Case No. D10/02

Salaries tax – employment – source of income – sections 8(1), 8(1A), 8(1B), 61, 68(4) and 70 of the Inland Revenue Ordinance ('IRO') – costs – frivolous and vexatious – section 68(9) of the IRO.

Panel: Kenneth Kwok Hing Wai SC (chairman), Shirley Conway and Tse Tak Yin.

Date of hearing: 22 March 2002.
Date of decision: 7 May 2002.

This is an appeal against the determination of the Commissioner whereby additional salaries tax assessment for five years of assessment were raised. The appellant claimed that the income he received from Ipco should not be chargeable to tax because he rendered all his services to Ipco outside Hong Kong.

At all relevant times, Ipco, a company incorporated in Country A, was a wholly-owned subsidiary of Iistco1, a company listed in Hong Kong. Ipco was registered as an overseas company. The appellant commenced his employment with Listco1 as group financial controller on 1 January 1991. On 17 March 1993 the appellant entered into a service agreement with Ipco whereby he was appointed regional manager. On 16 January 1997, the appellant entered into another employment agreement with Ipco whereby it was provided that no services would be required from the appellant in Hong Kong; that the appellant might be called upon by other group company to provide services or perform duties in Hong Kong and that regardless of whether Ipco might directly or indirectly benefit from these other services, Ipco should not be responsible for payment of remuneration of these other services. The appellant was provided with quarters in Hong Kong throughout the five years by way of rent refund. The appellant, through his tax representative, claimed that two of his employment agreements were executed by Ipco in Country D and the appellant in Country E. During the relevant years, the appellant had different employments with different companies within the listed group.

The assessor was of the view that the income received by the appellant from Ipco should be assessable to tax. The appellant objected on the ground that they were incorrect and excessive.

Held:

1. In the Board's decision, the location and source of the appellant's employment by Ipco was in Hong Kong. His entire income from the employment by Ipco was caught by the charge under section 8(1) of the IRO and there was no provision for apportionment. The Board did not believe the appellant's assertion that two of the agreements were signed by the appellant in Country E and by Ipco in Country D. The Board did not believe that the two agreements went round Country E and Country D when in fact the two persons who signed on them both worked in Hong Kong at the office.

2. In the Board's decision, the employment of the appellant by Ipco was patently artificial. It was commercially unrealistic from both the appellant's and Ipco's points of view. Even if the appellant had, contrary to the Board's decision, succeeded on the source of employment, the Board would have found against the appellant under section 61.

3. The appellant had failed on both points. Clearly he had not discharged the onus under section 68(4) of proving that any of the assessments appealed against was excessive or incorrect.

4. The Board was of the opinion that the appeal was frivolous and vexatious. Pursuant to section 68(9) of the IRO, the Board ordered the appellant to pay the sum of $5,000 as costs of the Board.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

CIR v Geopfert (1987) 2 HKTC 210
D18/98, IRBRD, vol 13, 180
D77/99, IRBRD, vol 14, 528
D32/94, IRBRD, vol 9, 97
CIR v So Chak Kwong, Jack 2 HKTC 174
Seramco Trustees v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436

Tse Yuk Yip for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 27 November 2001 whereby:

(a) Additional salaries tax assessment for the year of assessment 1993/94 under charge number 9-2912289-94-0, dated 21 December 1999, showing additional net chargeable income of $1,274,645 with tax payable thereon of $184,816 was confirmed.

(b) Additional salaries tax assessment for the year of assessment 1994/95 under charge number 9-2847747-95-1, dated 21 December 1999, showing additional net chargeable income of $2,025,200 with tax payable thereon of $303,780 was confirmed.

(c) Additional salaries tax assessment for the year of assessment 1995/96 under charge number 9-4051547-96-9, dated 21 December 1999, showing additional net chargeable income of $2,732,331 with tax payable thereon of $409,849 was confirmed.

(d) Additional salaries tax assessment for the year of assessment 1996/97 under charge number 9-2390309-97-A, dated 21 December 1999, showing additional net chargeable income of $2,119,128 with tax payable thereon of $295,203 was confirmed.

