Case No. D9/22

**Profits tax** - conditional advance paid - whether assessable profits arising in or derived from the carrying on of a trade, profession or business - sections 14(1), 61A and 68(4) of the Inland Revenue Ordinance

Panel: Loh Lai Ping Phillis (chairman), Ling Chun Wai and Yuen Hoi Ying.

Dates of hearing: 3-4 November 2021.

Date of decision: 20 June 2022.

The Taxpayer carried on business as an insurance agent (the ‘Business’).

From 2000 to 2016, the Taxpayer had entered into various business agreements with Company C (the ‘Company’).

By an acknowledgement dated 23 January 2015, the Taxpayer confirmed that he had received a sum of conditional advance of $65,717,496 (‘the Sum’) from the Company pursuant to the New Benefit Agreement dated 28 September 2010 (‘NBA’).

The Assessor later considered that the Sum should be chargeable to Profits Tax and raised Additional Profits Tax Assessment for the year of assessment 2014/15 on the Taxpayer.

The Taxpayer contends that the Sum was not assessable profits arising in or derived from the carrying on of the Business.

**Held:**

1. The true nature of the NBA was an incentive scheme/ a bonus to attract the Taxpayer to stay/ continue to work/ lead the revival projects for the Company.
2. The offer under the NBA was an acknowledgement of the Taxpayer’s valuable contribution to the Company and hard work over the past 10 years.
3. The alleged buyout could not be the purpose of the NBA arrangement or payment of the Sum as there is no mention of any ‘buyout’ or ‘the Company taking full control of the Taxpayer’s agency teams’.
4. Both the Taxpayer and the Company’s intention was that the Taxpayer would continue to serve the Company under the Corporate Agency Agreement/ the ‘Second Addendum’ to the NBA.
5. During 2015 and 2016, the Taxpayer continued to serve and maintain an important role in the Company.
6. The Sum was revenue in nature and profits derived and received in the course of carrying on the Taxpayer’s insurance business.

**Appeal dismissed and costs order in the amount of $10,000 imposed.**

Cases referred to:

MIM Holdings Ltd v Federal Commissioner of Taxation (1997) 36 ATR 108

Higgs v Oliver [1952] Ch 311, at 320, 321

Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation (1989) 93 ALR 157

D12/90, IRBRD, vol 5, 118

Aviation Fuel Supply Co v Commissioner of Inland Revenue [2013] 4 HKLRD 463

Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd [2008] 1 HKC 151

Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 296

McLaurin v Commissioner of Taxation (Cth) (1961) 104 CLR 381, at 391

D76/98, IRBRD, vol 13, 420

Appellant in person.

Elizabeth Cheung, Counsel, instructed by the Department of Justice, for the Commissioner of Inland Revenue.

**Decision:**

1. **Introduction**
2. This is the Appeal of the Appellant/Taxpayer against the Determination of the Ag. Deputy Commissioner of Inland Revenue dated 4 November 2020 (‘Determination’) regarding the Taxpayer’s objection to the Additional Profits Tax Assessment for the year of assessment 2014/2015 raised on the Appellant.
3. The Taxpayer carried on business as a insurance agent under the name of ‘Business B’ (‘Business’).
4. The issue before the Board is whether the sum of HK$65,717,496 (‘Sum’) received by the Taxpayer from a company Company C (‘Company’)[[1]](#footnote-1) in the assessment year 2014/2015 should be subject to profits tax under Section 14(1) of the Inland Revenue Ordinance (Chapter 112) (‘IRO’). The Commissioner held in the affirmative in the Determination.
5. This Board held the hearing of this Appeal on 3 and 4 November 2021.
6. The Taxpayer had no representation and acted in person.
7. The Commissioner was represented by Counsel Elizabeth Cheung and Hikki Wong.
8. The Taxpayer and his witness Mr H gave oral evidence. The Commissioner did not call any oral evidence. Both referred to documents submitted and exchanged before this Board.
9. **The Taxpayer’s Grounds of Appeal/Arguments**
10. In his Notice of Appeal dated 3 December 2020, the Taxpayer raised the following grounds of appeal against the Determination:
11. The Commissioner has incorrectly treated the Sum as income subject to profits tax;
12. The Sum is capital in nature and non-taxable;
13. The Sum is not an upfront payment for any future services to be provided to the Company; and
14. The Sum is compensating the Appellant’s loss of rights (restrictive covenants) in carrying on business with others.
15. Subsequent to filing of the Notice of Appeal, the Taxpayer further argues that:
16. The Sum was not assessable profit arising in or derived from the carrying on of the Business;
17. The Sum was repayable subject to the terms of the Facility Letter (hereinafter defined in paragraph [30]). It was a conditional advance facility granted in consideration of certain conditions/restrictive covenants/non-competition clauses covering a period of 72 months from 1 January 2015 to 31 December 2020 and was repayable upon occurrence of any of the Repayment Events (hereinafter defined in paragraph [16] under Clause C(iii));
18. The Sum was capital in nature as the payment arrangement represents a buyout of the capital assets i.e. his agency sales team of 1,300+ sales agents to the Company (‘Buyout’); and
19. Even assuming the Sum was not a loan but of income nature (which was denied), only the portion of the Sum covering the period from 1 January to 31 March 2015 had been accrued and received during the year of assessment 2014/15, and chargeable to tax.
20. It is noteworthy that the Taxpayer has all along not raised the Buyout argument, not even in his written grounds of appeal, notwithstanding that he was initially represented and presumably advised by his appointed accountants (‘Representatives’) in this matter. The Buyout argument was first mentioned in the witness statement dated 1 March 2021 of his witness Mr H, and later in the Taxpayer’s statement dated 15 September 2021.
21. **Facts and Key Events**

1. Over the years from 2000 to 2016, the Company and the Taxpayer had entered into various business agreements as set out in paragraphs 1(4)-(14) of the Determination. The following facts and key events pertinent to the present appeal, supported by documentary evidence, are not in dispute:

***The ‘Agency Contracts’***

1. On 19 July 2000, the Taxpayer entered into an Agency General Manager’s Contract (‘Manager Contract’) and an Agent’s Contract for Selling Long Term Insurance Business (‘Agent Contract’) with the Company (collectively ‘Agency Contracts’).
2. The Manager Contract contained, *inter alia*, the following terms:
	1. The Taxpayer was authorized to recruit, train and supervise agents for the Company. There was no employer and employee relationship either express or implied between the Company and the Taxpayer.
	2. The Taxpayer would be paid various allowances and bonuses in respect of life insurance business which would be calculated based on the commission earned by him and agents under his direct supervision.
	3. The contract should be terminated by either party giving 30 days’ written notice to the other.
3. The Agent Contract contained, *inter alia*, the following terms:
	1. The Taxpayer should solicit applications for insurance and such other business as the Company might from time to time transact and service the needs and requirements of the owners of policies issued by the Company as a result of such applications.
	2. There was no employer and employee relationship either express or implied between the Company and the Taxpayer.
	3. The Taxpayer should not accept appointment as the agent of other company or person for the introduction of any insurance business without the Company’s prior written consent.
	4. The Taxpayer should be entitled to receive commission and bonuses for life insurance and other policies which would be calculated in accordance with the schedules specified in the contract.
	5. The Company or the Taxpayer might terminate the contract at any time without any reason for doing so by giving 30 days’ written notice to the other.

***The New Benefit Agreement***

1. By the New Benefit Agreement dated 28 September 2010 (‘NBA’), the Company offered the Taxpayer a conditional advance payment subject to the terms and conditions stated therein.

1. The provisions relevant to this Appeal under Clause (C) of the NBA (under which the Taxpayer subsequently elected to terminate the Agency Contracts) are summarised as follows:

***Clause (C)***

Provided that the Agency Contracts continued to be in full force up to and including 1 August 2014, both the Company and the Taxpayer should, between 1 August to 1 November 2014, discuss the continuous co-operation with an aim to achieving mutual benefits.

