

Case No. D11/21

Profits tax – whether the signing fee was assessable profits – constitutional principle relating to taxation – sections 2(1), 14, 16(1) and 18 of Inland Revenue Ordinance – deduction of outgoings and expenses – liability to repay the signing fee – repayment of signing fee was made outside the period of the year of assessment – cardinal principles of tax law – whether the received signing fee was part of profits from the taxpayer’s trade, profession or business arising in or derived from Hong Kong during the year of assessment

Panel: Lo Pui Yin (chairman), Ling Chun Wai and Wong Kin Yan Vanessa.

Date of hearing: 19 April 2021.

Date of decision: 22 October 2021.

The Appellant was trading as Company B. The Appellant and Company C signed a Letter of Understanding and Company C paid a signing fee to the Appellant pursuant to the Letter of Understanding. The Acting Deputy Commissioner’s Determination considered determine two issues: (a) whether the Signing Fee received by the Taxpayer should be assessed to Profits Tax in the year of receipt; and (b) whether the Taxpayer’s liability to repay the Signing Fee should be allowed for deduction for the year of assessment. The Acting Deputy Commissioner therefore rejected the Taxpayer’s objection and confirmed the Profits Tax Assessment for the year of assessment. The taxpayer appealed against the Profits Tax Assessment for the year of assessment.

The Taxpayer essentially raises three grounds of appeal: (1) The Commissioner of Inland Revenue can and should charge Profits Tax upon a taxpayer if and only if the taxpayer as a matter of fact and actually has made profits in his trade, profession or business, and that the taxpayer has to and should pay Profits Tax if and only if the taxpayer as a matter of fact and actually has made profits in his trade profession or business; (2) The signing fee was not ‘assessable profits’ upon the Taxpayer. The Taxpayer was only entitled ‘to receive’ the signing fee ‘contingent on’ his having been able to achieve the validation requirements. The Taxpayer had returned the signing fee to Company C. The Taxpayer ‘did not receive’ the signing fee. Also, the signing fee was not and could not be treated as ‘outgoings and expenses’ that are deductible under section 16(1) of the IRO. Further, the signing fee was not and could not be treated as ‘loss’ that can be carried forward and taken into account under section 19C of the IRO. Furthermore, it is against fairness and justice that the Commissioner of Inland Revenue charges Profits Tax on the entire signing fee against the Taxpayer and also charges Profits Tax on the entire signing fee against Company C. (3) The signing fee was not ‘assessable profits’ upon the Taxpayer because the signing fee was paid to the Taxpayer ‘in consideration of’ his ability to achieve the validation requirements and the Taxpayer would be under the contractual duty and obligation to return 100% of the signing fee to Company C when he was unable to achieve the validation requirement at the end day of the first contract year. In anticipation that he would not be able to achieve the

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

validation requirement, the Taxpayer had returned the signing fee to Company C. The Taxpayer ‘failed to provide consideration’ for the signing fee, ‘did not make any profits’ of the signing fee and ‘did not earn’ the signing fee.

Held:

1. The first and foremost consideration in the determination of an Appeal against an assessment of tax is the law of taxation, consisting of the statutory provisions for the assessment and charging of the type of tax that is the subject of the Appeal and the principles of tax law. The Taxpayer’s Appeal is one against an assessment and charge of Profits Tax. The fundamental constitutional principle in Hong Kong relating to taxation is that the subject is to be taxed by the legislature and not by the courts, and that it is the responsibility of the courts to determine the meaning of legislation. This is not a responsibility which can be delegated to accountants, however eminent. This does not mean that the generally accepted principles of commercial accounting are irrelevant, but their assistance is limited. The question what constitutes a taxable profit is a question of law. While the amount of that profit must be computed and ascertained in accordance with the ordinary principles of commercial accounting, these are always subject to the overriding requirement of conformity, not merely with the express words of the statute, but with the way in which they have been judicially interpreted. Even where the question is a question of computation, the court must ‘always have the last word’ (Nice Cheer Ltd v Commissioner of Inland Revenue (2013) 16 HKCFAR 813 followed).
2. Profits Tax is assessed in Hong Kong in respect of the assessable profits of a person arising in or derived from Hong Kong for each year of assessment as ascertained in Part 4 of the IRO; see section 14 of the IRO. Section 18B(1) of the IRO (which is in Part 4 of the IRO) provides that the assessable profits for the year of assessment from the Taxpayer’s trade, profession or business carried on in Hong Kong shall be computed on the full amount of the profits from his trade, profession or business arising in or derived from Hong Kong during the year of assessment. The year of assessment is, pursuant to the definition in section 2(1) of the IRO.
3. The ascertainment of the full amount of the profits of the Taxpayer from his trade, profession or business arising in or derived from Hong Kong during the year of assessment involves section 16(1) of the IRO, which concerns deduction of outgoings and expenses ‘*to the extent to which they are incurred during the basis period for that year of assessment*’. The ‘basis period’ for a year of assessment is defined in section 2(1) of the IRO as ‘the period on the income or the profits of which tax for that year ultimately falls to be computed’. The deduction could only be made in respect of expenses

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

incurred during the basis period for the year of assessment. The section envisages that there is a possibility that a certain profit for one year of assessment may be the result of certain expenses incurred in other assessment years. The corollary is that the fact that expenses may have to be incurred in a number of years does not necessarily mean that the profit resulted from such expenses must be treated as the profits for the years when the expenses are incurred (Lo Tim Fat v Commissioner of Inland Revenue [2006] 2 HKLRD 689 followed).

4. A certain amount received by the taxpayer beneficially in the course of his trade, where he was entitled to use it for whatever purpose he liked including for his trade and business, could be properly treated as trading receipt on the day of the receipt and for assessment of Profits Tax for the year when the sum was received and accrued to him, even when there is a possibility that he might have to repay or may be liable to refund all or part of the amount received in the future. (Lo Tim Fat v Commissioner of Inland Revenue [2006] 2 HKLRD 689 followed)
5. The liability to repay the signing fee was a possibility in the future, but, commercially there was no actual act or possible event during the year of assessment that could give rise to the liability to repay. As a result, there was nothing to preclude the signing fee from being properly considered as part of the Taxpayer's trading receipt for the year of assessment (Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] 1 WLR 986 followed).
6. The repayment of the signing fee was made outside and after the period of the year of assessment and cannot be taken into consideration in the ascertainment of the profits in respect of which the Taxpayer is chargeable to Profits Tax for that year of assessment. Because of this, the fact that the Taxpayer paid back the signing fee in whole was not material to the ascertainment of the assessable profits for the year of assessment.
7. The two 'cardinal principles of tax law' are: (i) the word 'profits' connotes actual or realised and not potential or anticipated profits; and (ii) neither profits nor losses may be anticipated. The two principles overlap and are often interchangeable, for they both involve questions of timing; but they are not identical. The first is concerned with the subject-matter of the tax, uses the word 'anticipated' in its secondary meaning of 'expected' or 'hoped for', and excludes profits which have not been and may never be realised. The second is concerned with the allocation of profits to the correct accounting period, uses the word 'anticipated' in its primary meaning of 'brought forward', and prevents profits being taxed prematurely. The word 'anticipated' has a particular meaning in each of the two principles. The signing fee could not be profit that was brought forward from a later year of assessment in relation to the second cardinal principle of tax since it was paid and did accrue in the year of assessment in question. The signing fee

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

also could not be profit that was expected or hoped for, or profit that had not been and may never be realized in relation to the first cardinal principle of tax. This is because the signing fee was in fact paid and did accrue in accordance with the relevant provisions in the Letter of Understanding. The possibility that the Taxpayer may become liable to pay upon demand by Company C for not meeting the validation requirements during the relevant period(s) is concerned with the arising of a liability calculated in terms of percentage(s) of the signing fee distinct from the payment and receipt of the signing fee itself. The signing fee was actual and realized profit of the year of assessment. (Nice Cheer Ltd v Commissioner of Inland Revenue and Lo Tim Fat v Commissioner of Inland Revenue followed)

8. This Board accepts the evidence of the Taxpayer that the signing fee was provided by Company C as part of the remuneration package to motivate or incentivize him to bring in more business and more clients to Company C in the coming years. However, this Board is duty bound to give effect to the charging provisions for Profits Tax in Part 4 of the IRO, which assess Profits Tax on the basis of the year of assessment defined under the IRO. If this Board were to give effect to the Taxpayer's understanding of his contractual duty, this Board would have been departing from the said duty and instead assessing Profits Tax chargeable to the Taxpayer on the impermissible basis of the 'first contract year' specified under the Letter of Understanding.
9. In the light of this Board's considerations above, this Board determines that the received signing fee was part of the profits from the Taxpayer's trade, profession or business arising in or derived from Hong Kong during the year of assessment from which the assessable profits for the year of assessment was to be computed. Having considered the evidence and submissions before it, this Board holds that the Taxpayer has failed to discharge the burden of proof to show that the Profits Tax Assessment for the year of assessment imposed on him was excessive or incorrect.

