have been fully and completely preserved until after the satisfactory finalization of all the tax affairs of Company B and, in this regard, it is not insignificant

[25] See page 36 of bundle B1.

that the Appellant was the only paid director of Company B. We also find that the Appellant, being an experienced qualified professional accountant specializing in liquidation and receivership matters, knew or ought reasonably to have known that the destruction of the books and accounts of Company B was contrary to section 283 of the CO. Accordingly, the failure on the part of the Appellant to produce documents relating to Company B's arrangement with Company A to support his appeal is, in our view, self-inflicted.

For all the above reasons, we conclude that the Appellant has failed to persuade us that, disregarding for these purposes the interposition of Company B between himself and Company A, the Commissioner was wrong in characterising his relationship with Company A as one of disguised employment.

(c) The result in relation to the operation of the IRO that, but for this section, would have been achieved by the transaction

If Company B had been accepted for tax purposes as having entered into a contract for services with Company A, the taxation result is dramatic. The amounts of $655,000, $710,000, $1,347,651 and $417,847, which on the basis of applying section 61A would have been taxable to the Appellant, would be reduced by the extraordinary level of expenses claimed in Company B's profits tax returns for the years of assessment 1992/93, 1993/94 and 1994/95 which disclosed profits (loss) respectively of $240,989, ($1,271) and $156,225.[26] Company B did not submit any profits tax return for the year of assessment 1995/96 or accompanying accounts for the period 1 July 1994 to 30 June 1995. This was so notwithstanding that it received at least $1,660,498 from Company A alone for that year of assessment.

(d) Any change in the financial position of the Appellant that has resulted, will result, or may reasonably be expected to result, from the transaction

On the basis that Company B was interposed between Company A and the Appellant, the latter has not derived the remuneration paid for his services. This change will of course be reflected in the change in the financial position of Company B, considered at (e) below.

[26] We assume that the Commissioner has accepted these expenses as proper deductions under section 16(1). Suffice to say that we have based our analysis on the objective facts disclosed in Company B's profits tax returns and the conclusion that many of the expenses would have been disallowed if the Appellant were liable to profits tax as an individual (in which case the myriad of director or employee fringe benefits disclosed in the accounts, which are prima facie deductible to Company B under section 16(1), would not be allowed to the Appellant as an individual profits tax taxpayer) and virtually totally disallowed if the Appellant were liable to salaries tax.

(e) Any change in the financial position of any person who has, or who had, any connexion … with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction

As far as Company A is concerned, there was no additional outlay to procure the services of the Appellant through Company B. On the other hand, if for tax purposes Company B were taken to have derived the remuneration paid by Company A, the change in its financial position (leaving aside any tax effect) would match the change in the financial position of the Appellant, considered at (d) above.

(f) Whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length

In accordance with the agreement with Company A, Company B received substantial remuneration. On the other hand, the Appellant only derived income from Company B amounting to $78,000, $625,000 and $122,000 (respectively for the years of assessment 1992/93, 1993/94 and 1994/95) and $0 (for the year of assessment 1995/96) as well as receiving certain (unquantified) director or employee fringe benefits. Apart from the tax benefits arising from the transaction these payments clearly had no commercial justification and no attempt was made by the Appellant to justify it on any arm's length basis. Why, for instance, were Company B's payments to the Appellant for each of the years of assessment in dispute so disparate? And why did Company B pay no remuneration to the Appellant for the year of assessment 1995/96? The answer is surely found in the level of profits shown in Company B's accounts (already having been reduced by tax free and tax reduced fringe benefits provided to the Appellant) and the different tax treatment and tax rates applicable to Company B as a profits tax payer and to the Appellant as a salaries tax payer.

(g) The participation in the transaction of a corporation resident or carrying on business outside Hong Kong

This factor has no application to this case.

37. Countering the tax benefit

(a) This Board finds the Commissioner was correct in concluding that the facts revealed a transaction entered into for the sole or dominant purpose of obtaining a tax benefit. Under section 61A(3) the phrase 'tax benefit' is widely defined in section 61A(3) to mean 'the avoidance or postponement of the liability to pay

tax or the reduction in the amount thereof'. By effecting the transaction, in the absence of section 61A, the Appellant would have had his personal tax liability avoided or reduced. This would clearly have amounted to a tax benefit.

(b) In the view of the Members (who constitute a majority of the Board), if the transaction in question were not effected, the Appellant in rendering personal services to Company A would have been personally liable to salaries tax on the full amount of Company A's payments to him for the services. The Members thus conclude that the Commissioner correctly countered that tax benefit by assessing the Appellant to salaries tax on the remuneration paid by Company A that otherwise would have been diverted to Company B for each of the years of assessment in dispute.

(c) In the view of the Chairman (who constitutes the minority of the Board), if the transaction in question were not effected, the Appellant in rendering personal services to Company A would have been personally liable to profits tax on the full amount of Company A's payments to him for the services, less his expenses incurred to derive those payments (including travel and entertainment expenses, but excluding the whole host of domestic and personal expenses appearing in Company B's accounts).

Double taxation

38. During the hearing the Appellant argued that if we upheld the salaries tax assessments raised on him, then he should be allowed deductions for the many legitimate expenses charged to Company B. He also argued that he would have received various employment fringe benefits from Company A and these would have reduced his salaries tax liability. We reject these arguments. Tax liability under the IRO must be determined on the basis of what was done, not what could have been done.

39. We agree, however, that the payments made by Company A to Company B should not also be subject to profits tax in the hands of Company B and should be excluded from the relevant profits tax assessments raised on Company B for the years of assessment in dispute. Since Company B has now been liquidated, we are not minded to disturb Ms Ng's concession that credit should be given to the Appellant for the tax borne by Company B on the remuneration paid by Company A. We accept Ms Ng's contentions on this matter as set out in her arguments above.

Conclusion and order

40. The Members who constitute the majority of the Board reject the Appellant's grounds of appeal and order that this appeal be dismissed.

41. The Chairman who constitutes the minority of the Board agrees that section 61 or, if necessary, section 61A can apply in this appeal. However, the Chairman does not accept that, having ignored the transaction attacked, a disguised employment is revealed. Rather, what is revealed is that the Appellant carried on business on his own account by entering into a joint business venture with Company A. The Commissioner should, in the Chairman's view, have raised profits tax assessments on the Appellant, not salaries tax assessments. The Chairman would thus annul the assessments in dispute.

42. The order of the Board, by majority decision, is to dismiss the appeal and uphold the salaries tax assessments raised on the Appellant.