In the absence of any agreement during the period from 1 August to 1 November 2014, and provided that the Agency Contracts continued to be in full force up to and including 1 November 2014:

***Clause (C)(i)***

The Taxpayer might elect in writing to terminate the Agency Contracts with effect from 1 January 2015 by giving the Company a written notice during the period from 1 November to 1 December 2014 notwithstanding the notice period required to terminate the Agency Contracts. Upon making the election in writing, the Agency Contracts should be terminated with effect from 1 January 2015, and the parties’ rights and obligations thereunder should cease save and except those which were expressed or implied to survive after termination.

***Clause (C)(ii)***

Provided that the Taxpayer had made the written election in accordance with clause (C)(i) (i.e. Fact (5)(b)(i)) and he did not commit any breach of the Agency Contracts prior to their termination on 1 January 2015, and subject to the execution of a facility letter, the Company agreed to offer him a conditional advance of an amount equal to 6 times the average annual earnings for the years from 2010 to 2014 inclusive in accordance with the terms and conditions of the facility letter. If no such written election was received by the Company during the period specified in clause (C)(i), the offer of the conditional advance would lapse and under no circumstances would the Taxpayer be entitled to the conditional advance or any other advance. The Company was entitled to charge interest on the conditional advance as provided.

***Clause (C)(iii)***

The conditional advance would be made subject to some restrictive covenants/non-competition clauses, i.e. prohibiting the Taxpayer from engaging in any insurance business. It would become repayable upon the occurrence of any of the five events of breach stated in Clause (C)(iv) (‘the Repayment Events’) within a 6-year period. If the Taxpayer had made the written election in clause (C)(i) which resulted in the conditional advance being granted and provided that all of the events did not occur during the 6-year period from 1 January 2015 to 31 December 2020, the Company agreed to waive the repayment of the conditional advance in full with interest on 31 December 2020.

***Clause (C)(iv)***

Upon occurrence of any of the Repayment Events within different periods after 1 January 2015, the Taxpayer should forthwith repay the Company different percentages of the conditional advance provided as follows:

| Occurrence of anyRepayment Events | Amount to berepaid by the Taxpayer conditional advance |
| --- | --- |
| Within 12 months after 1 January 2015 | Full amount of the conditional advance with all interest accrued thereon |
| Within 24 months but more than 12 months after 1 January 2015 | 80% of the conditional advance with 80% of all interest accrued on the full conditional advance |
| Within 36 months but more than 24 months after 1 January 2015 | 60% of the conditional advance with 60% of all interest accrued on the full conditional advance |
| Within 48 months but more than 36 months after 1 January 2015 | 40% of the conditional advance with 40% of all interest accrued on the full conditional advance |
| Within 60 months but more than 48 months after 1 January 2015 | 20% of the conditional advance with 20% of all interest accrued on the full conditional advance |
| Within 72 months but more than 60 months after 1 January 2015 | 10% of the conditional advance with 10% of all interest accrued on the full conditional advance |

1. To recap, Clause (C) of the NBA provided for a conditional advance based on completion of 4+ years of the Agency Contracts, i.e. termination with effect from 1 January 2015, of an amount equal to 6 times the average annual earnings for the years from 2010 to 2014 inclusive, subject to a 6-year restrictive covenant period.
2. Clause (A) of the NBA provided for a conditional advance based on a shorter period of completion of 2+ years of the Agency Contracts, i.e. termination with effect from 1 January 2013, of an amount equal to 4 times the average annual earnings for the years from 2010 to 2012 inclusive, subject to a 4-year restrictive covenant period.
3. Clause (B) of the NBA provided for a conditional advance based on completion of 3+ years of the Agency Contracts, i.e. termination with effect from 1 January 2014, of an amount equal to 5 times the average annual earnings for the years from 2010 to 2013 inclusive, subject to a 5-year restrictive covenant period.
4. In other words, the amount of the conditional advance entitlement of the Taxpayer would increase with the length of service provided by him to the Company under the Agency Contracts. At the same time, the duration of the post-service restrictive covenant would also increase in proportion to the increase in the amount of conditional advance. Importantly it is the Taxpayer, not the Company, who had the option to choose between the three different ‘packages’ under Clauses (A), (B) and (C).
5. The Taxpayer signified his agreement to the terms and conditions of the NBA on 29 September 2010.

***The ‘First Addendum’/The ‘Loan Agreement’***

1. In consideration of the Company agreeing to offer the Taxpayer a loan of $15,000,000 (‘Loan’) and entering into a loan agreement dated 15 April 2014 (‘Loan Agreement’) with him, by the First Addendum dated 15 April 2014 (‘First Addendum’), the Company amended the terms and conditions of the NBA by, *inter alia*, including a clause to the following effect:

The Taxpayer authorized the Company to deduct, from the proceeds of the conditional advance, an amount equal to the amount of outstanding indebtedness (if any) owed by him under the Loan Agreement as at the date of drawdown of the conditional advance, and the amount so deducted should be used by the Company to repay such outstanding indebtedness under the Loan Agreement.

1. By the Loan Agreement of the same date, the Company made available to the Taxpayer the Loan in the principal amount of $15,000,000 with interest. It provided, *inter alia*, that the Taxpayer should repay the Loan in full together with accrued interest and all other amounts then outstanding in connection with the Loan by a single payment on 31 December 2014. Repayment would be made by way of deduction from any conditional advance accrued and payable under the NBA by the First Addendum.
2. The Taxpayer signified his agreement to the terms and conditions of the First Addendum and the Loan Agreement on 15 April 2014.
3. Pursuant to the Loan Agreement, the Taxpayer issued a drawdown notice dated 15 April 2014 to the Company, and received the Loan as evidenced by an acknowledgement letter dated 16 April 2014 confirming receipt.

***The ‘Corporate Agency Agreement’/The ‘Second Addendum’***

1. In 2014, Company J, of which the Taxpayer was the Position M and Position N, was incorporated as a private company in Hong Kong.
2. On 10 September 2014, the Company and Company J entered into a Corporate Agency Agreement (‘Corporate Agency Agreement’) which contained, *inter alia*, the following terms and conditions:
	1. Company J should exclusively act as the appointed insurance agent of the Company commencing on 10 September 2014 for the purposes of (i) soliciting applications for insurance products and such other business as the Company might from time to time transact and agree to be included in that agreement; and (ii) servicing the needs and requirements of policyholders as a result of such applications.
	2. Company J should, and should procure its responsible officer and technical representative to, act exclusively for Company J in respect of the appointment under the Corporate Agency Agreement and not to act or accept appointment as the agent, representative or consultant of any other person whose business might be similar to or in competition with the Company’s business without prior written consent of the Company.
	3. There was no employer-employee, joint venture, franchise or partnership relationship either expressed or implied between the Company and Company J (or between the Company and Company J’s responsible officer/technical representative).
	4. Company J should be entitled to receive remuneration calculated in accordance with the rates and provisions set out in schedule 2 of the Corporate Agency Agreement, which included commission at a percentage of the premium due and received by the Company in respect of the policies for life business and production allowance. The rates of remuneration for services not specified therein should be determined by the Company in its absolute discretion from time to time.
	5. The Company or Company J might terminate the Corporate Agency Agreement at any time and without giving any reason for so doing by giving 30 days’ notice to the other in writing.
	6. Company J covenanted with and undertook to the Company that during the continuance of its appointment and for a period of 12 months after termination of the Corporate Agency Agreement, it would strictly comply with the terms under clause 16 on non-solicitation and non-competition and would not carry out the restricted activities specified in that clause.
3. By the Second Addendum dated the same day, i.e. 10 September 2014 (‘Second Addendum’), the Company further amended the terms and conditions of the NBA to the effect of permitting the Taxpayer to provide insurance services to the Company via Company J under the Corporate Agency Agreement.