Appeal dismissed.

Cases referred to:

Lincolnshire Sugar Company Limited v Smart [1937] AC 697
Lo Tim Fat v Commissioner of Inland Revenue [2006] 2 HKLRD 689
D18/05, (2005-06) IRBRD, vol 20, 323
D26/07, (2007-08) IRBRD, vol 22, 601
Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] 1 WLR 986
Nice Cheer Ltd v Commissioner of Inland Revenue (2013) 16 HKCFAR 813
D44/05, (2005-06) IRBRD, vol 20, 600
BSC Footwear Ltd v Ridgway [1972] AC 544
Commissioner of Inland Revenue v Tong Sui Lun [2008] 5 HKLRD 781

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

Allen Lam, instructed by S H Chan & Co, for the Appellant.
Lo Hok Leung Dickson, Fung Chi Keung and Leung Hoi Sze, for the Commissioner of
Inland Revenue.

Decision:

Introduction

1. This Appeal was lodged by the Appellant/Taxpayer, Mr A (trading as Company B) against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 17 December 2020 rejecting the Taxpayer's objection to the Profits Tax Assessment for the year of assessment 2017/18 raised by the Assessor of the Commissioner of Inland Revenue ('Revenue') and confirming the Assessor's assessment for the year of assessment 2017/18 ('the Determination').

2. The Taxpayer's Notice of Appeal, which was lodged with the Clerk to the Board of Review by his solicitors, is accompanied by a Statement of the Grounds of Appeal drafted by his counsel. The Taxpayer's legal representatives raise on his behalf that the Signing Fee referred to in a Letter of Understanding the Taxpayer signed with Company C on 30 October 2017 was not assessable profits and not chargeable to Profits Tax under section 14(1) of the Inland Revenue Ordinance (Chapter 112 of the Laws of Hong Kong) ('IRO'); that the said Signing Fee is not and cannot be treated as 'outgoing and expenses' that are deductible under section 16(1) of the IRO; that the said Signing Fee is not and cannot be treated as 'loss' that can be carried forward and taken into account of under section 19C of the IRO; that it is against fairness and justice for the Revenue to charge Profits Tax on the Signing Fee against the Taxpayer and also to charge Profits Tax on the Signing Fee against Company C; and that the Taxpayer 'desperately needs the excessive profits tax of \$1,850,040 to be returned by the Revenue because his wife is suffering from cancer and her treatment involves 'huge sum of medical expenses' and he and his wife are going to emigrate and start a new life in Country D.

3. This Board held the hearing of this Appeal on 19 April 2021. The Taxpayer attended was represented by Mr Allen Lam. The Revenue was represented by three Assessors of the Revenue and, of the three Assessors, it was Mr Lo who conducted the Revenue's case at the hearing.

4. The Taxpayer and Revenue have reached agreement on a set of Agreed Facts.

5. The Taxpayer testified under affirmation before this Board and was cross-examined by the Revenue. The Taxpayer did not call any other oral evidence. The Taxpayer referred to documents submitted before this Board.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

6. The Revenue did not call any oral evidence. The Revenue referred to documents submitted before this Board.

7. In the sections of this Decision that follow, this Board shall consider the Determination and the evidence placed before it by the parties to this Appeal and make findings of fact. Then this Board shall consider the submissions of the Taxpayer and the Revenue in the light of the facts found and determine this Appeal.

The Agreed Facts

8. The Agreed Facts reads as follows:

- (1) The Taxpayer has been trading as Company B since 2 April 2015 until 23 March 2021, the date of the signing of the Agreed Facts.
- (2) The Taxpayer and Company C signed a Letter of Understanding dated 30 October 2017 ('LOU'), a Career Representative's Contract dated 1 January 2018 ('CR Contract'), and a Career Representative Unit Manager's Contract dated 1 February 2018. The Taxpayer was validly registered as a Licensed Insurance Intermediaries (Individual) with a self-regulatory organization (namely, the Insurance Agents Registration Board, The Hong Kong Confederation of Insurance Brokers or Professional Insurance Brokers Authority) with Company C as the Position E since 1 January 2018 until 23 March 2021.
- (3) On or about 29 January 2018, Company C paid a Signing Fee of \$12,333,600 to the Taxpayer pursuant to clause 6(1) of the LOU.
- (4) In the Trading and Profit and Loss Account of Company B for the year ended 31 March 2018, dated 28 September 2018, the Taxpayer reported, *inter alia*, the receipt of the said Signing Fee of \$12,333,600. In his Tax Return – Individuals for the year of assessment 2017/18, the Taxpayer reported, *inter alia*, the said Signing Fee of \$12,333,600 to the Revenue.
- (5) In the Profits Tax Assessment Demanding Final Tax for 2017/18 and Notice for Payment of Provisional Tax for 2018/19 issued by the Revenue to the Taxpayer, dated 6 November 2018, the Commissioner of Inland Revenue demanded the Taxpayer to pay Profits Tax for the year of assessment 2017/18 in the total sum of \$2,276,233, which included Profits Tax of the whole amount of the said Signing Fee of \$12,333,600, namely a sum of $\$12,333,600 \times 15\% = \$1,850,040$.
- (6) On or about 29 November 2018, the Taxpayer returned the Signing Fee in a sum of \$12,333,600 to Company C pursuant to clause 6(3) and 6(4) of the LOU. Company C acknowledged receipt of the said

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

sum of \$12,333,600 from the Taxpayer by a letter dated 25 September 2019.

- (7) The Taxpayer, by a letter of his tax representative Kelvin Chong & Partners dated 4 December 2018, raised objection to assessment of Profits Tax for the year of assessment 2017/18 to the Commissioner of Inland Revenue on the ground that the assessment was excessive, namely that the Taxpayer had already returned the Signing Fee in a sum of \$12,333,600 to Company C and hence his assessable profits and Profits Tax should be reduced accordingly.
- (8) The Taxpayer, by two letters of his tax representative Kelvin Chong & Partners dated 25 April 2019 and 2 October 2019, provided further grounds of objection to the Commissioner of Inland Revenue.
- (9) The Taxpayer, by a letter of his solicitors S H Chan & Co, dated 4 November 2019, provided further grounds of objection to the Commissioner of Inland Revenue in that the assessment of Profits Tax for the year of assessment 2017/18 was excessive by a sum of \$1,850,040.
- (10) The Revenue, by a letter dated 26 May 2020, made a settlement offer to the Taxpayer in respect of his objection to assessment of Profits Tax for the year of assessment 2017/18.
- (11) The Taxpayer, by a letter of his solicitors S H Chan & Co, dated 29 June 2020, refused the settlement offer and provided further grounds of objection to the Commissioner of Inland Revenue.
- (12) The Acting Deputy Commission of Inland Revenue made a determination dated 17 December 2020 to refuse the Taxpayer's objection and to confirm the assessment of Profits Tax for the year of assessment 2017/18 (i.e. the Determination).
- (13) The Taxpayer, by his solicitors S H Chan & Co, filed a notice of appeal dated 14 January 2021 to appeal against the assessment of Profits Tax for the year of assessment 2017/18 to the Board of Review.