(e) Additional salaries tax assessment for the year of assessment 1997/98 under charge number 9-3755331-98-9, dated 21 December 1999, showing additional net chargeable income of $3,413,863 with tax payable thereon of $442,013 was confirmed.

The admitted facts

2. The following facts stated in the determination are admitted by the Appellant and we find them as facts.

3. The Appellant has objected against the additional salaries tax assessments for the years of assessment 1993/94 to 1997/98 raised on him. The Appellant claimed that the income he received from Ipco should not be chargeable to tax because he rendered all his services to Ipco outside Hong Kong.

4. At all relevant times, Ipco was a wholly-owned subsidiary of Listco1, a company listed in Hong Kong in May 1991. Ipco and Listco1 are members of the listed group.

5. Listco1 was a company incorporated in Hong Kong on 1 December 1987. At all relevant times, it carried on an investment holding business. Its business address was in Kowloon ('the Office').

6. Ipco was a company incorporated in Country A on 10 October 1988 and commenced business on 5 March 1991. It was registered as an overseas company in Hong Kong under section 333 of the Companies Ordinance (Chapter 32) ('CO') with effect from 25 September 1991. Under paragraph (c) of section 333(1) of the CO, Ipco is required, among other things, to deliver information to the Companies Registrar in specified form containing its business address. At all relevant times, Ipco stated that the Office was its business address. Ipco declared in its profits tax returns that its principal business activities were to 'hold patent rights for group companies and received royalty income therefrom.'

7. (a) The Appellant commenced his employment with Listco1 as group financial controller on 1 January 1991 at a monthly salary of $56,000 on a 14 months' basis (that is, $784,000 per annum). In a memorandum dated 17 March 1993 issued by Listco1 to the Appellant under the caption 'salary review', it was stated that:

> ' In view of the fact that [the Appellant has] provided and continue to provide services to [Ipco] and a service contract has been entered into by [the Appellant] with [Ipco] on March 17, 1993 which takes effect as from June 1, 1991, this is to confirm that [the Appellant's] annual salary payable by [Listco1] has been adjusted to HK$312,000 with effect from April 1, 1992.'

The Appellant signed on the memorandum to acknowledge his agreement.

(b) By agreement dated 17 January 1995, the Appellant entered into another employment agreement with Listco1 to supersede the one mentioned in subparagraph (a) above whereby he was appointed group financial controller and executive director for four years renewable for another term of four years with effect from 1 January 1994.

(i) The Appellant's duties included the following:

'For the purposes hereof [the Appellant] shall if and so long as he is so required by [Listco1]:

(a) carry out the duties of the [group financial controller and executive director of Listco1] on behalf of such other company in the Group.

(b) act as director, officer or employee of any such company; and

(c) carry out such duties attendant on any such appointment as if they were duties to be performed by him on behalf of [Listco1] hereunder.' (Clause 3.02)

(ii) The Appellant was to be remunerated by way of an annual salary of $450,000 per annum and a monthly housing allowance of $60,000.

(ii) Clause 11.03 of the agreement reads as follows:

'Notwithstanding any provision herein to the contrary, any company in the Group other than [Listco1] may enter into further agreements with [the Appellant] on or after the date hereof regarding his provision of specific services to such company.'

(c) Pursuant to a scheme of arrangement sanctioned by the then Supreme Court of Hong Kong which became effective on 29 May 1995, Listco1 became a wholly-owned subsidiary of Listco2, a company incorporated in Country B. On the same date, Listco2 was listed on The Stock Exchange of Hong Kong Limited in place of Listco1. The agreement between Listco1 and the Appellant dated 17 January 1995 referred to in paragraph 7(b) was superseded by a new agreement dated 28 July 1995 entered into between Listco2 and the Appellant which contained the same terms as those in paragraphs 7(b)(i), (ii) and (iii) with effect from 3 March 1995 retrospectively. The Appellant only took up the role of executive director of Listco2 under the agreement.

