HCIA4/2002

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

INLAND REVENUE APPEAL NO. 4 OF 2002

BETWEEN

SO KAI TONG STANLEY trading as STANLEY SO & CO. Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Chu J in Court
Dates of Hearing: 10 and 11 February 2003
Date of Judgment: 20 January 2004

J U D G M E N T

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1. This is an appeal under section 69 of the Inland Revenue Ordinance, cap.112 ("IRO"), by way of case stated by Mr So Kai-tong Stanley ("the appellant") against the decision of the Inland Revenue Board of Review ("the Board") in respect of two assessments of profits tax as determined by the Acting Deputy Commissioner of Inland Revenue ("the Commissioner").

The background

2. The appellant is a certified public accountant and commenced practice in the name of Stanley So & Co. ("the appellant's firm") on 7 October 1987. In the determination dated 18 July 2000, the Commissioner increased the Profits Tax Assessments on the appellant's firm for the years 1996/97 and 1997/98 after disallowing the following items of expenses claimed:

	1996/97 (HK$)	**1997/98 (HK$)**
Equipment rental	600,000	780,000
Office facilities charges	-----	636,000
Entertainment	346,487	-----

3. The appellant appealed against the determination. By its decision dated 21 May 2001, the Board dismissed the appellant's appeal in respect of the equipment rental and office facilities charges assessments. The Board however allowed the appellant's appeal on the entertainment expenses in part. Of the amount of $145,536.90, which the Commissioner accepted that the appellant had proved its incurrence by reference to his credit card statements, the Board allowed a deduction of 80% of the amount. The Board was not satisfied that the balance of the deduction claimed, being the sum of $200,949 (i.e. $346,487 - $145,536.90) was truly incurred.

4. The appellant now appeals by way of case stated against the Board's decision. There is no appeal by the Commissioner against the Board's decision on the entertainment expenses deduction.

The facts

5. The salient facts as found by the Board can be summarized as follows:

(1) In about 1977, Mr Yam Kin Kwok commenced practice as certified public accountant in the name of KK Yam & Co. ("KK Yam").

(2) The appellant commenced his practice on 7 October 1987.

(3) Nominsec Ltd ("Nominsec") is a company incorporated in Hong Kong and commenced business on 9 July 1986 in providing secretarial service. Before 1992, it was beneficially owned by the appellant and his wife. According to its annual return made up to 29 November 1995, its shareholders are the appellant's wife, one Nominshare Ltd ("Nominshare"), each holding 1 share, and a Liberian company called Nominsec Inc. holding 7,998 shares. The appellant, his wife and one of his sisters were the directors. Another of his sisters, Elly Soo, and the appellant's daughter were appointed additional directors on 1 May and 18 December 1996. According to an employer's

return dated 28 April 1997, the appellant was employed by Nominsec as director and was provided with a quarter at Kwong Fung Terrace, Third Street, Hong Kong, a property acquired by Nominshare in 1992.

(4) On 9 May 1987, Nominsec entered into an agreement for the hire purchase of one Ricoh plain copier. In about September 1988, the ownership of the copier passed to Nominsec.

(5) The accounts of Nominsec recorded the following equipment rental income for the years between 1994 and 1997:

	Year ending 30/4/1994	**Year ending 30/4/1995**	**Year ending 30/4/1996**	**Year ending 30/4/1997**
KK Yam	78,000	96,000	96,000	64,000
Appellant's firm	480,000	480,000	600,000	780,000

(6) Nominsec also received photocopying charges from 215 and 225 clients in the years 1995/96 and 1996/97 respectively.

(7) Yam & So Associates Ltd ("Yam & So") is a company incorporated in Hong Kong in 1986. Subsequently it changed its name to Golden Centre (188 Des Voeux Road) Ltd. Its principal activities at the material times were the provision of office facilities services. According to the annual return made up to 28 November 1995, the appellant and Nominsec were the shareholders, each holding one share. Its directors were the appellant, his sister, Elly Soo, and one Wong Fung Ling, who resigned on 10 December 1997. On 8 May 1998, the appellant resigned as director and Nominsec was appointed a director.

(8) At the material times in 1995 to 1997, the appellant's brother was employed by Yam & So as its maintenance officer.