9. This Board finds as facts the factual matters set out in the Agreed Facts and reproduced in the preceding paragraph.

The Determination

10. The Determination referred to the assertions made on behalf of the Taxpayer by his solicitors and considered that he would have to determine two issues: (a) whether the Signing Fee received by the Taxpayer should be assessed to Profits Tax in the year of

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

receipt; and (b) whether the Taxpayer's liability to repay the Signing Fee should be allowed for deduction for the year of assessment 2017/18.

11. The Acting Deputy Commissioner considered section 14 of the IRO, the charging provision in the IRO for Profits Tax. Having referred to the cases of Lincolnshire Sugar Company Limited v Smart [1937] AC 697 and Lo Tim Fat v Commissioner of Inland Revenue [2006] 2 HKLRD 689, the Acting Deputy Commissioner stated that he could not accept the Taxpayer's claim that the Signing Fee was not the income of his business for the year of assessment 2017/18 'as it was subsequently refunded to [Company C]'. Having referred to the matters that at the relevant times, the Taxpayer carried on his business in Hong Kong under name of Company B, he entered into the LOU and CR Contract with Company C in the ordinary course of his business, and pursuant to the LOU, he received the Signing Fee during the year of assessment 2017/18, the Acting Deputy Commissioner held that the Signing Fee received arose out of the Taxpayer's carrying on a trade, business or profession, that once received, the Taxpayer was entitled to use it for whatever purposes he liked, and so it was clearly a trading receipt chargeable to Profits Tax.

12. Regarding the possibility that the Taxpayer might have to repay all or part of the Signing Fee received to Company C in the future, the Acting Deputy Commissioner considered that this should only be considered as a contingent liability in the year of assessment 2017/18, as the Taxpayer's liability to repay would not arise if he remained as an agent of Company C and fulfilled the validation requirements and Company C could not enforce repayment of the Signing Fee before the Taxpayer had failed to meet the validation requirements. The Acting Deputy Commissioner thus determined that the Signing Fee received should properly be considered to be part of the trading receipts of the Taxpayer's business for the year of assessment 2017/18 in which it was received and accrued.

13. The Acting Deputy Commissioner turned to section 16(1) of the IRO in relation to the deduction of expenses incurred during the basis period of the relevant year of assessment by a person in the production of that person's chargeable profits. Having referred to the Board of Review's decision in D18/05, (2005-06) IRBRD, vol 20, 323 at 330 (paragraph 23), the Acting Deputy Commissioner considered that according to the LOU, the Taxpayer was liable to repay the Signing Fee on 1 January 2019 at the earliest (which was the time he could not meet the validation requirement after the first year), and that fell within the year of assessment 2018/19. Therefore, the Taxpayer's liability to repay the Signing Fee did not arise in the year of assessment 2017/18. The Acting Deputy Commissioner thus determined that the Taxpayer's liability to repay the Signing Fee should not be allowed for deduction in the year of assessment 2017/18.

14. The Acting Deputy Commissioner did not accept the Taxpayer's claim that the Signing Fee should not be subject to tax by reason of the Board of Review's decision in D26/07, (2007-08) IRBRD, vol 22, 601. The Acting Deputy Commissioner stated that it is not uncommon that for the same type of income/expense the tax treatment under Salaries Tax and Profits Tax is totally different. The case in D26/07 concerned income assessed under Salaries Tax and was not applicable to the Taxpayer's case, which concerned assessment for Profits Tax.

15. The Acting Deputy Commissioner therefore rejected the Taxpayer's objection and confirmed the Profits Tax Assessment for the year of assessment 2017/18.

The Testimony of the Taxpayer and Findings of Fact

16. The Taxpayer testified before this Board. He confirmed and adopted as his evidence the contents of two witness statements he signed. He also produced in the course of his testimony a letter dated 12 April 2021 that he received from Company C one week before the hearing of this Appeal and relied on the contents of this letter. As the Revenue did not object to the production of this document, this Board allowed the Taxpayer to produce and rely on this letter.

17. The Taxpayer testified that he began working as a self-employed insurance agent (i.e. a licensed insurance intermediary (individual)) in 2015, operating as a sole proprietorship under the name 'Company B' since April 2015. At that time, he earned commission from Company F by introducing customers to Company F for the purchase of, mainly, life insurance policies.

18. The Taxpayer testified that towards the end of 2017, he intended to join Company C to continue his career as an insurance agent. He explained that when an insurance agent joined a new insurance company, there would some discussion between the parties for an arrangement that would motivate and incentivize the insurance agent to work hard and bring business to the insurance company. Such an arrangement usually involved, *inter alia*, signing fee. He stated that the signing fee was an inducement for him to join Company C and part of the remuneration package so that he would bring in more business and bring in his clients to Company C. The signing fee was 'an amount of money paid by the company to the insurance agent at the beginning of their working relationship but on the condition that the insurance agent is to work and to be able to earn and achieve an agreed total sum of commission in the coming years ... A certain amount of commission (commonly called "validation requirement") is agreed between the parties for each of the coming years and that if the insurance agent is unable to meet and achieve the agreed amount of commission for any of the coming years, he would be under the contractual obligation and duty to return the signing fee, in whole or in part, to the company in accordance with the terms and conditions of the contract signed between the parties.'

19. The Taxpayer testified that he decided to join Company C as a self-employed insurance agent under Company B after the discussion with the management of Company C. The LOU was signed between the parties on 30 October 2017. The Taxpayer referred to clause 6 of the LOU, which concerned the signing fee, and stated that this clause provided that Company C would pay a signing fee in the sum of \$12,333,600 to him in consideration of his commitment to achieve the validation requirements provided in the LOU for the three years that followed.¹ Given that the validation requirement for the first contract year was \$4,111,200, the Taxpayer stated that that meant he was under a contractual obligation and duty to bring in business to Company C and would be able to earn

¹ The Taxpayer stated that the total amount of commission he committed to achieve in the said three years was \$20,556,000.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

commission in a total amount of not less than \$4,111,200 at the end of the first contract year he was to work with Company C and if he was unable to meet and achieve the validation requirement at the end of the first contract year, he was under an obligation to return 100% of the signing fee of \$12,333,600 to Company C. When the Taxpayer was questioned over the terms of the clause 6(1) of the LOU for the payment of the signing fee, namely the full compliance of three ‘condition precedents (sic) as set out in Clause 1 above to the satisfaction of the Company’,² he emphasized that clause 1 was ‘only part of it’ and ‘it is subject to other terms and conditions in the LOU’. He elaborated that one had to consider everything in clause 6; his understanding was that the payment of the signing fee by Company C was subject to the terms and conditions in the LOU, the signing fee he received was only for him to keep for the time being, he had not actually earned the money until and unless the requirements set out in the LOU were met, and if he could not meet the validation requirements set out in clause 6(3) of the LOU for the first, second and third year, he was obliged as a contractual duty to return the signing fee. It was only when all the obligations in clauses 6(3)(a), (b) and (c) of the LOU were met then he could keep the signing fee.

20. The Taxpayer testified that his working relationship with Company C commenced on 1 January 2018 and the first contract year would end on 31 December 2018. On or about 29 January 2018, Company C paid the signing fee of \$12,333,600 to him by cheque. He deposited the cheque into his Bank G account on or about 20 February 2018.

21. The Taxpayer testified that on 31 March 2018, he was under no obligation to repay the signing fee; and that at that time, after the first three months into the first contract year, it was not anticipated that he could not meet the validation requirement for the first contract year.

22. The Taxpayer testified that his work and achievement started to fall and some time after the middle of 2018, he became concerned that he would not be able to meet and achieve the validation requirement set out under clause 6 of the LOU at the end of the first contract year, i.e. 31 December 2018. The Taxpayer stated that in or about September or October 2018, he found that the falling behind in meeting and achieving the validation requirement had become very significant and he was able to meet and achieve only about 50% of the validation requirement for the first contract year. He considered that it ‘unlikely, indeed impossible’ that he would be able to catch up and meet and achieve the validation requirement at the end of the first contract year. He spoke to the management staff of Company C about the situation and told them that he intended to return the signing fee to Company C without waiting until the end of the first contract year. The management staff of Company C responded that it might be premature for him to make the decision to return the signing fee and encouraged him to continue to work hard. In the event, the Taxpayer issued a Bank G cheque dated 29 November 2018 in the amount of \$12,333,600 and sent it to Company C to return the signing fee. The withdrawal of the amount of \$12,333,600 by virtue of the cheque was made on 3 December 2018 from the Taxpayer’s Bank G account.