***Termination of the Agency Contracts/Payment of the Sum***

1. By a letter dated 4 November 2014, the Taxpayer served a notice on the Company electing to terminate the Agency Contracts with effect from 1 January 2015 pursuant to the NBA as amended by the First Addendum and the Second Addendum. The election was made pursuant to Clause (C) of the NBA.
2. By a letter dated 1 January 2015 (‘Facility Letter’), the Company informed the Taxpayer that it was willing to make available a conditional advance in the principal amount of $65,717,496 (‘the Sum’) to him subject to the terms and conditions stated therein.
3. The Taxpayer signified his acceptance of the terms, conditions and arrangement of the Facility Letter.
4. By an acknowledgement dated 23 January 2015, the Taxpayer confirmed that he received the Sum in the following arrangements:
	1. Part of the Sum should be kept by the Company and be used to offset the Loan (i.e. $15,000,000) and an interest of $300,000 that the Taxpayer owed to the Company according to the Loan Agreement; and
	2. The balance of $50,417,496 (i.e. $65,717,496 ‒ $15,000,000 ‒ $300,000) had been released to him by the Company through a cheque payment.
5. The Taxpayer did not repay any part of the Sum. There was no question of occurrence of any of the Repayment Events.

***The ‘Consultancy Agreement’***

1. By a consultancy agreement dated 19 January 2015 (‘Consultancy Agreement’), the Taxpayer was engaged as a consultant of the Company to provide consultancy services in relation to agency management matters. The Consultancy Agreement contained, *inter alia*, the following terms of engagement:
	1. The Taxpayer’s external title was Position K. He, as an independent contractor and a self-employed person, should begin to provide the consultancy services as described in Schedule 1 of the Consultancy Agreement to the Company on 1 January 2015 until 31 December 2015 or upon termination of the Consultancy Agreement as provided therein. Subject to mutual agreement by both parties, the Consultancy Agreement might be renewed on a yearly basis for the years 2016 and 2017 respectively.
	2. In consideration of the Taxpayer’s provision of consultancy services, the Company would pay him a monthly consultancy fee of $150,000. He would enjoy special benefits specified in clause 5 of the Consultancy Agreement during the term of his engagement.
	3. There was no employer-employee and agency relationship either express or implied between the Company and the Taxpayer. Provision of the special benefits should not be construed to create an employer-employee or agency relationship between him and the Company.
	4. The Taxpayer would be paid by the Company a growth bonus at each year end during the term of the Consultancy Agreement if the annualized first year commission produced by the direct region[[2]](#footnote-2) for that year achieved 10% growth when compared with that of the previous year. The amount of the growth bonus would be equal to 2% of the annualized first year commission produced by the direct region for that year.
	5. Except otherwise provided, termination of the Consultancy Agreement could be effected by either party giving to the other party 30 days’ prior notice in writing.
	6. The Taxpayer should not during the continuance of the Consultancy Agreement without the prior written consent of the Company on his own or in conjunction with or on behalf of any other person directly or indirectly introduce, arrange, advise on or otherwise promote to any person insurance contracts or products of any insurance companies, or carry on or being engaged (whether as an agent, consultant, proprietor, partner, direct or indirect shareholder or in any other capacity whatsoever), in any other business trade or occupation which was similar to or in competition with the business of the Company. For the avoidance of doubt, this clause was not applicable in respect of the Taxpayer’s capacity as the shareholder and/or director of Company J.
2. The Taxpayer signified his acceptance of the terms and conditions of the Consultancy Agreement on 4 February 2015.

***Termination of the Corporate Agency Agreement***

1. By a letter dated 30 November 2015, Company J gave 30 days’ prior notice to the Company to terminate the Corporate Agency Agreement.
2. By a letter dated 3 December 2015, the Company informed Company J that the effective date of termination of the Corporate Agency Agreement would be 30 December 2015.

***Tax***

1. The Company furnished a notification dated 27 April 2015 in respect of the Taxpayer for the year of assessment 2014/15 reporting the following particulars to tax for the period from 1 April 2014 to 31 March 2015:

|  |  |
| --- | --- |
|  | $ |
| 1. Commission
 | 16,971,607 |
| 1. Lump sum payment
 | 2,201,496 |
| 1. Loan (i.e. the Sum)
 | 65,717,496 |
|  | 84,890,599 |

1. The Taxpayer furnished a Tax Return – Individuals for the year of assessment 2014/15 together with a Profits Tax computation and declared, *inter alia*, the following particulars of the Business:
2. Gross income was $19,173,103 (i.e. $16,971,607 + $2,201,496)
3. Assessable profits after deduction of charitable donations were $16,558,507.
4. The Assessor, in accordance with the Taxpayer’s return, raised on him the following Profits Tax Assessment for the year of assessment 2014/15:

|  |  |
| --- | --- |
|  | $ |
| Assessable profits | 16,558,507 |
|  |  |
| Tax payable thereon |  2,463,776 |

1. The Taxpayer did not object to the above assessment. It became final and conclusive in terms of section 70 of the IRO.

1. The Assessor later considered that the Sum should be chargeable to Profits Tax and raised on the Taxpayer the following Additional Profits Tax Assessment for the year of assessment 2014/15:

|  |  |
| --- | --- |
|  | $ |
| Additional assessable profits (i.e. the Sum) | 65,717,496 |
|  |  |
| Tax payable thereon |  9,857,624 |

1. The Taxpayer, through the Representatives, lodged an objection to the additional assessment.
2. The Commissioner by the Determination dated 4 November 2020 affirmed the additional assessment.
3. **The Taxpayer’s Evidence**
4. Upon enquiries by the Assessor, the Taxpayer (by himself or through his Representatives) and the Company previously made representations and provided information as follows:
	1. The Sum was granted to the Taxpayer pursuant to the NBA, the First Addendum and the Second Addendum. The Company offered the Sum to the Taxpayer not only as an inducement to retain his future services but also for his agreement not to provide any services to the Company’s competitors or induce its agents and clients to terminate their relationship with the Company after termination of the Agency Contracts. For waiving repayment of the Sum, the Taxpayer was required to observe the restrictive covenants in the NBA during the six-year period after termination of the Agency Contracts;
	2. The Taxpayer’s past contribution, performance and influence in its sales force were considered when the Company offered the Sum to him;
	3. The Sum was reported as a taxable income because according to the terms of the Facility Letter, it was repayable by the Taxpayer only if he joined other insurance company. The Taxpayer did not repay any amount of the Sum;
	4. No agents previously under the Taxpayer’s supervision were transferred or assigned to Company J;
	5. The Consultancy Agreement was renewed on 12 January 2016 and was terminated on 31 December 2016 in accordance with the terms provided therein;
	6. Between late 2014 and 2016, the Company had an impending transaction with Company L for the sale of its shares(‘Takeover Transaction’). Since the Taxpayer’s leaving the Company at the relevant times and joining other insurance company might affect the valuation of the Takeover Transaction, the Company intended to impose restrictive covenants on the Taxpayer. By the Facility Letter, the Company agreed to pay the Sum to the Taxpayer subject to repayment on the occurrence of any Repayment Event between 1 January 2015 and 31 December 2020. The underlying purpose of the Repayment Events, as confirmed by the Company, was that the Sum was repayable by the Taxpayer only if he joined other insurance companies. There were no other services to the Company required of the Taxpayer under the terms of the Facility Letter. Hence, the Sum was not an upfront payment for services to the Company;
	7. To facilitate the Takeover Transaction after the Taxpayer had terminated the Agency Contracts with the Company, the Company engaged the Taxpayer to provide consultancy services by entering into the Consultancy Agreement in order to retain his services at the relevant times at a monthly consultancy fee of $150,000. The Consultancy Agreement had subsequently been renewed up to 31 December 2016. The consultancy fee received during the period from January 2015 to December 2016 (including $450,000 for 3 months from January to March 2015) had been offered for assessment for the years of assessment 2014/15 to 2016/17;
	8. To ensure the success of the Takeover Transaction, by a letter dated 12 January 2016, the Company further agreed to (and did subsequently) pay the Taxpayer a conditional retention bonus, stated to be ‘in recognition of (the Taxpayer’s) continued support and contribution (to the Company)’ totaling $30 million, of which $15 million would be payable within 1 month and the balance of $15 million would be payable within 1 month after either the completion of the Takeover Transaction or the official announcement made by the Company that the Takeover Transaction had been cancelled. The Taxpayer had received the respective sums of conditional retention bonuses and offered them for assessment in the years of assessment 2015/16 and 2016/17; and
	9. After completion of the Takeover Transaction, the Taxpayer had been restricted to conduct his insurance business up to December 2020 pursuant to the Facility Letter; otherwise he had to repay the Sum. Consequently, the Taxpayer had derived no income or profits from business since then.
5. The Assessor ascertained that the Company furnished the following notifications in respect of the Taxpayer for the years of assessment 2010/11 to 2013/14, 2015/16 and 2016/17 reporting his income as follows:

| Year of assessment | Income |
| --- | --- |
|  | $ |
| 2010/11 | 21,825,768 |
| 2011/12 | 18,339,704 |
| 2012/13 | 24,162,802 |
| 2013/14 | 22,772,936 |
| 2015/16 | 16,800,000 |
| 2016/17 | 16,350,000 |

1. In support of this Appeal, the Taxpayer has adduced in evidence his statement dated 15 September 2021 and Mr H’s witness statement dated 1 March 2021.
2. The Taxpayer’s case is that he had been providing insurance services to the Company since 2000. His business and agency workforce which brought voluminous commission income had been a valuable asset to the Company.
3. He states that the objective of the NBA was (i) to compensate his loss of rights from joining other insurance companies or taking part in any insurance business or activities which might compete against the Company; and (ii) a ‘buyout’ of his capital business assets in that he was to give up all his sales agents to the Company and the overriding commissions he would otherwise be entitled. He considered that the ownership of his agency and the benefits generated therein were his ‘asset’ or ‘business interest’. He argues that he was not allowed to come back to the insurance industry for six years up to 31 December 2020, and practically it was very difficult to re-join the industry after a long time being out of the market. He also claimed that he might have suffered a loss in deciding to terminate the Agency Contracts in return for the Sum under the NBA.
4. At the hearing before the Board, the Taxpayer supplemented his evidence by oral testimony as follows:
	1. He was not involved in the design of the NBA and did not negotiate its terms with the Company;
	2. He agreed in cross-examination that at the time when he tendered the notice of termination, the Company and himself both considered and agreed that he would continue to render insurance service to the Company. Hence the new company Company J (of which he was the Position M and Position N) was set up on 15 August 2014. Company J and the Company entered into the Corporate Agency Agreement pursuant to the Second Addendum to the NBA on 10 September 2014;
	3. Between late 2014 and 2016, negotiations of the Takeover Transaction were underway. The Taxpayer’s leaving the Company around that time would ‘rock the boat’ and affect the Takeover Transaction and valuation of the Company’s shares. It was in the interests of the Company to keep a continuing business relationship with the Taxpayer. Hence the Corporate Agency Agreement and the Consultancy Agreement were entered into around the time when the Taxpayer elected to terminate the Agency Contracts. However the Taxpayer had actually given up his sales teams to the Company (in accordance with the buyout arrangements under the NBA); he only kept a minimal role and was engaged in other new and insubstantial PRC insurance/new clients network building business which never really took off;
	4. He agreed that since the NBA was structured to give him the right to exercise an option at various points in time, the Company would not be able to gain control of his agency teams if he did not elect to exercise the option or terminate the Agency Contracts under the NBA. He also agreed that the Company had no intention to buy him out at the time of offering the NBA to him in 2010, because he was earning money for the Company. On the contrary, the Company had wanted him to stay to lead the revival projects. He agreed that the ‘buyout’ arrangement under the NBA was unreasonable and not comprehensible in the eyes of a reasonable person;
	5. He agreed that nothing in the NBA expressly required him to give up the control of his agency teams and the overriding commissions he was receiving. He contended, however, that this would be the practical effect because under the Manager Contract it was stated all rights of remuneration shall cease and be forever distinguished upon termination;
	6. He agreed that the NBA was not relevant to the Takeover Transaction because the NBA was entered into in 2010 whilst the acquisition negotiations for the Takeover Transaction only started in 2014;
	7. He agreed that his statement regarding the Company’s intention (of a buyout) in entering into the NBA was mere speculation on his part; there is no documentary evidence in support of the Company’s intention. He nevertheless drew this Board’s attention to an internal email dated 24 July 2012 from Ms Q, Position R of the Company, in which the NBA was referred as ‘the buyout agreement’;
	8. When asked when he had formed an intention to retire, the Taxpayer replied that he had intended to retire a few months prior to the end of 2014. He had planned to stop working immediately due to some medical problems;
	9. He agreed that it was his own free choice and decision as to whether or not to terminate the Corporate Agency Contract and if so when to do so. Similarly, the choice of when to retire (if at all) was also his own decision to make;
	10. He finally agreed that if the Sum was a bonus, he would have to pay tax for it.