(9) Since about April 1991, Yam & So was the tenant of the office premises situated at Unit 3, 22nd Floor, Golden Centre, 170-188 Des Voeux Road Central ("Golden Centre office"). By a letter of confirmation dated 6 July 1994, Yam & So renewed its tenancy for 2 years at the monthly rental of $91,980. By a tenancy agreement dated 17 December 1996, Yam & So was granted a further 3 years' term, commencing 8 July 1986 at $62,301 per month.

(10) Between 1994 and 1997, Yam & So had received the following office management fees:

	Year ending 30/4/1994	**Year ending 30/4/1995**	**Year ending 30/4/1996**	**Year ending 30/4/1997**
KK Yam	$788,000	$792,000	$792,000	$792,000
Appellant's firm	$50,000	$630,000	$396,000	$1,098,000
Nominsec	$230,000			
Total	$1,068,000	$1,422,000	$1,188,000	$1,890,000

(11) In the 6 years ending 30 April 1997, Yam & So incurred a total of $695,000 for decoration and acquisition of furniture, with no expenditure being incurred in the years 1994, 1995 and 1997.

(12) By a debit note dated 30 April 1996, Yam & So charged the appellant's firm $396,000 as "fee for granting licence to use" the Golden Centre office for the year ending 30 April 1996.

(13) By another debit note dated 30 April 1996, Yam & So charged the appellant's firm $1,128,000 as fee for granting licence for the use of the Golden Centre office for the year ending 30 April 1997.

(14) By a debit note dated 30 April 1997, Nominsec debited the appellant's firm $600,000 as rental charges for the use of computers, copier, printers and the like for the year ending 30 April 1997.

The parties' case and the Board's decision

6. Before the Board, the main issue was whether in ascertaining the assessable profits of the appellant's firm, the three items of expenses claimed for the years 1996/97 and 1997/98 should be allowed for deduction in full. The Board accepted the approach in Case no. D94/99 (1999) 14 IRBRD 603, paras. 24-25 at 612, and considered that each item of expense should be approached objectively to see to what extent, if any, it is incurred in the production of chargeable profits.

Equipment rental expenses

7. On the equipment rental expenses for the two years in question, the Commissioner contended it was commercially unrealistic for the appellant's firm to pay the sums, pointing out that Nominsec only incurred $178,676 on acquisition of office equipment for the 7 years ending 30 April 1997. The Board also referred to the small amounts of equipment rental paid by KK Yam to Nominsec. The Commissioner was not satisfied that the equipment rental was incurred for the production of assessable profits. The Commissioner further regarded the arrangement an artificial transaction within section 61 of the Inland Revenue Ordinance ("IRO"). At the hearing before the

Board, the appellant produced a schedule containing justifications for the expenses: see p.17 of the Case Stated. The appellant however stated that he had no idea how the rental was charged and the schedule was merely his estimate.

8. The Board rejected the schedule for the reasons that the appellant had made no reference to it in his previous correspondence with the Commissioner, and that the schedule was his own estimate when he admittedly had no personal knowledge of how the rental was fixed. Additionally, the appellant had also indicated to the Commissioner that the amounts were fixed by reference to sums involved in previous years. The schedule of justifications contradicts such assertion. The Board held that there was no rational basis for the sums claimed, pointing out that Nominee's debit note did not show any breakdown or contractual arrangement for the payments, that there was no periodical billing and no regular entry in the books of Nominsec and the appellant's firm on the materials consumed. The Board did not accept that the amount of equipment rental claimed had been incurred, and did not find it necessary to deal with the Commissioner's arguments on section 61 of the IRO.

Office facilities charges

9. On the office facilities charges, the Commissioner considered that they were in fact payments of rent and rates, commenting that the arrangement was for Yam & So to rent the Golden Centre office and then sublet it to the appellant's firm and KK Yam. The Commissioner pointed out that in the year 1997/98, the rent paid by Yam & So was reduced, but the amount paid by the appellant's firm to it was drastically increased from $396,000 to $1,032,000, with the amount paid by KK Yam remained unchanged. The Commissioner found it commercially unrealistic for the appellant's firm to have agreed to such arrangement, and restricted the deduction to the same level as in previous year.

10. In his closing speech before the Board, the appellant justified the payment on the basis that Yam & So had undercharged the appellant's firm in the years ending 30 April 1996 and had a net liability of $615,286 as at 30 April 1996. The increased payment in 1997 was to rectify the position, and to enable Yam & So to pay the arrears of rent to the landlord to avoid claims for possession of the premises. It was said that the appellant's firm was contractually bound to make the payment. In response, the Commissioner pointed out that the appellant's assertions that there had been underpayment by the appellant's firm in the previous years and it was contractually bound to make good the loss incurred by Yam & So were not supported by evidence. On the contrary, the payment salary to the appellant's brother and the provision of quarter to Wong Fung Ling were the causes of the loss.