² There were three ‘condition precedents (sic)’ stated in clause 1 of the LOU. The first concerned the signing of the LOU and the CR Contract and the registration with the Insurance Agents Registration Board. The second concerned the provision of the most current credit grading report. The third concerned the taking out and maintenance of a credit life insurance policy on his own life with Company C and/or assigning and transferring his rights, etc in the life policy to Company C.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

Company C acknowledged receipt of the sum of \$12,333,600 from the Taxpayer by a letter dated 25 September 2019.

23. The Taxpayer testified that in the meantime, he was advised by his accountant that he had to report the receipt of the signing fee of \$12,333,600 as part of the trading and profit and loss account of Company B for the year ended 31 March 2018. He instructed his accountant to do so but a rider about the return of the signing fee to Company C was also included in the said profit and loss account.³ Also, upon the advice of his accountant, the Taxpayer included the receipt of the signing fee of \$12,333,600 in his tax return – individuals for the year of assessment 2017/18.

24. The Taxpayer testified that he instructed his accountant to object to the assessment of Profits Tax for year of assessment 2017/18 on the ground that the assessment was excessive since he considered that he should not be demanded to pay any Profits Tax on the signing fee of \$12,333,600 ‘because I did not receive it as a matter of fact’. He considered that it was ‘wholly unreasonable and against common sense’ that he should be demanded to pay Profits Tax on the signing fee ‘when as a matter of fact, I have already returned the whole sum of \$12,333,600’ to Company C on or about 29 November 2018.

25. The Taxpayer testified that he paid in full the final Profits Tax for the year of assessment 2017/18 and the provisional Profits Tax for the year of assessment 2018/19 the Revenue demanded of him.

26. The Taxpayer produced two sets of documents to show the details of his earnings in the 12 months of 2018. By reference of these two sets of documents, particularly the set of monthly agent statements, he provided a clarification on the amount of ‘first year commission’⁴ he earned for each of the 12 months of 2018. By reference to the cumulative ‘first year commission’ figures from month to month in 2018, he provided an explanation of the situation that he began to be unable to achieve by the end of May 2018 the cumulative percentage of the ‘first contract year target FYCC’⁵ stipulated in the table under clause 7(2) of the LOU and had continued to be unable to do so in all the succeeding months. The Taxpayer emphasized that he secured ‘few’ or ‘very few’ insurance policies in July 2018,

³ The Trading and Profit and Loss Account of Company B for the year ended 31 March 2018 stated the commission income from Company C in the amount of \$6,761,703, which was calculated in terms of deducting \$8,222,400 from the sum of \$14,984,003 that Company C reported to the Revenue. The deduction of \$8,222,400 was explained in a note as the application of a ‘3 years apportionment’ on the basis that ‘[an] initial advance payment of HK\$12,333,600 had been granted by the Insurance Co in returning (sic) for 3 years commitment of new business turnover to the Insurance Corporation. The Corporation can claim back the credit advance payment within 3 years period according to the level of commitment.’

⁴ It is stated in clause 6(3) of the LOU that ‘First Year Commission’ meant ‘the commission payment that the Applicant is entitled to receive from the Company during the first twelve (12) months in respect of the Insurance Business that he/she procured.’

⁵ It is stated in clause 6(3) of the LOU that ‘FYCC’ meant ‘the amount to be achieved by the Applicant which is the sum of the net amount of the First Year Commission after taking into account of termination and/or cancellation of all insurance business ... (“Insurance Business”) written with the Company by the Applicant, plus, where applicable, the Basic Override, Agency Development Override and Management Override as stated in the Agency Leader’s Contract and earned by the Applicant, but exclude any First Year Commission earned from the Insurance Business in which the policyowner and/or Insured is/are the Applicant, the Applicant’s spouse, agents under the Applicant’s direct agency or their respective spouses.’

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

August 2018, September 2018, and October 2018. Although there was an increase in earning that could be included as part of the 'first contract year target FYCC' in September 2018,⁶ the cumulative figure up to October 2018 was \$2,519,578.05 and the cumulative figure on 31 December 2018 (i.e. the date of the first contract year) was \$2,523,097.50.⁷ As the validation requirement for the first contract year was \$4,111,200, his cumulative FYCC at the end of the first contract year was only 61.37% of that validation requirement. The Taxpayer therefore stated that he was bound by his contractual duty and obligation under clause 6(4) of the LOU to return the full amount of the signing fee of \$12,333,600 to Company C.

27. Having heard the testimony of the Taxpayer and considered the documents placed before this Board by the parties, this Board makes the following findings of fact in addition to those already found in paragraphs 8 and 9 above:

- (1) On or about 29 January 2018, Company C paid by cheque a signing fee of \$12,333,600 to the Taxpayer pursuant to clause 6(1) of the LOU (which the parties agreed per paragraph 8(3) above).
- (2) On or about 20 February 2018, the Taxpayer deposited the cheque of \$12,333,600 into his Bank G account.
- (3) On 31 March 2018, the Taxpayer was able to achieve the cumulative percentage of the validation requirement for the first three months of the first contract year stipulated in the table under clause 7(2) of the LOU.
- (4) The Taxpayer reported the receipt of the signing fee of \$12,333,600 as income from Company C in the Trading and Profit and Loss Account of Company B for the year ended 31 March 2018 (which the parties agreed per paragraph 8(4) above).
- (5) The Taxpayer reported in his Tax Return - Individual for the year of assessment 2017/18 the signing fee of \$12,333,600 (which the parties agreed per paragraph 8(4) above).
- (6) The Revenue issued to the Taxpayer the Profits Tax Assessment Demanding Final Tax for 2017/18 and Notice for Payment of

⁶ The Taxpayer explained that a substantial part of the earning in September 2018 was basic override and agency development override. They were commissions an insurance agent earned if a down-line agent under him/her brought business to Company C.

⁷ The cumulative figure of \$2,523,097.50 on 31 December 2018 that the Taxpayer provided in his Supplemental Witness Statement did not include 'override' commissions that Company C stated that the Taxpayer earned in October 2018 and December 2018 in the letter dated 12 April 2021 of Company C. Also, the letter dated 12 April 2021 of Company C stated that the Taxpayer earned more commission in May 2018 but that did not appear to affect materially the Taxpayer's testimony that he was not able to meet the cumulative percentage of the 'first contract year target FYCC' stipulated for the fifth month in the table under clause 7(2) of the LOU.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

Provisional Tax for 2018/19 dated 6 November 2018, demanding the Taxpayer to pay Profits Tax for the year of assessment 2017/18 in the total sum of \$2,276,233, which included Profits Tax for the whole amount of the signing fee of \$12,333,600 (which the parties agreed per paragraph 8(5) above).

- (7) The Taxpayer issued a cheque of his Bank G account in the amount of \$12,333,600 on or about 29 November 2018 and sent the cheque to Company C with a covering letter dated 29 November 2018 that stated that he was returning the signing fee pursuant to clause 6(4) of the LOU (which the parties agreed per paragraph 8(6) above).
- (8) The Taxpayer's Bank G cheque of \$12,333,600 was cashed and a withdrawal of the said sum from his Bank G account was made on 3 December 2018.

28. This Board agrees with the parties that the substantial issues in the Taxpayer's Appeal concern the application of the law to the facts found and/or the legal consequences of the facts found in light of the relevant charging provisions in the IRO. This Board considers in the sections below the submissions of the parties and the evidence of the Taxpayer on his understanding of the LOU, the CR Contract and other documents he signed with Company C and of the intention of the parties to these documents on these issues.

The Relevant Charging Provisions

29. (1) Section 14(1) of the IRO provides that:

'Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'

- (2) Section 18B(1) of the IRO provides that:

'Subject to subsection (2) and to sections 18C, 18D, and 18E, the assessable profits for any year of assessment commencing on or after 1 April 1975 from any trade, profession or business carried on in Hong Kong shall be computed on the full amount of the profits therefrom arising in or derived from Hong Kong during the year of assessment.'