***Mr H’s Evidence***

1. Mr H’s evidence relevant to this Appeal, given in his oral testimony at the hearing and his witness statement dated 1 March 2021, can be summarised as follows:
	1. He worked at the Company from 2007 to 2014 in the position of Position P;
	2. The Taxpayer was working for the Company all through those years (as the Agency Contracts were signed back in 2000). His work performance in insurance business was exceptional and he had a good reputation in the field;
	3. In 2008 to 2009, a global financial crisis erupted. The Company was badly hit and lost over 1,000 sales agents from the original force of 2,800. It badly needed a revival plan/strategy for a turnaround;
	4. As Position P, he worked on workable plans as a revival strategy to salvage the situation. New agent recruitment initiatives and projects had been put in place;
	5. The Taxpayer had been doing well for the Company over the past years and had large good teams of sales agents – he was considered to be the only person qualified for the tasks of leading a few projects in reviving sales and recruitment;
	6. Under those circumstances, Mr H initiated the NBA made between the Company and the Taxpayer in 2010;
	7. The objective of the NBA was to enable the Company to take full control of the Taxpayer’s agency sales force in order to mitigate the risk brought by the sales mix of the Taxpayer’s agency hierarchy (which was over 50% compared to that of the Company). By terminating the Agency Contracts, the Taxpayer would be required to return to the Company the ownership of his whole team of agency staff and its benefits entitlement therein. Mr H opines that the arrangement also provided non-competing undertakings against the Company’s business;
	8. It was Mr H’s desire to retain the Taxpayer under the NBA as part of the Company’s plan devised by him for the sake of its survival;
	9. Mr H agreed that at the time of designing the work plans and initiating the NBA, the Company wanted and needed the Taxpayer to continue his services. He considered that the conditional advance arrangement was ‘an attractive option’ to the Taxpayer to secure the latter’s agreement to stay on with the Company, because the Company actually could have exercised the right of termination simply by giving 30 days’ notice without giving reasons (or compensation) in accordance with the termination clauses under the Agency Contracts, whereupon all the Taxpayer’s rights thereunder shall forthwith cease;
	10. The Company was willing (by entering into the NBA) to give this option for the Taxpayer to elect to terminate the Agency Contracts and receive a conditional advance because the Taxpayer hadmade good contributions to and had done a lot of good things for the Company in the past and should not be poorly treated. This attractive package would pave a rosy, decent and respectful fading out path for the Taxpayer should he choose to retire and leave the Company in future after a few years of work under the Agency Contracts;
	11. The option to terminate with the conditional advance offered under the NBA was actually a mitigating measure – this is to neutralize the concentration risk when e.g. due to the revival projects becoming extremely successful and the Taxpayer having over 50% of the Company’s sales mix or agency force. He would become a key player capable of ‘rocking the boat’ in the event of his departure, falling sick, etc. Some measures would have to be in place to mitigate or neutralize the risks. Upon election to terminate the Agency Contracts, the Taxpayer would be entitled to the conditional advance. This would enable the Company to take over or retain full control of or buy out his large agency teams;
	12. Should the Taxpayer not elect to terminate the Agency Contracts by end-2014, the offer would lapse and he would not be entitled to any conditional advance. In that case, the Agency Contacts and the Taxpayer’s services to the Company would continue. It might well be for the mutual benefit of the Company and the Taxpayer if he continued to do well and earn money for the Company;
	13. At the time of entering into the NBA, the Company did not have a concrete plan for the situation where the Taxpayer did not exercise the option to terminate the Agency Contacts under the NBA, but the Company might come up with other risk management or mitigating measures (to neutralize the concentration risks) should that happen;
	14. Mr H agreed that the proposed arrangement (upon the Taxpayer’s election to terminate) of ‘the Company taking over full control of or buying out the Taxpayer’s large agency teams’ was not expressly stated or spelled out in the NBA, nor recorded in any other documents or internal company documents because ‘it was a very unusual and highly confidential arrangement’;
	15. He stated (this being hearsay) that it was the opinion of the Company’s legal team that given the substantial amount of the Sum, it could not be paid to the Taxpayer just as a gross lump sum. The Sum was thus structured in a form of ‘loan’ so as to give the Company easy recourse for the Sum against the Taxpayer if he breached any of the terms under the Facility Letter; and
	16. Mr H agreed that at the time of entering into the NBA, the Company wanted the Taxpayer to stay and, in response to this Board’s question. He also agreed that the NBA arrangement could be seen as an ‘incentive scheme’ – because the longer the Appellant stayed with the Company and the better he performed (in terms of average annual earnings), the more money (i.e. the conditional advance) he could receive if the Company survived.
2. **Relevant Legal Principles/Case Authorities**
3. The following provisions in the IRO govern the issue of this Appeal, i.e. chargeability of the Sum to Profits Tax:

***Section 14(1):***

‘*… profits tax shall be charged for each year of assessment at the standard rate 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)…*’

***Section 61A:***

‘*(1) … where any transaction… has, or would have had but for this section, the effect of conferring a tax benefit on a person…, and, having regard to –*

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

*(b) the form and substance of the transaction;*

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

*(d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;*

*(e) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;*

*(f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm’s length under a transaction of the kind in question; and*

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

*it would be concluded that …the transaction, did so for the sole or dominant purpose of …obtain a tax benefit.*’

***Section 68(4):***

‘*The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.*’

1. This Board has considered the following case authorities referred to in the Commissioner’s Closing Submissions and the principles stated therein relevant to this Appeal:

***Case Authorities***

1. It is trite that amounts paid in consideration of the performance of services will almost always be income - Principle #7 stated inMIM Holdings Ltd v Federal Commissioner of Taxation (1997) 36 ATR 108, at 117.
2. A payment made to a person to fetter that person’s capacity to perform services or to carry on business may be a capital payment: Principle #8 stated inMIM Holdings Ltd (*supra*), at 117;Higgs v Oliver [1952] Chapter 311, at 320, 321. However, if the restriction does not significantly affect the taxpayer’s business or change the taxpayer’s business structure, payment for such restriction may not be capital in nature: MIM Holdings (*supra*), at 117, lines 30-33.
3. In Higgs v Oliver (*supra*), the taxpayer, who was a famous actor, made an agreement with a film company whereby in consideration of £15,000 he agreed not to act in, or produce or direct any film anywhere for a period of 18 months, except for the company. The English Court of Appeal held that the sum was not a profit or gain arising or accruing from the taxpayer’s profession or vocation and was accordingly not chargeable to income tax. Giving the leading judgment, Lord Evershed MR (with whom Singleton LJ agreed) observed, at 318:

‘*I think [*counsel for the Revenue*] was disposed to agree that, if a trader, or a professional man, for a money consideration covenanted to give up his trade or profession for the rest of his life, then it would be difficult to say that the money was received ‘profits or gains accruing or arising from his trade or profession’. On the other hand, it is not difficult to see that a restriction of a very limited or partial character might less easily be taken out of the ambit of the taxing provision. One example in the argument was that of an actor who covenanted for a limited period not to act for one particular company out of a large number… But between the two extremes there is a large area, and for myself I am disposed to think that within that area it may well be a matter of degree.*’

1. In that case, the taxpayer had entered into an earlier agreement for the production of a film. The agreement contained a provision (clause 14) that during the currency of the contract the taxpayer should devote the whole of his time to the company’s services. It did not however include any post-contractual restrictions on the taxpayer’s activities. Hodson LJ said, *obiter,* at 323:

‘*…* *as the Master of the Rolls pointed out, … the taxpayer has not taken the point that clause 14 enables him to say that part of his salary payable under the original agreement is attributable to services rendered to the company and part to refraining from working for any other company. I agree that had he taken the point, it would have been likely to fail, because it would be said that the two parts were bound up together and no severance was possible.*’

1. In the Australian case Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation (1989) 93 ALR 157 it was said (at 162, 164-165) that:

‘*In characterising payments made under an agreement, the terms of the agreement must, of course, be examined; but so must the whole of the circumstances surrounding its execution, its operation and the receipt of the money in question…

Payments received by a taxpayer are not necessarily of an income nature even if loss of profits was used as a measure for calculating the amount of the payments…*

*…Normally in order for a contract to be regarded as a capital asset it must be a contract which is of substantial importance to the structure of the business itself. This is a factual matter and inevitably a matter of degree…*

*Contracts are made to be performed, not terminated, so in one sense the termination of contracts will be outside the ordinary course of business. Yet it is clear that payments made upon the termination of contracts may be of an income nature. What is important in characterising the payment is not the fact that it is made as compensation for the termination of the contract, which will often be outside the ordinary course of business, but rather the nature of the contract which generated the payment, and the way in which that contract related to the structure and business of the taxpayer.*’

(emphases added)

1. Allied Mills (*supra*) was considered in this Board’s decision in D12/90. In that case, the taxpayer was carrying on business as an independent insurance agent with a contract with an insurance company whereby the taxpayer received commission payments on business introduced. The taxpayer later relinquished and forfeited certain contractual rights in consideration of a cash lump sum payment. The lump sum payment was assessed to profits tax as being part of the taxable income of the taxpayer, and the taxpayer appealed against the assessment to the Board. The Board dismissed the appeal and held that:

‘*… where a person is carrying on a trading or agency type business, sums of money which the person receives for changing or giving up agencies or agency rights are to be construed as being payments received in the course of carrying on the business unless it is clear from the facts that the payment is of a capital nature… The question to be answered is whether or not the rights or benefits which the Taxpayer was entitled to under her agreement with the insurance company comprised a capital asset of her business…*