11. The appellant also argued that the words of "wholly and exclusively" were not included in the IRO so that the Commissioner was wrong to incorporate the concept in considering the deductions claimed. The Commissioner, however, indicated that it did not rely on such concept. Instead, the Commissioner referred to section 16 of IRO, which permits deductions "to the extent

to which they were incurred ... in the production of profits", as providing the basis for apportioning expenses incurred partly for the production of chargeable profits and partly for other purposes. As an alternative argument, the Commissioner argued that the sum of $1,032,000 could not have been incurred for the sole purpose of producing assessable profits to the appellant's firm. Under sections 16(1) and 17(1)(b) of IRO, it is necessary to apportion the expense. Rule 2A(2) of the Inland Revenue Rules ("IRR"), apportionment has to be made on such basis as is most reasonable and appropriate in the circumstances of the case. In response, the appellant argued that Rule 2A is inapplicable.

12. The Board did not allow the Commissioner to take the argument on section 61 IRO since she had not relied on it in arriving at the determination. The Board was however not satisfied that the whole amount claimed was incurred in the production of chargeable profits. The Board found that the appellant had failed to show that the retrospective fixation of the amount was related to a subsisting commercial agreement as opposed to any attempt to reduce the profits generated. The Board saw no reason to disturb the Commissioners' approach pursuant to Rule 2A of IRR and accepted the commissioner's assessment.

Entertainment expenses

13. As for entertainment expenses, the Commissioner disallowed them in full since the appellant had failed to produce the requested information. At the Board hearing the Commissioner prepared a schedule of disputed items for the appellant to identify the nature of the expenditure. The appellant did not make the identification within the time given, and his request to adjourn the hearing was refused. The appellant then produced 12 pages of credit card statements to substantiate the deduction claim. The appellant contended that the Commissioner was not entitled to the personal particulars sought.

14. On the basis of the appellant's evidence before the Board, the Board accepted the Commissioner's contention that the appellant had succeeded in proving the incurrence of $145,536.90 by reference to the credit card statements. The Board did not accept that expenses incurred in meeting fellow CPAs, and in purchasing gifts for staff parties and lunches were incurred in the production of chargeable profits. The Board therefore only allowed 80% of $145,536.90.

The opinions of law

15. The Board had stated six questions of law for the opinion of this court. They are as follows:

(1) In relation to office facilities charges, whether, as a matter of law and on the facts found by it, the Board was correct in holding the amount of $636,000 out of the sum of $1,032,000 charged in accounts of the appellant's CPA firm Stanley So & Co. for the year of assessment 1997/98 as charges accrued to Yam & So

Associates Limited for the use of the office premises at 2203 Golden Centre by the appellant as his firm's business office was not truly incurred in the production of chargeable profits of Stanley So & Co and thus not deducible under s. 16 of the IRO;

(2) In relation to equipment rental, whether, as a matter of law and on the facts found by it, the Board was correct in holding, on the totality of the evidence before it including (a) the recipient company is controlled by the appellant's family, (b) the yearly debit notes issued are not periodical billings, (c) the amounts recorded in he accounts are not regular entry in the books of accounts as to the material consumed, and (d) no breakdown in the debit note from the recipient, the amounts of $600,000 and $780,000 charged in Stanley So & Co.'s accounts for the respective years of assessment 1996/97 and 1997/98 as equipment rental accrued to Nominsec Ltd were not incurred and thus not to the extent deducible under s.16 of the IRO;

(3) In relation to both the office facilities and equipment rental, whether, as a matter of law and on the facts found by it, the Board was correct in refusing to apply Rule 2A of the IRR given the failure of the appellant to advance any positive case on the basis of that Rule;

(4) In relation to entertainment expenses, whether, as a matter of law and on the facts found by the Board, the Board was correct in holding only a sum of $145,000 out of the entertainment expenses paid during the basis period for the year of assessment 1996/97 as shown on the credit card statements mentioned in paragraph 29.3 of the Case Stated were qualified for the Board's 80% allowance for tax deduction and the balance have to be ignored;

(5) In relation to entertainment expenses, whether, as a matter of law and on the facts found by the Board, the Board was correct in holding those expenses incurred in meeting fellow CPAs; in gifts purchased for New Year Party and in staff lunch/staff party were not incurred in the production of chargeable profits; and

(6) In relation to entertainment expenses, whether, as a matter of law and on the facts found by the Board, the Board was correct in holding the balance of HK$200,949.10 of the total entertainment expenses of HK$346,486 (after deducting $145,536.90) as shown in the accounting records were not incurred in the production of chargeable profits.