It appears that sections 18B(2), 18C, 18D, and 18E of the IRO do not apply to the Taxpayer's Appeal.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

- (3) Section 16(1) of the IRO further provides that:

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

- (4) Section 19C(1) of the IRO furthermore provides that:

‘Subject to section 19CB, where in any year of assessment –

- (a) an individual sustains a loss in any trade, profession or business carried on by him ...*

the amount of that loss shall be carried forward and set off against the amount of his assessable profits from that trade, profession or business for subsequent years of assessment.’

It appears that section 19CB does not apply to the Taxpayer’s Appeal.

- (5) Relevant to the above provisions, section 2(1) of the IRO defines that:

‘year of assessment means the period of 12 months commencing on 1 April in any year’;

‘basis period for any year of assessment is the period on the income or the profits of which tax for that year ultimately falls to be computed’; and

‘assessable profits means the profits in respect of which a person is chargeable to tax for the basis period for any year of assessment, calculated in accordance with the provisions of Part 4’.

30. Section 66(3) of the IRO provides that save with the consent of the Board of Review and on such terms as the Board of Review may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given to the Board of Review in accordance with section 66(1) of the IRO. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

Discussion

31. The Taxpayer’s Statement of the Grounds of Appeal consists of 10 pages and raises various matters. Having read the written submissions of the Taxpayer and heard

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

Mr Lam's submissions at the hearing, this Board considers that the Taxpayer essentially raises three grounds of appeal. They can be summarized as follow:

- (1) The Commissioner of Inland Revenue can and should charge Profits Tax upon a taxpayer if and only if the taxpayer as a matter of fact and actually has made profits in his trade, profession or business, and that the taxpayer has to and should pay Profits Tax if and only if the taxpayer as a matter of fact and actually has made profits in his trade profession or business.
- (2) The signing fee of \$12,333,600 was not 'assessable profits' upon the Taxpayer. This is because under LOU, properly construed, the Taxpayer was only entitled 'to receive' the signing fee 'contingent on' his having been able to achieve the validation requirements set out in clause 6(3) of the LOU and the Taxpayer would be under the contractual duty and obligation to return 100% of the signing fee to Company C when he was unable to achieve the validation requirement set out in clause 6(3)(a) of the LOU at the end day of the first contract year. In anticipation that he would not be able to achieve the validation requirement under clause 6(3)(a) of the LOU at the end day of the first contract year, the Taxpayer had returned the signing fee to Company C on 29 November 2018. The Taxpayer 'did not receive' the signing fee. The facts that Company C paid the signing fee to the Taxpayer in one financial year and the Taxpayer returned the signing fee to Company C in a subsequent financial year did not alter the fact that the Taxpayer 'did not receive' the signing fee. Also, the signing fee was not and could not be treated as 'outgoings and expenses' that are deductible under section 16(1) of the IRO. Further, the signing fee was not and could not be treated as 'loss' that can be carried forward and taken into account under section 19C of the IRO. Furthermore, it is against fairness and justice that the Commissioner of Inland Revenue charges Profits Tax on the entire signing fee against the Taxpayer and also charges Profits Tax on the entire signing fee against Company C.
- (3) The signing fee of \$12,333,600 was not 'assessable profits' upon the Taxpayer. This is because under LOU, properly construed, it was contractually agreed between Company C and the Taxpayer that the signing fee of \$12,333,600 was paid to the Taxpayer 'in consideration of' his ability to achieve the validation requirements set out in clause 6(3) of the LOU and the Taxpayer would be under the contractual duty and obligation to return 100% of the signing fee to Company C when he was unable to achieve the validation requirement set out in clause 6(3)(a) of the LOU at the end day of the first contract year. In anticipation that he would not be able to achieve the validation requirement under clause 6(3)(a) of the LOU at the end day of the first contract year, the Taxpayer had returned the signing fee to Company

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

C on 29 November 2018. The Taxpayer ‘failed to provide consideration’ for the signing fee, ‘did not make any profits’ of the signing fee and ‘did not earn’ the signing fee.

32. Mr Lam for the Taxpayer submitted that this Board should construe LOU as the whole document as to the common intention for Company C to pay the substantial amount of signing fee to the Taxpayer at the beginning of their relationship. Mr Lam referred to the principles of construction of a contract in Chitty on Contracts and submitted that this Board should consider the Taxpayer’s evidence of his subjective understanding of the function of the signing fee and the purpose of paying the signing fee, as well as the objective intention reflected from drafting of the LOU, including the whole of clause 6 of the LOU, that would show clearly the commercial sense of the arrangement Company C had for the paying of the signing fee: The Taxpayer had to work hard and bring in more business to the extent stated in clause 6(3) of the LOU. If he was able to do that, he could keep the signing fee. But if he was unable to meet the validation requirements set out in clause 6(3), he had to return the signing fee. That was the reason why clause 6(2) of the LOU stated that the signing fee was paid in consideration of the Taxpayer’s commitment to achieve the purpose. Mr Lam submitted that the very reason why Company C agreed to pay the huge sum of the signing fee of \$12,333,600 was that Company C expected the Taxpayer to bring more business to Company C and the Taxpayer promised to do so and was under the contractual duty and obligation to bring more business to Company C, to the extent set out in clause 6(3) of the LOU. If the Taxpayer was unable to meet the validation requirements, he had to return the signing fee to Company C in accordance with clause 6(4) of the LOU. This again made commercial sense, and also reflected the intention of Company C and why it agreed to pay such a huge sum to the Taxpayer. Mr Lam therefore submitted that the proper construction of the LOU was that the Taxpayer did not earn the signing fee at the time the sum of \$12,333,600 was paid by Company C to him. The Taxpayer earned the signing fee if and only if he was able to meet the validation requirements set out in clause 6(3) of the LOU, providing the consideration required in clause 6(2) of the LOU. While it might be that the Revenue would have to wait for three years before it could charge the signing fee for Profits Tax because of all the requirements in the LOU, the point of emphasis was that the Taxpayer did not earn the signing fee at the beginning of the relationship with Company C. Also, by reference to Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] 1 WLR 986, Mr Lam submitted that since the Taxpayer had the contractual obligation to return the signing fee to Company C and this continued until after he was able to meet the cumulative validation requirements at the end of the third contract year and so the proper construction of the LOU was that the Taxpayer received the signing fee contingent upon his being able to meet the cumulative validation requirements. Further, Mr Lam submitted that while clause 11 of the LOU made provision for the refund of the signing fee in the event of termination of the contracts after the commencement date, this clause did not affect the result since on the facts, the Taxpayer’s case only concerned the events of the first contract year.

33. Mr Lam turned to the Board of Review’s decision D26/07, (2007-08) IRBRD, vol 22, 601, a decision that the Taxpayer relied on heavily in this Appeal. Mr Lam submitted that the facts of this decision were very similar to those in the Taxpayer’s Appeal. In D26/07, the appellant was employed in February 2005 by a bank which paid him a sign-

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

on bonus and settling-in allowance on the condition that if he resigned within 12 months afterwards, he would be required to repay part of the sums paid. The appellant resigned in June 2005 and returned a sum of money in the following financial year. Although the appellant's tax return for the year of assessment in the appeal declared the total income inclusive of the sign-on bonus, he later wrote to the Revenue seeking an adjustment on the ground that he had returned the money representing part of the sign-on bonus and the settling-in allowance. The Revenue assessed the total income inclusive of the sign-on bonus for Salaries Tax. The appellant appealed to the Board of Review, which identified the issue as whether the whole of the sign-on bonus and the settling-in allowance should be treated as income, notwithstanding that the appellant had to refund part of these payments upon termination of his contract. The Board of Review did not regard the amount refunded as a deductible expense under section 12 of the IRO because it was not paid wholly exclusively and necessarily incurred in the production of assessable income and was in any event of a capital nature. The Board of Review held that the premise that a person cannot be taxed for money that he has not received was not affected by section 11D(b) of the IRO and that on the proper construction of the contract of employment, the amount that the appellant had to refund to the bank could not be considered as damages for termination of contract and he was only entitled to receive the full sign-on bonus and settling-in allowance contingent on his having served the full 12 months from the date of employment. Since the appellant did not serve the full 12 months of employment and was thus not entitled to the full sign-on bonus or the full settling-in allowance, he, as a matter of fact, did not receive the full sign-on bonus and the full-settling-in allowance. The Board of Review therefore allowed the appellant's appeal and remitted the assessment to the Commissioner of Inland Revenue.