(d) The agreement in paragraph 7(c) above was subsequently replaced by two other agreements dated 18 August 1995 and 7 January 1997 which took effect from 1 September 1995 and 1 January 1996 respectively. Under the agreement dated 18 August 1995, the Appellant was appointed executive director of Listco2 whilst under the agreement dated 7 January 1997, the Appellant was appointed executive director and chief financial officer of

Listco2. Under both agreements, the Appellant was entitled to a discretionary cash bonus in addition to annual salary and housing allowance. The two agreements do not contain the clause referred to in paragraph 7(b)(iii).

8. (a) On 17 March 1993, the Appellant entered into a service agreement with Ipco whereby he was appointed regional manager with effect from 1 June 1991. The agreement includes, inter alia, the following clauses:

(i) '3.02 The duties and powers ... shall include securing the vesting of any trademarks and/or patents in the name of [Ipco] used in connection with any business carried on by any Group Company, protection of such trademarks and/or patents, negotiating and making such necessary arrangements for use of the same by any Group Company or other entities in connection with their business and it is acknowledged that such services shall normally be required to be performed in such parts of the world including [several regions and countries] and such other countries in which the trademarks and/or patents may from time to time be registered in the name of [Ipco].

3.03 [The Appellant] shall at all times keep the Board promptly and fully informed (in writing if so requested) of his conduct of the business or affairs of the Company and provide such explanations as the Board may require in connection therewith.'

(ii) '4.01 [The Appellant] shall, during the continuance of his appointment, be entitled to receive:

(a) a salary at the rate of US$87,500 per annum, ... be payable in Hong Kong dollars, being converted at the rate of US$1 = HK$7.8 ...

(b) a discretionary cash bonus at a rate to be decided by the Board ...'

(iii) '9. This Agreement shall be governed by and construed in accordance with the laws of [Country A], but this Agreement may be enforced in any court of competent jurisdiction.'

(b) The agreement dated 17 March 1993 was later superseded by two other employment agreements dated 17 January 1995 and 18 August 1995 effective from 1 January 1994 and 1 September 1995 respectively. The terms of the

two agreements were similar to those in the agreement dated 17 March 1993 except that the Appellant was entitled to certain bonuses in addition to salary.

(c) On 16 January 1997, the Appellant entered into another employment agreement with Ipco which became effective from 1 January 1996. Clause 4.05 of the agreement provided the following:

> 'It is explicitly understood and agreed by [the Appellant] and [Ipco] that pursuant to this Agreement no services will be required from [the Appellant] in Hong Kong. It is also understood that [the Appellant] may be called upon by other Group Company to provide services or perform duties in Hong Kong for the Group Company or for group management purposes and thus covering issues directly or indirectly associated with [Ipco]. Regardless of whether [Ipco] may directly or indirectly benefit from these other services, [Ipco] shall not be responsible for payment of remuneration of these other services. The remuneration provided in this Agreement shall not be applied in part or whole to satisfy any fee, reward or entitlement which [the Appellant] may claim or be entitled to for the other services in Hong Kong.'

9. Listco1 and Listco2 filed employers' returns for the years of assessment 1993/94 to 1997/98 in respect of the Appellant showing, inter alia, the following particulars:

		1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
Employer	:	Listco1	Listco1	Listco1	Listco2	Listco2
Capacity in which employed	:	Group financial controller	Executive director	Executive director	Executive director	Executive director
Income –		$	$	$	$	$
Salary:		260,000	704,050	425,350	493,200	521,132
Leave pay	:	-	-	225,913	200,724	218,944
Bonus:		-	-	391,302	-	-
Total	:	260,000	704,050	1,042,565	693,924	740,076

The Appellant was also provided with quarters in Hong Kong throughout the five years by way of rent refund.

10. In his tax returns for the years of assessment 1993/94 to 1997/98, the Appellant declared the same particulars of income as shown in paragraph 9.

11. On divers dates, the assessor raised on the Appellant the following salaries tax assessments for the years of assessment 1993/94 to 1997/98:

	1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
	$	$	$	$	$
Income	260,000	704,050	1,042,565	693,924	740,076
Add: Rental value	26,000	70,405	104,256	69,392	74,007
Assessable income	286,000	774,455	1,146,821	763,316	814,083
Less: Charitable donations	14,200			-	-
Allowances	90,000			154,000	179,000
Net chargeable income	181,800			609,316	635,083
Tax payable thereon	33,650	116,168	172,023	114,063	116,216

(a) The Appellant did not object to the above assessments which have become final and conclusive in terms of section 70 of the IRO.