*In the present case, if one carefully looks at the facts before us, it is clear that the business of the Taxpayer continued after the receipt of this lump sum payment much as it had done before. We cannot see any justification for finding on the facts that the rights given up by the Taxpayer were capital assets of her business. She was doing no more than accepting a lump sum payment in exchange for giving up the right to receive override commissions in respect of two out of seven ‘units’. The Taxpayer had not invested any capital in acquiring these ‘units’ and indeed so far as we are aware, she had no formal contractual relationships with the “units”. Her contractual relationship was with the insurance company. In all of the circumstances, we find on the facts that the payment received was a trading receipt received in the course of the business of the Taxpayer and accordingly is subject to profits tax.*’

(emphases added)

1. The case ofD12/90can be distinguished from the present case: the payment to the taxpayer in that case was compensated in respect of two out of seven ‘units’, and there was no issue of post-termination restrictive covenants. That said, consideration of factors of the nature of the payment and continuing business after receipt of payment is relevant and helpful to this Board’s consideration of this Appeal.
2. In Aviation Fuel Supply Co v Commissioner of Inland Revenue [2013] 4 HKLRD 463, the taxpayer company entered into a franchise agreement with the Airport Authority (‘AA’), under which the taxpayer company would design, construct and commission an aviation fuel service system (‘facility’) for the new airport in Chek Lap Kok. Among other things, the franchise agreement provided that the taxpayer company would receive payment from the operator of the facility (‘facility operator’) which would enable the taxpayer company to recover the costs of construction with a reasonable rate of return. The franchise agreement also provided an option for AA to make an accelerated payment to the taxpayer company, upon which the facility would be vested with AA and the facility operator would pay AA instead of the taxpayer company. AA subsequently exercised the option and paid an accelerated payment to the taxpayer company. The issue was whether the accelerated payment received by the taxpayer company was chargeable to profits tax.

The Court of Appeal held that the accelerated payment was not a receipt derived from the taxpayer company’s business but capital in nature, hence not chargeable to profits tax. It was a payment to bring about the termination of the taxpayer company’s business/destruction of a capital asset.

1. Aviation Fuel Supply (*supra*) is readily distinguishable from the present case for at least two reasons. First, in the present case, the Taxpayer was providing service to the Company under the Agency Contracts, for which he was remunerated. Secondly, the Sum was calculated by reference to past earnings and the length of his service; and thirdly the Taxpayer had the choice whether to elect to terminate the Agency Contracts. Moreover, the evidence of the present case is such that the Taxpayer continued to sell insurance products on behalf of the Company (via Company J under the Corporate Agency Agreement) and to provide consultancy services to the Company (under the Consultancy Agreement).
2. On the application of section 61A of the IRO, reference is made to the case of Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd [2008] 1 HKC 151, in which the Court of Final Appeal explained (at [14]) as follows:

‘*…s.61A raises a straightforward question of causation and comparison. If the effect of the transaction is that your liability to tax is less than it would have been on some other appropriate hypothesis, you have had a tax benefit. Provided that the calculation is properly done, the section is not concerned with how the elements of the calculation are categorised for other purposes of tax law.*’

1. As to how the power under section 61A should be exercised by the Commissioner, the Court of Final Appeal gave guidance in Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue (2009) 12 HKCFAR 296, (at [34]-[37]):

‘*34. Three intersecting conditions must be satisfied before the Commissioner can exercise her power to raise an assessment under s.61A(2). They are that:*

*(a) a transaction (broadly defined to include an operation or scheme) has been entered into;*

*(b) such transaction has, or would have had but for this section, the effect of conferring a tax benefit on the relevant person (that is, on the taxpayer against whom the section has been invoked); and*

*(c) viewing the transaction through the prism of the seven matters enumerated in s.61A(1)(a)–(g), it would objectively be concluded that it was entered into or carried out for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit.*

*35. If s.61A is to be applied, it is essential to identify with some precision what the tax benefit allegedly conferred (or which would, but for the section be conferred) on the taxpayer consists of. Only then can one confidently identify the transaction, if any, which has the effect of conferring that tax benefit on him. And only then is one able to examine that transaction in the light of the seven specified matters to determine whether its sole or dominant purpose is to enable the taxpayer to obtain a tax benefit.*’

1. **Analysis**

***Nature of the Sum***

1. In considering the true nature of the Sum paid under the NBA (as amended by the First Addendum and the Second Addendum) for the purposes of the IRO, this Board considers the evidence of Mr H on the background leading to the inception and initiation of the NBA, and the objectives thereof, important.
2. Mr H’s evidence in this regard is unambiguous and sensible, and is on the whole consistent with the Taxpayer’s evidence. This Board finds him a credible witness and accepts his evidence.
3. The key terms of the NBA are that, provided that the Agency Contracts continue to be in full force, upon the Taxpayer electing to terminate the Agency Contracts by no later than (A) 1 December 2012; (B) 1 December 2013; or (C) 1 December 2014, the Taxpayer would be entitled to be paid by the Company a conditional advance equivalent to (A) 4 times the average annual earnings for the years 2010-2012; (B) 5 times the average annual earnings for the years 2010-2013; or (C) 6 times the average annual earnings for the years 2010-2014, subject to a (A) 4-year; (B) 5-year; or (C) 6-year restrictive covenant/non-competition period. The conditional advance is structured as a ‘loan’ repayable upon occurrence of any of the Repayment Events including a breach of the restrictive covenants.
4. The NBA was initiated by Mr H – it is accepted that he should know the objectives behind and the purposes underlying the arrangement. It was initiated as part of a revival plan during a world economic crisis when the Company’s business was badly hit. The Company needed and wanted the Taxpayer to stay with the Company to execute the revival projects.
5. It is clear that under the NBA, the longer the Agency Contracts continue to be in full force/the Taxpayer worked for the Company and the better he performed (based on annual earnings), the higher the conditional advance he would receive upon termination.
6. The true nature of the NBA, as Mr H agreed, was an incentive scheme to attract the Taxpayer to continue to work for the Company in leading the revival projects for 2 to 4 years (up to November 2014) in times of difficulty when the NBA was initiated or entered into in 2010.
7. The offer under the NBA was also (on Mr H’s evidence) an acknowledgement of the Taxpayer’s valuable contribution to the Company and hard work over the past 10 years. In this sense, the Sum can be viewed as a retirement bonus should the Taxpayer elect to terminate the Agency Contracts and gradually retire after 2+ to 4+ years from the date of the NBA.