Extra question

16. Additionally, the appellant wishes to place a further question for the opinion of this court, as follows:

> "Whether, as a matter of law and in the exercise of its discretion, the Board was correct in refusing the appellant's application for adjournment for the purpose of producing further supporting details to support the nature of each expense for the purpose of the Board's examination and to respond to the questions stated in the schedule of the disputed items of entertaining expenses which was prepared by the Revenue at he direction of the Board."

17. The Board takes the view that this question does not involve a question of law fit for the determination by the court and does not agree to include it as a question to be determined by the court. But for the purposes of saving costs and expenses, the Board had set out the question under a separate section in the Case Stated.

18. The appellant argues that since the Board had "stated" the question, though reluctantly, the court has to answer it. I have no hesitation in rejecting this argument. There can be no doubt that the Board included this additional question not as one of the questions stated for the opinion of the court, but in order that the court is made aware of it.

19. I am in agreement with the Board's view that this is not a question of law fit for determination by the court. The decision whether to grant or refuse an adjournment is a matter of managing and regulating the proceedings before the Board and lies within the discretion of the Board. The court is slow to interfere with such decisions, though it may interfere when it is shown that an injustice had occurred: see *Gault v CIR* **(**1990) 63 TC 465 at 475G-I. The appellant says that he had been deprived of a full opportunity to adduce sufficient evidence. As the appellant acknowledges, he bears the burden of showing the items of entertainment expenses claimed are properly allowable expenses. The Board noted that the issue of the nature and details of the items of entertainment expenses had been repeatedly canvassed between the appellant and the Commissioner, and that the appellant should have on his own volition and as part of his case provided the details sought in the schedule prepared by the Commissioner. In my view, the Board is clearly entitled to have regard to these matters and to refuse further adjournment for the appellant to complete the information in the schedule. I do not consider the refusal of an adjournment has caused any injustice.

20. Further, under section 69 of the IRO, the decision of the Board shall be final provided that the applicant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. It has been noted that the Board carried the final responsibility for stating the case, and is not bound by the draft questions submitted to him: see *CIR v. Inland Revenue Board of Review* [1989] 2 HKC 66, 69D. In *CIR v Emerson Radio Corporation* [1999] 2HKLRD 671, at 679H-680F, Rogers JA held that the court might

determine a question of law that it considered arose from the case stated, noting at the same time that problems might arise if the new question had not been argued before the Board.

21. In the present case, the Board held a separate session to enable the appellant to argue the extra question. Given that the Board had examined the propriety or otherwise of the question in depth and had decided not to include it, it is not opened to the appellant to seek to override the Board's conclusion on the matter. It would be an abuse of process to attempt to argue the question at the appeal when the Board had after full deliberations refused to state it for the opinion of the court. Accordingly, this court will not accede to the appellant's request to consider this extra question at this appeal.

The relevant principles

22. There does not appear to be any differences between the parties on the principles upon which the Court operates in a case stated. They have been succinctly set out in the judgment of Barnett J in *CIR v. Inland Revenue Board of Review and Aspiration Land Investment Ltd* (1988) 2 HKTC 575 at 594 as follows:

> "The decision of a Board of Review is like a pyramid. At its base is a number of blocks consisting of primary facts found by the Board upon evidence presented to it. Above these is another line of blocks, consisting of inferences drawn from the primary facts. At the apex of the structures lies the Board's final conclusion based upon the primary facts and inferences.
>
> The final decision may be attacked in three principal ways. First, it can be impugned on the basis that the Board has misdirected itself, for example, upon the burden of proof, or by misinterpretation of a statute. Second, an inference or inferences of the final conclusion may be attacked upon the basis that the primary facts do not admit of an inference drawn from them, or that the primary facts or inferences, or a combination, do not admit of the final conclusion. Third, one or more findings of primary fact may be attacked upon the basis that there was no evidence upon which they could be found. Alternatively, it may be contended that the Board should have made findings of other relevant facts. If the applicant is successful in displacing any of the blocks below the final conclusion or its successful in inserting additional blocks of fact, the structure may be so distorted that the final conclusion must topple and will be set aside by the court."