(b) The tax of $116,216 for the salaries tax assessment for the year of assessment 1997/98 was subsequently reduced to $104,594 by virtue of Tax Exemption (1997 Tax Year) Order.

12. It has come to the assessor's notice that the Appellant received the following remuneration from Ipco:

	1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
	$	$	$	$	$
Salary	781,950	841,091	1,224,248	1,238,480	1,308,616
Bonus	295,000	1,000,000	1,259,689	548,000	1,632,168
	1,076,950	1,841,091	2,483,937	1,786,480	2,940,784

13. The assessor was of the view that the income received by the Appellant from Ipco [paragraph 12] should be assessable to tax. On 21 December 1999, she raised on him the following additional salaries tax assessments for the years of assessment 1993/94 to 1997/98:

	1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
	$	$	$	$	$
Income from Listco1 or Listco2 [paragraph 9]	260,000	704,050	1,042,565	693,924	740,076
Income from Ipco [paragraph 12]	1,076,950	1,841,091	2,483,937	1,786,480	2,940,784
Total income	1,336,950	2,545,141	3,526,502	2,480,404	3,680,860
Add: Rental value	133,695	254,514	352,650	248,040	368,086
Assessable income	1,470,645	2,799,655	3,879,152	2,728,444	4,048,946
Less: Charitable donations	14,200				
	1,456,445				
Less: Net chargeable					

income already assessed [paragraph 11]	181,800	774,455	1,146,821	609,316	635,083
Additional net chargeable income	1,274,645	2,025,200	2,732,331	2,119,128	3,413,863
Tax payable thereon	184,816	303,780	409,849	295,203	442,013

14. The Appellant, through Accountants' Firm C ('the Former Representative'), objected against the above additional assessments on the ground that they were incorrect and excessive. It claimed that:

> '... [The Appellant's] duties and services rendered to [Ipco] were rendered under his employment with [Ipco] which is separate and distinct from his employment with [Listco1]/[Listco2]. In addition, all his related services rendered to [Ipco] were performed exclusively outside of Hong Kong. In consequence, his emoluments from [Ipco] were offshore non-taxable income and should be exempted from Hong Kong salaries tax pursuant to Section 8(1A)(b)(ii) of the IRO.'

15. In correspondence with the assessor, the Former Representative supplied the following information and documents in relation to the Appellant's employment with Ipco:

(a) The employment agreements dated 17 March 1993 and 18 August 1995 were executed in Hong Kong whilst the two agreements dated 17 January 1995 and 16 January 1997 were executed by Ipco in Country D and the Appellant in Country E.

(b) The Appellant's emoluments were paid from Ipco's overseas account to his overseas bank accounts maintained in Country A during the period from April 1993 to March 1994 and in Country F after April 1994. Copies of the letters of bank instructions authorising the payments dated 13 April 1993 and 25 April 1994 were supplied.

(c) During the years of assessment 1993/94, 1994/95, 1995/96, 1996/97 and 1997/98, the Appellant travelled outside Hong Kong for business trips for a total of 78 days, 123.5 days, 106 days, 181 days and 107.5 days respectively. The Appellant's travelling itinerary for the period from 1 April 1993 to 31 March 1998 was supplied.

16. The assessor has since ascertained the following information in relation to Ipco:

(a) On 5 March 1991, Ipco acquired the then existing trademarks from a limited company which was a member of the listed group for a total consideration of $380,000,000 and then leased back the trademarks to that member of the

listed group earning royalties income. For years ended 31 December 1993 to 1998, Ipco's turnovers comprised royalties income mainly received from Listco1, that member of the listed group and two related companies, Relatedco1 and Relatedco2.

(b) The relevant trademarks were registered both in Hong Kong and overseas countries.

(c) Ipco had engaged a firm of solicitors in Hong Kong ('Hong Kong solicitors') as its trademark agent.