34. Relying on D26/07 (above), Mr Lam submitted that notwithstanding that this was a decision based on the charging provisions for Salaries Tax, the premise that a person cannot be taxed for money that he has not received applies in the Taxpayer's Appeal in the sense that the Taxpayer here had not actually earned the signing fee because he failed to provide the consideration. Like D26/07 (above), it was not material that the Taxpayer was paid the signing fee on 29 January 2018 within the year of assessment 2017/18 and he returned the signing fee on 29 November 2018 within the following year of assessment of 2018/19.

35. Mr Lam also commented on the Board of Review's decision in D85/03 (unpublished) that the Revenue relied on. The appellant in this case was an insurance agent appointed by an insurance company with effect from 20 October 1998 subject to the terms and conditions of several written agreements, which provided *inter alia* for the payment of a sign-on fee which was repayable immediately upon cessation of association with the insurance company within two years from the effective date. The sign-on fee was paid to the appellant by the insurance company which reported it as part of the income for the relevant year of assessment. The appellant also declared profits for the relevant year of assessment based on income that included the sign-on fee in the tax return. The Revenue assessed and demanded Profits Tax for the relevant year of assessment based on the appellant's return. The insurance company terminated all agreements with the appellant on 8 October 1999 and issued a letter on 13 October 1999 demanding repayment by the appellant of 50% of the sign-on fee. The appellant appealed against the Revenue's refusal to adjust the assessment for the relevant year of assessment by excluding from the assessable

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

profits the 50% of the sign-on fee that the appellant had to repay. The Board of Review dismissed the appeal, upon considering that during the relevant year of assessment, the contingency of possible payment or ‘repayment’ of the 50% of the sign-on fee did not in fact arise and the appellant was free to use the whole of the sign-on fee in any way she liked.

36. Mr Lam submitted that the Board of Review in D85/03 (above) did not construe the agreements in accordance with the ‘usual principle’. Mr Lam submitted that the relevant term in the agreements, construed for the purpose of ascertaining the common intention of the parties, must be that the sign-on fee was paid contingent that the appellant insurance agent continued to work for the future two years, and that was the consideration under the agreement. If the appellant failed in providing that consideration, then he had to return 50% of the sign-on fee. In other words, said Mr Lam, he had not earned the money because he failed to provide the consideration. This construction made perfect common sense and commercial sense. Mr Lam submitted that D26/07 (above) and D85/03 (above) were conflicting decisions and this Board should follow the more recent decision of D26/07 (above).

37. Mr Lam submitted that the English case of Lincolnshire Sugar Company Limited v Smart (above) was of no assistance because the subsidies received in the context of the English case arose from legislation whose purpose was to provide subsidy to the company to carry on its business. These circumstances were different from those of the Taxpayer’s case.

38. Mr Lam emphasized that the Appellant’s explanations in his testimony, including his point that the purpose of the signing fee was to provide incentive and motivation for him to bring in more business but not for the purpose of carrying on his trade, was not challenged.

39. Mr Lam submitted that the return of the signing fee was not deductible outgoings or expenses under section 16 of the IRO. For money to be deducted as outgoing and expenses, it must be ‘in the production of assessable income’ or, in other words, ‘made for the purpose of earning the profits’. As the Taxpayer’s return of the money to Company C could not be ‘for’ the purpose of earning more profit or ‘in’ the production of profits, that amount of money was not deductible expenses. It would defy logic to say that the return of the sum in November 2018 was for the purpose of earning the sum 10 months ago in January 2018. Also, it followed that the return of the signing fee was not loss under section 19C of the IRO.

40. Mr Lam referred to the Court of First Instance’s judgment in Lo Tim Fat v Commissioner of Inland Revenue (above). The appellant in the case was also an insurance agent who entered into an agreement with an insurance company that provided for the payment of an initial signing fee, a balance signing fee and a maximum of 12 months monthly bonus after the appellant had entered into certain contracts, registered with the Hong Kong Federation of Insurers, commenced service as an insurance agent, and agreed to abide by the terms and conditions of those agreement and contracts. The appellant in fact received a loan from the insurance company in an amount equivalent to the said initial signing fee, the said balance signing fee and the said maximum of 12 months monthly bonus

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

several months before he commenced service as an insurance agent of the insurance company. The Board of Review determined that the amount representing the initial signing fee should be treated as trading receipt for the relevant year of assessment and the amount representing the balance signing fee should be treated as trading receipt for the year of assessment that followed. The appellant contended that he could not be treated as having earned or made a profit in those amounts because under the agreement he would be liable to refund the amounts or a part thereof if his agreement and contracts with the insurance company were prematurely terminated, and one of the obligations that could lead to premature termination was failure to meet specified performance criteria required by the insurance company in each of the years of appointment. On appeal by case stated, the Court of First Instance described the issue for determination in the appeal as ‘whether a certain amount received by the taxpayer beneficially in the course of his trade could be properly treated as trading receipt on the day of the receipt when there is a possibility that in the future the taxpayer may be liable to refund certain part of the amount.’ The Court of First Instance then determined that in the appellant’s case, ‘once the amount of the balance of signing fee was received, the appellant held the sum beneficially and was entitled to use it for whatever purpose he liked including for his trade and business’. Applying Lincolnshire Sugar Company Limited v Smart (above), the Court of First Instance held that ‘the amount should properly be considered to be part of [the appellant’s] trading receipt for the year when the sum was received and accrued to him’. Mr Lam stressed that Lincolnshire Sugar Company Limited v Smart (above) and Lo Tim Fat v Commissioner of Inland Revenue (above) were different from the Taxpayer’s case where it was a known fact that Taxpayer had already returned the money. Mr Lam also submitted that Lo Tim Fat v Commissioner of Inland Revenue (above) was distinguishable from the Taxpayer’s case since the appellant in that case had sought to report only 20% of whole of the sum(s) received in the first year and said that he was entitled to spread out those sum(s) in five years and so the issue involved in that case was different, and also, the contingency involved in the agreement and contracts in that case did not arise. Mr Lam thus submitted that Lo Tim Fat v Commissioner of Inland Revenue (above) was distinguishable.

41. Finally, Mr Lam submitted on the Court of Final Appeal’s judgment in Nice Cheer Ltd v Commissioner of Inland Revenue (2013) 16 HKCFAR 813. Mr Lam relied on Lord Millett NPJ’s discussion in that case on what was ‘profit’. Mr Lam referred particularly to the ‘two cardinal principles of tax law’ discussed in paragraph 21 of Lord Millett NPJ’s judgment, and submitted that the application of those two cardinal principles to the Taxpayer’s case would mean that the signing fee was ‘anticipated’ or ‘potential’ profit that the Taxpayer might be able to actually earn at the end of the third year and when he was able to meet the validation requirements for those three years. The fact that the Taxpayer ‘received’ the money did not mean that he actually earned the money. Therefore, the signing fee was not profit, and was not chargeable profit.

42. The Revenue submitted to this Board that the issue in the Taxpayer’s appeal concerned two transactions. The first was the receipt of the signing fee by the Taxpayer. The second was the subsequent repayment of the signing fee by the Taxpayer. These were two different transactions. The tax treatment of each of them should be considered separately.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

43. The Revenue made the following submission on the tax treatment of the receipt of the signing fee. The determination of the tax treatment of the receipt of the signing fee involved the identification of the true nature and character of the payment. In this connection, the label of the payment was irrelevant. By reference to Lincolnshire Sugar Company Limited v Smart (above), the Revenue underlined that the income of a taxpayer should be treated as trading receipt in the year of receipt, the year when the taxpayer was free to use it for the purpose of business, and it should be assessed for tax in that year. Other cases that applied this principle included Lo Tim Fat v Commissioner of Inland Revenue (above) and D85/03 (above). Next, concerning the contingency of repayment, again by reference to Lincolnshire Sugar Company Limited v Smart (above), the Revenue submitted that no provision was required in the case that the contingency did not occur the year in question. D85/03 (above), which concerned an insurance agent who made a repayment, was a case that applied this principle. Then, concerning the assessment of receipt of chargeable profit, the Revenue made the point reaffirmed in Nice Cheer Ltd v Commissioner of Inland Revenue (above) that both profits and losses therefore must be ascertained in accordance with the ordinary principles of commercial accounting as modified to conform with the IRO, and in a case where the taxpayer's financial statements are correctly drawn and in conformity with the IRO, no further modifications are required or permitted.