In the present case, the questions stated by the Board do not involve any challenge to its finding of facts. Thus the court will only intervene where the decision of the Board is inconsistent with a true and reasonable conclusion on the facts found: *Edward v. Bairstow* [1956] AC 14, 36.

Reasons for decision on the appeal

23. Before turning to address the arguments advanced by the appellant in support of this appeal, I feel bound to point out that it is not altogether easy to understand the arguments advanced by the appellant. Although he had before the hearing lodged with the court a document called "Preliminary Argument of the Appellant", his oral submissions departed from it substantially, whether in terms of arrangement and contents. The appellant said he had intended to produce a written submission but did not get to finalizing it, so he had to read from notes that he had made. That is regrettable. The result is that the oral submission is convoluted and repetitive, making it difficult to follow and understand.

Objective test

24. The appellant contends that the Board erred in following the Board's decision in Case no. D94/99 and in turn its approach to the items of expenses. In D94/99, an appeal in which consultancy service fee was claimed as a deductible expense, the Board stated:

> "24. ... The question here is whether that payment is a deductible expense in law when computing the chargeable profits. This question must be answered objectively. The agreement between the Taxpayer and Company D does not preclude us from examining whether the payment is or is not a deductible expense incurred in the production of profits.
>
> 25. Such expense must have been bona fide incurred in the production of profits. We must look at all surrounding circumstances. For example, the relationship between the payer and the payee is a relevant circumstance. So is the purpose or the reason of the payment. The basis and the breakdown of the amount are also important. The lack of a rational basis may lead us to the conclusion that the amount is wholly arbitrary, lacking in commercial reality, and thus not bona fide incurred."

25. The appellant submitted at one stage that D94/99 was wrongly decided in that it relied on 2 English authorities when the English legislation was different from our section 16(1), and the Board was wrong to adopt an objective test. There is no merit in this argument. The two English cases of *Copeman v William Flood & Sons* (1940) 24 TC 53 at 56 and *Earlspring Property Ltd v Guest* [1993] STC 473 at 486 held that where the Revenue had concluded that the expense was not wholly and exclusively incurred for the purpose of the taxpayer's business, it was for the Revenue to determine as a fact how much, if any, of the expense could be treated as so incurred. Although the words "wholly and exclusively" are no longer part of section 16(1), the section nevertheless entitles the Commissioner to ascertain the extent to which the expense is incurred in the production of chargeable profits. In the same vein, the Commissioner would have to ascertain whether the expense was incurred solely or partly for the production of profits. Common sense would dictate that once he concluded that the expense was not solely for the production of profits,

he should go on to determine how much of it was incurred for the production of chargeable profits. These are common sense principles and do not depend on the interpretation of English legislation.

26. The appellant subsequently clarified that he had no disagreement that it should be an objective test. What he contends the Board to have gone wrong is what he calls "the level of the objective test". He says it is wrong "if the objective test is concerning a level connected with wholly and exclusively" because that is not part of section 16(1). I am unable to understand this argument. The objective test simply requires all circumstances be looked at in deciding whether an item is a deductible expense. The Board may conclude that the item is or is not a deductible expense, and if it is, the extent to which it is deductible in accordance with the plain words of section 16(1).

Sections 16 & 17 IRO

27. The appellant argues that there is under the IRO no concept of a computation of expenses. He says that section 16(1) is a "qualifying section" that sets out the allowable tax deductions. Section 17(1), on the other hand, is a "disallowing section" that sets out the expenses that cannot be allowed, even though they are qualified under section 16. The appellant contends that where an expense is qualified as a deduction under section 16(1), so long as it is not disallowed by section 17(1), then it should be allowed in whole, and there is no room for apportionment. In other words, the appellant suggests that section 16(1) has to be read subject to section 17(1).

28. I am unable to accept this submission. Firstly, there is nothing in the two sections to suggest, let alone permit, such a construction. It is unsupported by any authority. Neither do the judgments of the Privy Council in *CIR v Mutual Investment Co Ltd* [1967] AC 587 and *Lo & Lo v CIR* (1986) 2 HKTC 34 supports such construction. Secondly, the appellant is effectively saying that once an expense of the kind recognized under section 16(1), but not disallowed under section 17(1), had been effected, then irrespective of the amount involved or the reason for it, the Revenue cannot question its genuineness or the amount of the expense. This plainly defies logic and defeats the role of the Revenue in determining the amount of chargeable profits.