(d) Legal actions had been taken in Hong Kong against infringers for the infringement or unauthorised use of the relevant trademarks.

(e) The board of directors of Ipco comprised one named person (up to 1993), the Appellant and two named persons (commencing from 1994), all of whom were Hong Kong residents. Other than these directors, Ipco did not have any employees.

(f) Ipco's accounting books were prepared and kept in Hong Kong whereas the statutory records such as share register and minutes were kept in its registered office in Country A.

(g) The annual general meetings of Ipco were held in Hong Kong.

(h) Ipco had registered a branch office in Hong Kong at the same address as the listed group's head office in Hong Kong. It reported its business functions to the group's office in Hong Kong.

17. The assessor has also obtained the following documents concerning matters relating to the relevant trademarks:

(a) Letter dated 15 July 1993 to the Appellant as the group financial controller of Listco1 regarding ownership and title in Country G of the relevant trademarks.

(b) Letter dated 8 December 1993 to the Appellant as the group financial controller of Listco1 regarding the taking up of the rights and obligations.

(c) Letter dated 28 July 1994 to the Appellant as the executive director of Listco1 regarding the extension of the date for obtaining relevant trademarks in Country G.

(d) Licencing agreement dated 18 August 1995 between Ipco and Relatedco1.

(e) Letter dated 25 June 1996 to the Appellant as a member of Listco1 regarding trademark watching service.

(f) Licencing agreement dated 1 January 1997 between Ipco and Relatedco2.

18. In reply to the assessor's enquiries, the Appellant, through Accountants' Firm H ('the New Representative'), gave the following assertions:

(a) 'The terms [of the employment agreements between the Appellant and Ipco] were fixed by the management of the [listed group]. There were practically no negotiation in the usual sense of such word. The agreements were put to [the Appellant] to sign for acceptance. As [the Appellant] was not allowed to act in Hong Kong as an employee of [Ipco], he indicated his readiness to agree to the agreements when he was not in Hong Kong.'

(b) '[The Appellant] was not allowed to perform any services in Hong Kong under the employment with [Ipco] during the years and did not require any office for such employment when he was not on overseas trips.'

(c) '[The Appellant] held out to the public as a staff member of [Ipco] when he was acting for [Ipco]. You may note that ... [a named person's] image was therefore discounted by the market participants in [Country E] and those having concerns there. To promote the business of [Ipco] as far as possible given such background, the [Appellant] therefore would try to represent himself a member of [Ipco] as far as possible.

19. In response to the assessor's request to comment on paragraphs 3 to 17 above, the New Representative by its letter dated 4 October 2001 stated the following:

(a) During the relevant years, the Appellant had different employments with different companies within the listed group. All these employments were separate and distinct from each other. The employment with Ipco was a non-Hong Kong employment under which the Appellant did not render any services in Hong Kong during the years. A letter dated 13 September 2001 from the company secretary of Listco2 confirming the same was supplied.

(b) 'Whether the [Appellant's] employment agreements with whatever company were approved by the Compensation Committee of [Listco1] or [Listco2] is irrelevant ... In any event, it is not an unusual commercial practice that the employment contracts of an employee at the [Appellant's] levels of seniority

be approved by a committee composed of the most senior persons in the group of companies. Such practice is usually adopted to ensure sufficient internal controls are in place to check the legitimacy, genuineness and reasonableness of the respective agreements. It has no relevancy to whether the [Appellant] has rendered in Hong Kong his services under the employment with [Ipco] and whether he should be entitled to time basis for the years.'

(c) 'The firm of solicitors was dealing with [Ipco] on a principal to principal basis and as such, there is no principal-agent relationship between the firm and [Ipco. Ipco] cannot thereby be regarded as resident in or carrying on a business in Hong Kong ... we reiterate that whether [Ipco] was carrying on business in Hong Kong during the relevant times has no relevance whatsoever to the points at issue in this case.'

(d) 'The residency of the directors of [Ipco] and whether [Ipco] had any employees during the years have no relevancy to the residency of [Ipco]. In any event, the nature of [Ipco's] business did not require any employee. The locations where [Ipco] prepared and kept its accounting books are irrelevant.'