44. On the basis of the three principles above, the Revenue submitted that the sum received of \$12,333,600 should be wholly assessed in the year of assessment 2017/18, the year it was received, by virtue of section 14 of the IRO. Firstly, the Taxpayer received the said sum on 29 January 2018 from Company C. After receipt, the Taxpayer was free to use it in the business. Secondly, the liability to repay the said sum in whole or in part did not arise in the year of assessment 2017/18. The Taxpayer admitted in evidence that as at 31 March 2018, he had no obligation to repay the said sum. Therefore, he was not permitted to make provision in the year of assessment 2017/18 on the contingent liability. Finally, the Taxpayer had reported the receipt of the whole of the said sum in his financial statements, which were prepared by certified public accountants and approved by him. He was not permitted to exclude the said sum from the chargeable profits in the year of assessment where the financial statements were in conformity with the IRO. The Revenue disagreed with the Taxpayer's case that he was only entitled to receive or earn the signing fee at the end of the contract years, reiterating the submission that the receipt of the signing fee and the subsequent and contingent repayment of the sum were to be considered separately, and also the Taxpayer's submission that Lo Tim Fat v Commissioner of Inland Revenue (above) was distinguishable and not applicable to the Taxpayer's appeal since that case and the Taxpayer's appeal both concerned contingent liability to repay. The Revenue also disagreed with the Taxpayer's case that this Board should follow D26/07 (above) and made the additional point that this case was not applicable because assessment of income under Salaries Tax and assessment of income under Profits Tax are governed by different charging provisions of the IRO.

45. The Revenue made the following submission on the tax treatment of the repayment of the sum of \$12,333,600 by the Taxpayer to Company C. The Revenue made the point by reference to Commissioner of Inland Revenue v Lo and Lo (a firm) (above) that an expense incurred at least includes a sum which there is an obligation to pay. Next, the Revenue made the point that for an income with a contingency for repayment, it was

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

explained in D18/05 (above) and D44/05, (2005-06) IRBRD, vol 20, 600 that in the case that the contingency subsequently arises, the repayment could only be deducted in the year when the repayment obligation arises. Then, by reference to BSC Footwear Ltd v Ridgway [1972] AC 544, the Revenue made the point that any loss in year two could not be used to diminish liability for tax in year one.

46. On the basis of the three principles above, the Revenue submitted that the repayment of the sum of \$12,333,600 could be wholly deducted in the year of assessment 2018/19 but not in the year of assessment 2017/18 since the Taxpayer was only liable to repay the signing fee on 1 January 2019 at the earliest in the case that he could not meet the validation requirements after the first contract year. Company C did not have the right to demand repayment of the signing fee from the Taxpayer as at the end of the business period for the year of assessment 2017/18. Therefore, the Taxpayer did not incur any expenses that could be deducted in the year of assessment 2017/18. As the Taxpayer's liability to repay the signing fee subsequently arose in the year of assessment 2018/19 when he could not meet the validation requirements after the first contract year, the contingency of repayment of the said sum arose in the year of assessment 2018/19 and such repayment could be allowed for deduction under section 16(1) of the IRO in the year of assessment 2018/19. The repayment was deductible in the year of assessment of 2018/19 because the repayment was for him to earn the profits in the year of assessment 2017/18. In this relation, the case of Commissioner of Inland Revenue v Tong Sui Lun [2008] 5 HKLRD 781 did not assist because it was concerned with deduction under section 12(1)(a) of the IRO for assessing Salaries Tax which was a more restrictive provision.

47. This Board is unable to accept Mr Lam's submissions advanced on behalf of the Taxpayer that the signing fee of \$12,333,600 was not 'assessable profits' upon the Taxpayer so that the Profits Tax Assessment for the year of assessment 2017/18 was excessive or incorrect.⁸ The Board's reasons are as follows:

- (1) The first and foremost consideration in the determination of an Appeal against an assessment of tax is the law of taxation, consisting of the statutory provisions for the assessment and charging of the type of tax that is the subject of the Appeal and the principles of tax law. The Taxpayer's Appeal is one against an assessment and charge of Profits Tax. As Lord Millett NPJ stated in Nice Cheer Ltd v Commissioner of Inland Revenue (above) at paragraphs 34 and 35,⁹ the fundamental constitutional principle in Hong Kong relating to taxation is that *'the subject is to be taxed by the legislature and not by the courts, and that it is the responsibility of the courts to determine the meaning of legislation. This is not a responsibility which can be delegated to accountants, however eminent. This does not mean that the generally accepted principles of commercial accounting are*

⁸ Mr Lam's submissions on 'assessable profits' cover the grounds of appeal summarized in paragraphs 31(2) and (3) above.

⁹ Lord Millett NPJ's judgment was agreed to by the other members of the Court (Ma CJ, Ribeiro and Tang PJJ and Litton NPJ).

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

irrelevant, but their assistance is limited. ... [The] question what constitutes a taxable profit is a question of law. While the amount of that profit must be computed and ascertained in accordance with the ordinary principles of commercial accounting, these are always subject to the overriding requirement of conformity, not merely with the express words of the statute, but with the way in which they have been judicially interpreted. Even where the question is a question of computation, the court must “always have the last word”.

- (2) Profits Tax is assessed in Hong Kong in respect of the assessable profits of a person arising in or derived from Hong Kong for each year of assessment as ascertained in Part 4 of the IRO; see section 14 of the IRO. Section 18B(1) of the IRO (which is in Part 4 of the IRO) provides, for present purposes, that the assessable profits for the year of assessment 2017/18 from the Taxpayer’s trade, profession or business carried on in Hong Kong shall be computed on the full amount of the profits from his trade, profession or business arising in or derived from Hong Kong during the year of assessment 2017/18.
- (3) The year of assessment 2017/18 is, pursuant to the definition in section 2(1) of the IRO, the period of 12 months commencing on 1 April in the year 2017. This means the period between 1 April 2017 and 31 March 2018.
- (4) The ascertainment of the full amount of the profits of the Taxpayer from his trade, profession or business arising in or derived from Hong Kong during the year of assessment 2017/18 involves section 16(1) of the IRO, which concerns deduction of outgoings and expenses ‘*to the extent to which they are incurred during the basis period for that year of assessment*’. The ‘*basis period*’ for a year of assessment is defined in section 2(1) of the IRO as ‘*the period on the income or the profits of which tax for that year ultimately falls to be computed*’. In respect of the year of assessment 2017/18, the basis period for that year of assessment is therefore the period between 1 April 2017 and 31 March 2018. In Lo Tim Fat v Commissioner of Inland Revenue (above), the Court of First Instance summed up in paragraph 16 that ‘*the deduction could only be made in respect of expenses incurred during the basis period for the year of assessment. ... [The] section envisages that there is a possibility that a certain profit for one year of assessment may be the result of certain expenses incurred in other assessment years. The corollary is that the fact that expenses may have to be incurred in a number of years does not necessarily mean that the profit resulted from such expenses must be treated as the profits for the years when the expenses are incurred.*’
- (5) In the Taxpayer’s case, the signing fee was received in the period between 1 April 2017 and 31 March 2018. It was received from the

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

Taxpayer's trade, profession or business carried on in Hong Kong. It was reported as income from Company C in the Trading and Profit and Loss Account of Company B for the year ended 31 March 2018. Although the Taxpayer, through his representative at the time, sought to report one-third of the signing fee as income from Company C in the Trading and Profit and Loss Account for the year ended 31 March 2018 for the purpose of an application to the Revenue for a '3 year apportionment' of the signing fee for the charge of Profits Tax (see footnote 3 above) and describe the signing fee as '[an] initial advance payment of HK\$ 12,333,600 ... granted by the Insurance Co. in returning (sic) for 3 years commitment of new business turnover to the Insurance Corporation', they did not detract from the entering of the receipt of the signing fee in the Trading and Profit and Loss Account as income.