The decision of Lo & Lo v CIR

29. The appellant places great emphasis on the decision of *Lo & Lo v CIR*. In particular, it is said that the case shows that with the amendment to section 16(1), the concept of "wholly and exclusively incurred" outgoings and expenses is no longer part of our tax law. That being the case, there is no legal basis for questioning the amount of a deductible expense, and there is also no room for any apportionment. In the appellant's submission, Rule 2A of IRR is therefore inapplicable.

30. It is correct for the appellant to say that the words "wholly and exclusively" had been removed from section 16(1). In its place, however, the words "to the extent to which" the outgoings and expenses had been enacted. In *Lo & Lo v CIR*, Lord Brightman (at 71) pointed out that:

> "Sections 16 and 17 provide exhaustively for deduction sin the sense that permitted deductions are confined to outgoings and expenses incurred in the production of profits in respect of which tax is chargeable; that such permitted deductions expressly include those specified in (a) to (h) of section 16(1), and expressly exclude those in section 17." (Emphasis supplied)

31. Therefore, notwithstanding the deletion of the words "wholly and exclusively", it remains necessary to identify what part of the outgoings and expenses are incurred for the production of chargeable profits. As noted above, once the Commissioner, on the material before her, comes to the view that only part of the outgoing or expense under examination is incurred for the production of chargeable profits, she is under a duty to ascertain the extent to which such outgoing and expense is so incurred. In performing the task, regards will have to be made to Rule 2A of IRR, which provides, *inter alia*, that:

> "(1) ... for the purpose of ascertaining the extent to which such outgoing or expense is deductible under section 16 of the Ordinance, an apportionment thereof shall be made on such basis as is most appropriate to the activities of the trade, profession or business concerned.
>
> (2) Where, ... , it is necessary to make an apportionment of any outgoing or expense by reason of it having been incurred not wholly and exclusively in the production of profits in respect of which a person is chargeable to tax under Part IV of the Ordinance, such apportionment ... shall ... be made on such basis as is most reasonable and appropriate in the circumstances of the case."

32. As noted above, an objective approach is called for in determining what part of the outgoing or expense is deductible. This involves looking at all the circumstances, including commercial considerations: *Lo & Lo v CIR* at 71.

33. I pause here to observe that notwithstanding the amendments to section 16(1) and Rule 2A(1) in 1965 and 1986 respectively, the words "wholly and exclusively" in Rule 2A (2) have been retained. This runs counter to the appellant's argument that there cannot be any apportionment of outgoing or expense with the removal of the words "wholly and exclusively" from section 16(1).

Question (1): Office facilities charges

34. The appellant argues that Question (1) falls within all three categories of challenge referred to in the *Aspiration* case mentioned above. The appellant further argues that the Board was not entitled to reject the case of the appellant's firm that it is under a contractual obligation to pay the increased amount to Yam & So.

35. As noted above, the questions stated in this appeal do not involve any challenge to the findings of facts made by the Board. The appellant acknowledges this in his oral submissions. This appeal does not come within the third category of challenge mentioned in the *Aspiration* case. It is also apparent from the questions stated that this is not a case that falls within the first category of challenge. Question (1) is only a challenge under the second category, namely, the inferences or conclusions drawn by the Board are not supported by the primary facts.

36. On the issue of whether the appellant's firm is contractually obliged to pay Yam & So the drastically increased amount, the appellant relies on *Lo & Lo v CIR*, in which it was stated that deductions are not confined to a disbursement, but included an obligation to pay. What the appellant has overlooked is that the obligation to pay must be an accrued liability, which is undischarged: at 72. It is therefore imperative to identify the legal basis for giving rise to the liability to pay. The appellant says that his firm will be obliged to pay up if Yam & So brings a claim against it in a court of law. This is a circular argument because it does not address the core issue of why the appellant's firm will be adjudged to be liable to Yam & So's claim. It is not the appellant's case that the parties had entered into a legally binding agreement on the matter. Indeed no such material had ever been adduced to explain the nature of the obligation. The appellant has throughout not identified the basis upon which the alleged obligation is founded. The Board is entitled to reject the contention that the appellant's firm was under an obligation to pay make good the loss or liability incurred by Yam & So. There is no basis for challenging the Board's conclusion that the retrospective fixation of the amount of office facilities charges was not related to a commercial agreement.