The appeal

20. By letter dated 18 December 2001, the Former Representative gave notice of appeal on behalf of the Appellant, appealing on the grounds that:

'the income from the employment with [Ipco] is not subject to Salaries Tax under Section 8(1) of the IRO. In addition, all the services in connection with the employment with [Ipco] were rendered outside Hong Kong, hence the income is exempt from salaries tax under Section 8(1A)(b)(ii)'.

21. By letter dated 29 January 2002, the assessor gave notice to the Appellant of the Respondent's intention to rely on section 61 of the IRO.

22. At the hearing of the appeal, the Appellant appeared in person and the Respondent was represented by Miss Tse Yuk-yip, senior assessor.

23. The Appellant confirmed his case on oath and was cross-examined by Miss Tse Yuk-yip. Miss Tse Yuk-yip did not call any witness.

24. No authority was cited by the Appellant. Miss Tse Yuk-yip cited:

(a) CIR v Geopfert (1987) 2 HKTC 210

(b) D18/98, IRBRD, vol 13, 180

(c) D77/99, IRBRD, vol 14, 528

(d) D32/94, IRBRD, vol 9, 97

Our decision

Source of employment by Ipco

25. Section 8(1), (1A) and (1B) of the IRO provides that:

'*(1) Salaries tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources –*

(a) any office or employment of profit ...

(1A) For the purposes of this Part, income arising in or derived from Hong Kong from any employment –

(a) ...

(b) excludes income derived from services rendered by a person who –

(i) ...

(ii) renders outside Hong Kong all the services in connection with his employment ...

(1B) In determining whether or not all services are rendered outside Hong Kong for the purposes of subsection (1A) no account shall be taken of services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period for the year of assessment.'

26. In our decision, the location and source of the Appellant's employment by Ipco was in Hong Kong. His entire income from the employment by Ipco is caught by the charge under section 8(1) of the IRO, and there is no provision for apportionment, CIR v Goepfert (1987) 2 HKTC 210 at page 238.

(a) Ipco was a wholly-owned subsidiary of Listco1, a company incorporated and listed in Hong Kong. Ipco was registered under section 333 of the CO, had its

only permanent business office in Hong Kong; prepared and kept its accounting records in Hong Kong; held its annual general meetings in Hong Kong and reported its business functions to the group's offices in Hong Kong.

(b) On the Appellant's own admission, the employment agreements dated 17 March 1993 and 18 August 1995 were signed in Hong Kong. The 17 March 1993 agreement was the most important in that the others were renewals.

(c) We do not believe the Appellant's assertion that the other two agreements (that is, dated 17 January 1995 and 16 January 1997) were signed by the Appellant in Country E and by Ipco in Country D. We do not believe that the two agreements went round Country E and Country D when in fact the two persons who signed on them both worked in Hong Kong at the Office. Nor do we believe the assertion that the Appellant 'indicated his readiness to agree to the agreements when he was not in Hong Kong'.

(d) Instructions to pay the Appellant in Hong Kong dollars were given in Hong Kong to a bank at its office in Hong Kong.

(e) We draw the inference which in our decision is compelling and irresistible that the Appellant's employment by Ipco arose out of his employment by Listco1.

27. What we are concerned with under section 8(1B) are 'visits not exceeding a total of 60 days'. In each of the relevant years of assessment, the Appellant had been in Hong Kong in excess of 60 days.

28. In CIR v So Chak Kwong, Jack 2 HKTC 174, it was held that the words 'not exceeding a total of 60 days' in section 8(1B) qualify the word 'visits' and not the words 'services rendered'. Thus, section 8(1B) is not applicable in this case because the Appellant's 'visits' exceeded 60 days, assuming that his trips to and from Hong Kong were 'visits'.

29. The Appellant claimed that he rendered all the services in connection with his employment by Ipco outside Hong Kong. We reject his claim and find against him on this factual issue.

(a) The Hong Kong solicitors, engaged as the trademark agent, sent faxes to the Appellant in Hong Kong. On the Appellant's own testimony, he received 20 to 30 faxes on a daily basis. We do not believe his assertion that he did not attend to any of them.