- (6) Lo Tim Fat v Commissioner of Inland Revenue (above) is an authority of the Court of First Instance that binds this Board. Its principal holding is that a certain amount received by the taxpayer beneficially in the course of his trade, where he was entitled to use it for whatever purpose he liked including for his trade and business, could be properly treated as trading receipt on the day of the receipt and for assessment of Profits Tax for the year when the sum was received and accrued to him, even when there is a possibility that he might have to repay or may be liable to refund all or part of the amount received in the future; see paragraphs 20-22.
- (7) The signing fee in the Taxpayer's case was received and accrued to him pursuant to clause 6(1) of the LOU in the year of assessment 2017/18. Although under clause 6(2) of the LOU, it was expressed that the Taxpayer agreed that the signing fee was paid in consideration of his commitment to achieve the validation requirements during the relevant periods as set out in clause 6(3) of the LOU and that if he was unable to achieve the validation requirements during the relevant periods and/or failed to maintain with Company C as its insurance agent, he should repay Company C in whole or in part the signing fee upon his receipt of a notice of demand issued by Company C in accordance with the table of percentage rates set out in clause 6(4) of the LOU, this did not qualify the Taxpayer's receipt and accrual of the signing fee in the year of assessment 2017/18 at all and the consequence that, upon receipt, he was entitled to use it for any purpose, including for his trade and business. He received from Company C a cheque drawn in the amount of the signing fee in his name 'Mr A' under the cover of a 'Payment Advice' that contained no instructions for him. He deposited the cheque into his Bank G account. In other words, he received the signing fee beneficially in the year of assessment 2017/18. This is because in the year of assessment 2017/18, the Taxpayer was able to achieve the validation

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

requirement applicable for the relevant period and no notice of demand was issued by Company C to require him to repay any part of the signing fee. Applying Lo Tim Fat v Commissioner of Inland Revenue (above), in the determination of the Taxpayer's Appeal, the liability to repay the signing fee was a possibility in the future, but, commercially (per Commissioner of Inland Revenue v Lo and Lo (a firm) at 991C-D), there was no actual act or possible event during the year of assessment 2017/18 that could give rise to the liability to repay. The Taxpayer's testimony in paragraph 21 above confirms this. As a result, there was nothing to preclude the signing fee from being properly considered as part of the Taxpayer's trading receipt for the year of assessment 2017/18.

- (8) This Board is unable to accept Mr Lam's submission that the Taxpayer's Appeal was distinguishable from Lo Tim Fat v Commissioner of Inland Revenue (above). In the Taxpayer's case, the repayment of the signing fee was made outside and after the period between 1 April 2017 and 31 March 2018. This repayment was not made during the basis period for the year of assessment of 2017/18 and cannot be taken into consideration in the ascertainment of the profits in respect of which the Taxpayer is chargeable to Profits Tax for that year of assessment. Because of this, the fact that the Taxpayer paid back the signing fee in whole on 29 November 2018 was not material to the ascertainment of the assessable profits for the year of assessment 2017/18.
- (9) The two 'cardinal principles of tax law' that Lord Millett NPJ summarized in Nice Cheer Ltd v Commissioner of Inland Revenue (above) at paragraph 21 are relevant in respect of the Taxpayer's Appeal. They are: *'(i) the word "profits" connotes actual or realised and not potential or anticipated profits; and (ii) neither profits nor losses may be anticipated. The two principles overlap and are often interchangeable, for they both involve questions of timing; but they are not identical. The first is concerned with the subject-matter of the tax, uses the word "anticipated" in its secondary meaning of "expected" or "hoped for", and excludes profits which have not been and may never be realised. The second is concerned with the allocation of profits to the correct accounting period, uses the word "anticipated" in its primary meaning of "brought forward", and prevents profits being taxed prematurely.'*
- (10) Mr Lam, for the Taxpayer, submitted that the Taxpayer could rely on the discussion of the two 'cardinal principles of tax law' in Nice Cheer Ltd v Commissioner of Inland Revenue (above) to contend that the signing fee was not profit for the purpose of tax law because it was 'anticipated' or 'potential' profit. This Board is unable to accept this submission. It must be noted that Lord Millett NPJ discussed two

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

principles of tax law in paragraph 21 and the word ‘anticipated’ has a particular meaning in each of the two principles. The signing fee could not be profit that was brought forward from a later year of assessment in relation to the second cardinal principle of tax since it was paid and did accrue in the year of assessment in question. The signing fee also could not be profit that was expected or hoped for, or profit that had not been and may never be realized in relation to the first cardinal principle of tax. This is because the signing fee was in fact paid and did accrue in accordance with the relevant provisions in the LOU. The possibility that the Taxpayer may become liable to pay upon demand by Company C for not meeting the validation requirements during the relevant period(s) is concerned with the arising of a liability calculated in terms of percentage(s) of the signing fee distinct from the payment and receipt of the signing fee itself. The signing fee was actual and realized profit of the year of assessment 2017/18. The conclusions reached here in the application of Nice Cheer Ltd v Commissioner of Inland Revenue (above) are, in the opinion of this Board, consistent with those reached in the application of Lo Tim Fat v Commissioner of Inland Revenue (above) in (7) and (8) above.

- (11) Mr Lam, for the Taxpayer, relied on the decision of the Board of Review in D26/07 (above). This Board does not find D26/07 to be decisive or of significant assistance in the determination of the Taxpayer’s Appeal. Firstly, the charging statutory provisions are different. Secondly, this Board of Review has to be guided by the subsequent and binding authorities of the Court of First Instance and the Court of Final Appeal.
- (12) This Board accepts the evidence of the Taxpayer that the signing fee was provided by Company C as part of the remuneration package to motivate or incentivize him to bring in more business and more clients to Company C in the coming years.¹⁰ However, this Board is duty bound to give effect to the charging provisions for Profits Tax in Part 4 of the IRO, which assess Profits Tax on the basis of the year of assessment defined under the IRO. If this Board were to give effect to the Taxpayer’s understanding of his contractual duty under the LOU and Mr Lam’s submissions that: (i) the objective intention from the drafting of and the commercial sense of clause 6 of the LOU meant that the Taxpayer did not earn the signing fee at the beginning of the relationship with Company C; and (ii) the Taxpayer in fact did not earn the signing fee because he had returned it on 29 November 2018, this Board would have been departing from the said duty and instead assessing Profits Tax chargeable to the Taxpayer on the

¹⁰ See paragraphs 18 to 22 above.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS
(PUBLISHED IN NOVEMBER 2022)

impermissible basis of the 'first contract year' specified under the LOU.¹¹

- (13) In the light of this Board's considerations above, this Board determines that the received signing fee was part of the profits from the Taxpayer's trade, profession or business arising in or derived from Hong Kong during the year of assessment 2017/18 from which the assessable profits for the year of assessment 2017/18 was to be computed.

48. Having considered the evidence and submissions before it, this Board holds that the Taxpayer has failed to discharge the burden of proof to show that the Profits Tax Assessment for the year of assessment 2017/18 imposed on him was excessive or incorrect.

Decision

49. This Board determines that the Taxpayer has failed to discharge the burden of proof he has under section 68(4) of the IRO to show that the Profits Tax Assessment for the year of assessment 2017/18 imposed on him was excessive or incorrect. The Taxpayer's appeal is dismissed. This Board affirms the Profits Tax Assessment for the year of assessment 2017/18 that the Acting Deputy Commissioner of Inland Revenue, by his Determination dated 17 December 2020, had confirmed.

¹¹ The ground of appeal summarized in paragraph 31(1) also ignores the year of assessment basis of the charging provisions of Profits Tax in Part 4 of the IRO and is also unsustainable.