37. The appellant also complains that there was no indication that the Commissioner did not accept that the amount claimed by way of deduction was actually paid or incurred. This is a bad point because it must be blatantly clear from the determination that the Commissioner did not accept the figure that was stated in the Return and it is up to the appellant to adduce evidence to convince the Commissioner, and subsequently the Board, otherwise. Equally clear from the Commissioner's determination to allow an amount similar to that of the previous year, is that the Commissioner had undertaken an apportionment of the expense claimed. The appellant says the Commissioner did not make an apportionment, but had only disallowed part of the expense claimed. It is to me a distinction without a difference. It would have been plain to the appellant that the Commissioner only regarded part of the amount claimed as a deductible expense.

38. Approaching the matter from another perspective, the Board is not bound to accept every part of the Commissioner's determination; it itself is a fact-finding body and is entitled to make findings of primary facts and also draw inferences and conclusions upon them. There is no substance in the appellant's complaint.

39. In the context of Question (1), the appellant had also raised the arguments on the adoption of an objective test, the interpretation of sections 16 and 17 and the case of *Lo & Lo v CIR*. These arguments have been considered and dealt with in the preceding part of this judgment.

40. In short, for the reasons set out under this section and the preceding sections, Question (1) must be answered in the affirmative.

Question (2): Equipment rental

41. The bulk of the appellant's arguments under Question (2) overlap with those under Question (1), and they have already been canvassed. The appellant additionally argues that his firm had a proper system of recording the number of photocopies made on the copier provided by Nominsec, and the charges were included as part of the equipment rental. In the premises, the appellant says that it is justified to pay the equipment rental to Nominsec. The appellant however also says that the system of recording the number of photocopying is to enable his firm to charge its clients for the copies made. It was pointed out to him that the photocopying charges were disbursements or expenses incurred by the clients and would not be qualified as a deductible expense. The appellant then attempts to explain that Nominsec charged his firm a lump sum for the use of the copier, irrespective of the number of copies taken. According to him, it would be a commercial decision.

42. In my view, this argument does not take the appellant's case any further because admittedly the calculation of office equipment rental was undertaken by Miss Wong and he had accepted both before the Board and in this appeal that he had no idea how the calculation was worked out. Miss Wong had not given evidence before the Board. Anything the appellant says about the basis or the calculation of the equipment rental, including the schedule or table of justifications he produced to the Board, are only his beliefs and estimates.

43. As Mr Fung puts it, the only evidence before the Board in respect of the equipment rental is the schedule produced by the appellant. But this schedule cannot be acted upon because he had no idea how the equipment rental was determined. On this basis and having regard to the fact that Nominsec was at all material times controlled by the appellant's family, that the debit notes did not give the basis or breakdown for the rental and the absence of regular entry on this in the books of Nominsec and the appellant's firm, the Board concluded that it had not been shown that the appellant's firm had incurred the equipment rental. In my judgment, the Board is perfectly entitled to come to this conclusion on the facts as found by it.

44. Question (2) has to be answered in the affirmative.

Question (3): Rule 2A of IRR

45. The appellant's arguments under this question are twofold. Firstly, it is said that the application of Rule 2A only arose in the Commissioner's closing submission and the appellant was prevented from adducing evidence to support a case for apportionment. Secondly, the appellant says that the Board erred in refusing to apply Rule 2A if indeed the appellant's firm is entitled to an apportionment because Rule 2A is not intended to be relied upon by a taxpayer.

46. The two arguments can be taken together. Plainly, Rule 2A relates to apportionment of outgoings and expenses. It is open to the appellant to invoke Rule 2A as an alternative to his case that both the equipment rental and the office facilities expenses should be allowed in full. Had the appellant wished to advance an alternative case that there should be an apportionment of these expenses, it would be for the appellant to adduce the necessary evidence in support of it. But as the Board had noted, the appellant did not advance an alternative case of apportionment. On the contrary, he had argued that Rule 2A is inapplicable and therefore irrelevant. Apportionment under Rule 2A could not have arisen for consideration by the Board. It is an untenable submission that the Board should have considered or applied Rule 2A on its own volition when the appellant expressly disavowed it. It is also irrelevant that Rule 2A was only referred to in the closing submission.