(b) Legal actions had been taken in Hong Kong against infringers and Hong Kong was said by the Appellant to be the second largest market. We simply do not believe that the Appellant did not render any service at all in Hong Kong.

(c) The documents referred to in paragraph 17(a) to (c) were addressed to the Appellant in Hong Kong and countersigned by him in Hong Kong. As Ipco had no permanent establishment outside Hong Kong, we believe that as a general rule, persons conducting businesses with Ipco had to contact the Appellant in Hong Kong through the Office, the telephones and faxes there.

Section 61

30. Although the Commissioner did not invoke section 61, Miss Tse Yuk-yip has given ample advance written notice to the Appellant of the Respondent's intention to rely on the provision. We see no reason (and none has been put forward by the Appellant) why we should ignore section 61.

31. Section 61 of the IRO provides that:

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

32. We remind ourselves of the observations made by Lord Diplock, delivering the advice of the Privy Council in Seramco Trustees v Income Tax Commissioner [1977] AC 287 at pages 297 to 298:

> *'It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10(1). Whether it can properly be so described depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.*
>
> *"Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic, that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as*

descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.'

33. Lord Diplock considered whether the impugned transaction was 'unrealistic from a business point of view' (at page 294).

34. In Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441, Cons J (as he then was) considered whether the impugned transaction was 'commercially unrealistic'.

35. In our decision, the employment of the Appellant by Ipco was patently artificial. It was commercially unrealistic from both the Appellant's and Ipco's points of view. Even if the Appellant had, contrary to our decision, succeeded on the source of employment, we would have found against the Appellant under section 61.

(a) The Appellant was the chief financial officer of the listed group and had at some stage been an executive director of Listco1 and Listco2. Ipco was one of the subsidiaries of Listco1 and Listco2. On the Appellant's own admission, Ipco derived all its income from companies in the listed group or from related companies. The commercially unrealistic employment by Ipco can best be seen from a table which Miss Tse Yuk-yip prepared and which we reproduce below.

(b) The agreement dated 17 March 1993 took retrospective effect from 1 June 1991 despite the fact that according to the Appellant, work did not commence until late 1991 or 1992.

(c) The Appellant was employed by Ipco as 'regional manager' but was unable to tell us what the 'region' comprised of.

(d) On entering into the agreement dated 17 March 1993, the Appellant agreed to a 60.2% reduction of his annual salary payable by Listco1 from $784,000 to $312,000 with effect from 1 April 1992. Except with a view to reducing the amount of tax payable by him, we see no reason why the Appellant should or

would have agreed to such a reduction of his salary payable by Listco1 and with retrospective effect.

(e) Hong Kong was Ipco's second largest market and the headquarters of the listed group. It is so commercially unrealistic as to be absurd for the employment contracts to exclude Hong Kong as a place for the Appellant to render his services.

36. We reproduce below the table prepared by Miss Tse Yuk-yip:

	1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**
Income from Listco1 or Listco2	$260,000	$704,050	$1,042,565	$693,924	$740,076
Income from Ipco	$1,076,950	$1,841,091	$2,483,937	$1,786,480	$2,940,784
Total income	$1,336,950	$2,545,141	$3,526,502	$2,480,404	$3,680,860
Percentage of total income from Listco1 or Listco2	19.4%	27.7%	29.6%	27.9%	20.1%
Percentage of total income from Ipco	80.6%	72.3%	70.4%	72.1%	79.9%
Number of days in Hong Kong during the basis period	287	241.5	260	184	257.5
Number of days outside Hong Kong during the basis period	78	123.5	106	181	107.5
Daily rate by Listco1 or Listco2	$905.9	$2,915.3	$4,009.9	$3,771.3	$2,874.1
Daily rate by Ipco	$13,807.1	$14,907.6	$23,433.4	$9,870.1	$27,356.1

Disposition

37. The Appellant has failed on both points. Clearly he has not discharged the onus under section 68(4) of proving that any of the assessments appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessments as confirmed by the Commissioner.

Costs

38. We are of the opinion that this appeal is frivolous and vexatious. Pursuant to section 68(9) of the IRO, we order the Appellant to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.