***Buyout?***

1. Before the Board, there is a debate as to whether or not the Sum was a payment made by the Company to the Taxpayer for the purposes of ‘buying out’ his agency business. To some extent the answer depends on how one understands the meaning of word ‘buyout’, which is a commercial rather than a legal term. However, it is important to remember that even if the arrangement under the NBA could somehow be described as a ‘buyout’ this does not by itself answer the critical question, namely, whether or not the Sum is capital or income in nature.
2. The Taxpayer gave oral testimony at the hearing that the Company had no intention of buying him out by entering into the NBA. On the contrary, the Company (and Mr H the one who initiated the NBA) had wanted him to stay. As observed above, under the terms of the NBA the decision to elect to terminate the Agency Contracts in return for, among other things, the conditional advance (and its amount), rested with the Taxpayer, not the Company. In this sense, the arrangement differs from a usual ‘buyout’ situation in which the buyer takes the initiative or enjoys a compulsory power, as in Aviation Fuel Supply (*supra*), to purchase another’s business or assets.
3. There is no dispute that the alleged buyout or the Company taking full control of the Taxpayer’s agency teams is not provided in the NBA, nor recorded in any documentation as such.
4. It is argued by the Commissioner that in any event, this would equally be the outcome should the Company or the Taxpayer choose to exercise his or its unqualified rights to terminate the Agency Contracts upon giving 30 days’ notice. Therefore it is contended that the alleged buyout could not be the purpose of the NBA arrangement or payment of the Sum.
5. The Commissioner contends that the evidence rather shows that the real point of the NBA was to confer on the Taxpayer a bonus to attract him to stay with the Company to lead the revival projects.
6. The evidence shows that at the time of the Taxpayer’s tendering the notice of termination in November 2014, both he and the Company’s intention was that he would continue to serve the Company, and that he would be bound by the restrictive covenants of non-solicitation and non-competition under clause 16 of the Corporate Agency Agreement anyway. Further the Company should not have the intention to restrict the Taxpayer’s ability to conduct insurance business as it would be mutually beneficial to the Company and the Taxpayer. The conditional advance would only be repayable if he joined other insurance companies.
7. The Taxpayer referred to an internal email dated 24 July 2012 from Ms Q, Position R, to Mr S (who reported to Mr H), in which she referred to the NBA as ‘the buyout agreement’. In the Board’s view it is unnecessary to decide whether the description or label was correctly applied. Instead, one should look into all the circumstances of the payment, including the substance of the Taxpayer’s involvement in the Company’s business before and after the election to terminate the Agency Contracts, in determining the true nature of the Sum.
8. The design of the NBA plainly could not guarantee that the Company could ‘buy out’ the Appellant. The evidence is that under the NBA, had the Taxpayer not elected to terminate the Agency Contracts, the Company would not be able to gain control of his agency teams. The buyout could not be achieved by giving the Taxpayer the discretion to terminate.
9. It is right to say that no mention of any ‘buyout’ is made in the NBA. Nor does it contain any express terms to the effect that the Taxpayer would have to give up his agency teams and give full control of the agency teams to the Company. What is provided in the NBA, however, is that by accepting the conditional advance, the Taxpayer submitted to a wide range of restrictive covenants which disabled him from carrying on any type of insurance business for a specified period. In financial terms, by electing the option under Clause (C), the Taxpayer stood to lose a vast amount of override commission generated by his sizeable agency force. In practical terms, the six-year embargo meant he would probably never be able to resume his previous business or level of earnings.

***Continuing with the Taxpayer’s Business***

1. During 2015 and 2016, the Taxpayer continued to serve the Company (by himself as a consultant and through Company J). He continued to maintain an important role in the Company. His continued presence was considered to be vital to the success of the Takeover Transaction, so much so that the Company was willing to grant him a conditional retention bonus of $30 million, stated to be ‘in recognition of [his] continued support and contribution’ to the Company: see the Company’s letter to the Taxpayer dated 12 January 2016. According to that letter, the chief conditions for receiving the bonus were that (a) he should continue to observe the terms of the NBA (as amended) and the Consultancy Agreement, and (b) the Consultancy Agreement (or its renewal) should remain in force on the payment dates. In other words the Taxpayer was not required to do anything in addition to what he had previously agreed to do (other than to stay within the agreed roles until the completion of the Takeover Transaction) in order to earn the rather substantial bonus. As seen from his tax returns, his income from service fees and the conditional retention bonus came to substantial total sums of $16,800,000 and $16,350,000 in 2015/16 and 2016/17 respectively, after termination of the Agency Contracts and the alleged buyout.
2. The Taxpayer’s evidence that he had formed the intention to retire in mid-2014 does not sit well with the fact that he had continued to act as a consultant for the Company in 2015 up to 31 December 2016.
3. Moreover, Company J was established in August 2014 which was on his own evidence for insurance business of building up a new network of clients in the Mainland. Company J entered into the Corporate Agency Agreement with the Company on 10 September 2014 for the provision of corporate agency services. The Second Addendum was signed on the same day which essentially introduced an ‘escape clause’ into the NBA by carving out an exception for services to be provided by Company J.
4. The timing of (i) the establishment of Company J, (ii) signing of the Second Addendum and the Corporate Agency Agreement, (iii) the Taxpayer’s notice to terminate the Agency Contracts and (iv) signing of the Consultancy Agreement, all of which took place at the end of 2014 and early 2015, is telling. Such evidence clearly supports the Taxpayer’s intention to continue and the fact that he continued to provide service to the Company, despite the so-called buyout.
5. In reality, the Taxpayer continued to provide service to the Company under the Corporate Agency Agreement and the Consultancy Agreement after termination of the Agency Contracts for up to two years. He made substantial income in years 2015 to 2017, comparable to those of previous years, by continuing his service to the Company.

***No Substantial or Fundamental Change to the Taxpayer’s Business***

1. In conducting his insurance agency business with the Company pursuant to the Agency Contracts, the Taxpayer was to recruit, train and supervise agents for the Company (under the Manager Contract) and to solicit applications for insurance (under the Agent Contract). In return, he would be paid various allowance and bonuses in respect of insurance business which would be calculated based on the commission earned by him and the agents under his direct supervision, as well as various commission and bonuses in respect of issuance of insurance policies.
2. Subsequent to termination of the Agency Contracts, the Taxpayer entered into the Consultancy Agreement with the Company, under which he would provide consultancy services to the Company in relation to agency management matters, for instance, (i) to conduct weekly agency meetings for the Direct Region[[3]](#footnote-3); (ii) to provide consultancy services and ring-fencing supports to counter poaching of agents of the Direct Region; (iii) to provide consultancy services to the relevant Position R of agency regarding day-to-day operation of the Direct Region; (iv) to provide recruitment support for managers of the Direct Region whenever deemed necessary or upon request; and (v) to provide special development supports to region managers of the Direct Region for preparing them to promote to regional directors. The Taxpayer was paid a monthly consultancy fee of $150,000 for the provision of the consultancy service, as well as bonuses depending on the performance of the Direct Region.
3. Under the terms of the Consultancy Agreement, the consultancy services provided by the Taxpayer to the Company similarly involved elements of recruitment, training and supervision of agents, albeit it may be done with the assistance of, or via the other Position R of agency of the Company. The mode of remuneration under the Consultancy Agreement also shared similarities with the Manager Contract in that he was entitled to bonuses depending on the performance of the agents under his supervision.
4. The Taxpayer gave evidence at the hearing that the service he rendered to the Company under the Consultancy Agreement was different from and negligible compared to his prior services. He further claimed that in fact he was not required to perform the duties as set out in the Consultancy Agreement. This claim is somewhat surprising, and is not mentioned in his statement.
5. The Second Addendum clearly reflected the intention of the Company to allow the Taxpayer to continue conducting insurance business for the Company without breaching the NBA.
6. Further, under the Corporate Agency Agreement, Company J was appointed the Company’s corporate agent for the marketing, promotion and sale of insurance products offered by the Company in Hong Kong, and would be paid commissions and allowance. In other words, similar to the Agent Contract, the Taxpayer would be able to earn commission and allowance through the sale of insurance products of the Company via Company J.
7. The Taxpayer further claimed that Company J suffered a loss. This is in this Board’s view irrelevant to the nature of the relationship between the Company and the Taxpayer post termination. Nor does it mean that the nature of the Taxpayer’s insurance business had changed. This is consistent with Mr H’s evidence that the Company did not wish to create too much of ‘rocking the boat’ which might lead to breaking up of the agency force.
8. The evidence summarised above clearly shows that the Taxpayer continued to play a role in providing services to the Company after the termination of the Agency Contracts and within the first two years of the operative period of the restrictive covenants. At the same time, the Taxpayer was at pains to emphasise that the services envisaged under the Corporate Agency Agreement and the Consultancy Agreement were significantly different and separate from those provided by him under the Agency Contracts. In his view, they marked a clean break in terms of his long-standing and lucrative relationship with the Company under the terminated Agency Contracts.
9. To take stock, the Board finds that the essence of the NBA (as twice amended) is as follows. First, the primary object of the NBA is to confer on the Taxpayer a sizeable bonus sufficient to induce him to remain as an agent and manager for a number of years and, at the same time, to accept extensive post-contractual restraints for a commensurate period. Secondly, the formula for calculating the bonus was structured in a way so that its amount would be directly proportional to the number of years for which the Taxpayer was prepared to be restrained. Thus, the length of service and the restrictive covenants are effectively a form of calibrated price that the Taxpayer had to pay for the bonus. Thirdly, it is undoubtedly relevant to bear in mind the fact that the restrictive covenants contained in the NBA are subject to an ‘escape clause’ enabling the Taxpayer to continue serving the Company in other shapes or guises after the termination of the Agency Contracts. However, we do not think this factor is necessarily fatal to the characterisation of the Sum as non-taxable capital. As we have seen in the leading case of Higgs v Olivier, there was a similar reservation allowing the taxpayer to work for the film company during the 18-month post-contractual period. Despite this the Master of the Rolls opined in relation to the restriction against film acting for other companies that ‘[s]till it was a substantial piece, so to speak, out of the ordinary scope of the professional activities which otherwise were open to him’: *supra*, at 319. Again, as mentioned above, his Lordship made the plainly sensible observation that the severity of post-contractual restrictive covenants in every case is a matter of degree.
10. In the opinion of the Board, the NBA (as twice amended) serves at least a dual purpose. In the first place, it serves as an incentive scheme for the Taxpayer to carry on working as an agency manager for as long as possible (up to 1 January 2015) by providing a conditional advance whose amount is pegged to the length of continued service at the choice of the Taxpayer. At the same time, the NBA imposes severe handicaps on the Taxpayer’s ability to carry on insurance business in competition with the Company, in effect, handcuffing him for a commensurate period of time after termination. On this view of the matter, the question arises whether it is possible to apportion the Sum into two parts, one part representing that which represents the taxable element (see Principle #7 in MIM Holdings, *supra*), and the other part representing that which represents the non-taxable element (see Principle #8 in MIM Holdings, *supra*).
11. There is no doubt that in a proper case, a single payment of a mixed nature may be apportioned amongst the several heads to which it relates and an income or non-income nature attributed to portions of its accordingly. But while it may be appropriate to follow such a course where the payment or receipt is in settlement of distinct claims of which some at least are liquidated or otherwise ascertainable by calculation, it cannot be appropriate where the payment or receipt is in respect of a claim or claims for unliquidated damages only and is made or accepted under a compromise which treats it as a single, undissected amount of damages. In such a case the amount must be considered as a whole: see McLaurin v Commissioner of Taxation (Cth) (1961) 104 CLR 381, at 391, followed in Case No D76/98, a decision of the Board dated 19 August 1998, at [46].
12. In this case the Sum in question was arrived at by the Company presumably by applying the formula under Clause (C) of the NBA, namely, six times of the Taxpayer’s average annual earnings for the years from 2010 to 2014. The Company has not provided any breakdown or details of the calculation. In the circumstances it is not open to the Board to dissect or apportion the Sum into several portions and attribute to each an income or non-income nature. However, as analysed above, it is undeniable that the conditional advance is structured in a way so as to incentivise the Taxpayer to remain in service as an agent and manager for as long as possible, and not simply to buy his freedom of operation after the period of service. In the absence of any valid basis for apportionment, the Board concludes that the whole Sum is taxable under Principle #7 in MIM Holdings, *supra*.