47. Question (3) must be answered in the affirmative.

Questions (4) to (6): Entertainment expenses

48. The appellant's argument under question (4) is that the total of the amounts recorded on the credit card statements the appellant produced to the Board, i.e. $183,967.90, should qualify for the 80% allowance for tax deductions. It is said that two sums appearing on the credit card slips, namely, $26,645 and $12,711, were wrongfully excluded. These two sums relate to expenditure incurred on occasions that took place before the basis period (i.e. 1 May 1995 to 30 April 1996). The appellant however argues that since he made his credit card payments within the basis period, the two sums were incurred within the basis period.

49. In my view, the appellant has confused the liability to pay the credit card with the liability for the items of entertainment expenses on which a deduction is claimed. The appellant incurred a liability to pay for the services or goods consumed at the dates of the social occasions. He met that liability by making payment through his credit card. When he subsequently made payments to the credit card company, he was meeting his payment obligation to the credit card company. In other words, he was settling the credit or loan extended by the credit card company. Thus analyzed, it is clear that the dates on which the credit card payments are irrelevant to the question of whether the entertainment expenses were incurred within the basis period. The relevant dates are the dates on which the social occasions took place.

50. It is further erroneous for the appellant to suggest that the entertainment establishment had extended a credit to him. The entertainment establishment gave no credit because the bills were paid immediately by credit card. The credit was extended by the credit card company instead.

Since the two sums in question relate to social occasions that took place before 1 May 1995, the Board was correct in not including them in the computation of allowable deduction.

51. Question (4) must be answered in the affirmative.

52. On Question (5), the appellant argues that fellow CPAs and staff, being business associates and employees, are related to the business operations. It follows that meetings with fellow CPAs and gifts for staff should qualify for deductions. But in so asserting, the appellant had not adduced any evidence to show how these meetings and gifts were incurred for the production of chargeable profits. It cannot be inferred that meetings with fellow CPAs and staff parties are necessarily related to business operations so that the costs incurred are connected with the production of chargeable profits. The burden is on the appellant and he must discharge this by evidence explaining how these occasions were related to the business operations of the appellant's firm.

53. The Board has acted reasonably in disallowing the sums spent on lunches with fellow CPAs and in purchasing gifts for staff. Question (5) must be answered in the affirmative.

54. As to Question (6), the appellant contends that the Board acted unreasonably in not accepting the ledger on the entertainment expenses when there is no suggestion that it is not a contemporaneous document. The appellant also says that he had been prevented from producing credit card statements, receipts and other evidence on the entries in the ledger.

55. As noted above, the Board is essentially a fact-finding body. It is not obliged to accept everything put before it. In the present case, the Board had in its Case Stated commented extensively on the quality of the appellant's evidence. It indicates that the Board had carefully reviewed the evidence adduced before coming to a view on it.

56. The appellant argues that the Board acted unreasonably in accepting some of the entries on the ledger, while rejecting the others. I do not agree. It is within its power to reject those entries on the ledger that are not borne out by other evidence, such as the credit card statements. After all, the appellant bears the burden of showing that the items of expenses were truly incurred in the production of chargeable profits. The ledger is only a secondary document. It would be incumbent upon the appellant to adduce the primary documents to support his case.

57. It is not open to the appellant to assert that he had no opportunity to produce the supporting documents. As already noted, it is within the Board's power to decline further adjournment to enable the appellant to adduce further materials. Additionally, the appellant was appealing to the Board against the Commissioner's determination disallowing the entertainment expenses in its entirety. He is well aware that he carries the burden of proving the incurrence of the entertainment expenses. The Board had directed the Commissioner to compile a schedule of the disputed items, and directed the appellant to state the details of the items in the schedule. Yet he did

not do so within the time granted. When he testified before the Board, he also did not see fit to adduce the documentary evidence or elaborate on the items. There is no basis for the complaint that he had no opportunity to lead supporting documents.

58. Question (6) must also be answered in the affirmative.

Conclusion

59. For the reasons above, the answer to each of the six questions of law stated for the opinion of this court is "yes". The appeal is accordingly dismissed. There is no reason to depart from the normal course of costs follows event. I also make an order *nisi* that the appellant pays the respondent the costs of this appeal, to be taxed if not agreed.

(C Chu)
Judge of Court of First Instance
High Court

Representation:

The applicant, unrepresented, appeared in person.

Mr Eugene Fung instructed by Department of Justice for the Respondent.