***Conclusion Under Section 14(1) of the IRO***

1. Considering all evidence, the Board comes to the conclusion that the Sum was offered to the Taxpayer as an incentive for him to stay and continue to provide services to the Company from 2010 to 2014. It was revenue in nature and profits derived and received in the course of carrying on the Taxpayer’s insurance business, and is chargeable to profits tax.
2. **Tax Avoidance**
3. In view of the Board’s conclusion that the Sum was chargeable to Profits Tax under section 14(1) of the IRO, it is not necessary to determine the application or otherwise of section 61A. The section is considered and determined as set out hereunder for completeness and in case this matter goes further.

**[Paragraphs 100-106 represent the majority decision of this panel (Phillis Loh and Yuen Hoi-ying, with Ling Chun-wai dissenting.)]**

1. The Board has considered the Commissioner’s Amended Statement of Particulars for section 61A of IRO [Annex] and the seven matters set out in section 61A(1)(a)-(g) in light of the evidence.
2. It is clear that for the purposes of section 61A(1)(d) (i.e. *any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction*) the Taxpayer’s financial position has changed with the transaction: he has been paid the Sum.
3. In regard to section 61A(1)(c), namely the result in relation to the operation of the IRO that, but for this section, would have been achieved by the transaction, the following is pertinent:
	1. The evidence is that the Company wished to retain the Taxpayer to continue to provide service to the Company despite the termination of the Agency Contracts;
	2. Mr H’s evidence is that the NBA could be seen as an incentive scheme for retaining the Taxpayer to stay with the Company, though the Sum was deliberately structured as a loan with a view to facilitating repayment if required; and
	3. The Taxpayer agreed that had the Sum been paid as a bonus to him, he would have to pay tax.
4. In regard to the form and substance of the transaction (section 61A(1)(b)), this Board considers that the restrictive covenants in the NBA (i.e. the form) after termination of the Agency Contracts were not the major consideration, nor was the Sum of the sole or dominant nature of a compensation for entering into the restrictive covenants not chargeable to profits tax. The evidence shows however that in reality the Taxpayer had continued to provide service to the Company under the Corporate Agency Agreement and the Consultancy Agreement. He would under those agreements be subject to the restriction not to engage in business activities in competition with the Company anyway.
5. Mr H’s evidence is that the NBA was initiated partly due to the Taxpayer’s good contributions to the Company in the past; he should be treated well should he choose to leave the Company in future. On such evidence, the NBA/the Sum paid may be construed in its true nature also as a payment for the Taxpayer’s past services, or a retirement gratuity or bonus, which would otherwise be subject to profits tax.
6. In regard to section 61A(1)(a) (i.e. the manner in which the transaction was entered into or carried out), as the evidence shows, the NBA arrangement was unusual and, according to Mr H, had not been done before. The Company could have achieved the same practical result by terminating the Agency Contracts and entering into new contract(s) with non-competition clause and minimum period of service for retaining the Taxpayer’s service. Under those circumstances, payment made under the new contract(s) by way of signing off bonus, commissions, etc. would be subject to profits tax.
7. On the whole of the evidence and having regard to the seven matters set out in section 61A(1)(a)-(g), this Board concludes that the transactions set out in the Annex were for the dominant purpose of conferring a tax benefit on the Taxpayer in that there was an avoidance of liability to pay profits tax in respect of the Sum for the year of assessment 2014/2015.
8. **Conclusion**
9. The Appeal is dismissed. This Board confirms the Additional Profits Tax Assessment that the Deputy Commissioner of Inland Revenue confirmed in his Determination dated 4 November 2020, which is particularised in paragraph 42 above.
10. We order the Taxpayer to pay costs of $10,000 which shall be added to the tax charged and recovered therewith pursuant to section 68(9) of the IRO.
1. The Company, a Bermuda company, was registered as an oversea company in Hong Kong in 1985 in the name of Company D. On divers dates, its name was changed to Company E, Company F and Company C. In 2016, the Company changed to its present name as Company G. [↑](#footnote-ref-1)
2. Direct region meant all insurance agents under the Taxpayer’s direct or indirect supervision but excluded the regional director belonging to the second and lower tiers under his supervision and all agents under the supervision of other regional directors. [↑](#footnote-ref-2)
3. ‘Direct Region’ was defined in the Consultancy Agreement to mean ‘*all insurance agents under [the Taxpayer’s] direct or indirect supervision, but excludes (i) the regional director belonging to the second and lower tiers directly or indirectly under [the Taxpayer’s] supervision (the “Other RDs”) and (ii) all agents directly or indirectly under the supervision of Other RDs.*’ [↑](#footnote-ref-3)