INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D129/01

Profits tax – whether certain sum could be deducted as 'expense' – onus of proof on appeal rests on the appellant – interposition of different companies and the appellant – the test to be applied – identify any commercial realism between different companies – whether the impugned transaction was 'unrealistic from a business point of view' or 'commercially unrealistic' – any contemporaneous document in support – whether precluded by the Personal Data (Privacy) Ordinance (Chapter 486) ('PD(P)O') from disclosing details of appellant's client(s) – wholly unmeritorious appeal – penalized in costs – section 58(1)(c) and (2) and principle 3 of the PD(P)O – sections 61, 68(4) and 68(9) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Arthur Chan Ka Pui and Vincent Mak Yee Chuen.

Dates of hearing: 30 November and 1 December 2001.
Date of decision: 7 January 2002.

The appellant appealed against a determination of a profits tax assessment for the year of assessment 1998/99 with assessable profits of $290,020.

In the year of assessment 1998/99, the appellant received commission from two insurance companies totaling $435,030. Her case was that, in reliance of an alleged agreement (' the Agreement'), she paid the said sum of $435,030 (' the Expense') to a Company A and this sum should be deducted as an expense. However, based on section 61 of the IRO, the Inland Revenue Department decided that it was not deductible.

Held:

1. The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant (section 68(4)).

2. As regards section 61 of the IRO, the Board reminded itself of the observations made by Lord Diplock in Seramco Trustees v Income Tax Commissioner [1977] AC 287 at pages 297 to 298.

3. Lord Diplock considered whether the impugned transaction was ' unrealistic from a business point of view' .

4. In Commissioner of Inland Revenue v D H Rowe [1977] HKLR 436 at 441, Cons J considered whether the impugned transaction was ' commercially unrealistic' .

5. Upon considering all the evidence, the Board was not satisfied that there was any connection between the payments made by the appellant to Company A totaling $403,900 and the amounts totaling $414,970.82 received by the appellant from InsuranceCo.

6. The Board was not satisfied that the appellant had incurred the Expense, whether in the sum of $435,030 or at all.

7. Further, the Board was not satisfied that even if (contrary to its findings) the appellant had incurred the Expense, any of it was incurred in the production of the profits in respect of which she was chargeable to profits tax. The Board decided that she was not precluded by the PD(P)O from disclosing data about her insurance customers: see section 58(1)(c) and (2) and principle 3 thereof.

8. Further and in any event, the Board was of the view that the Agreement was artificial within the meaning of section 61 and should be disregarded.

9. The Agreement was commercially unrealistic from both Company A's and the appellant's point of view.

10. The Board was not satisfied that the Agreement concerned was a contemporaneous document.

11. The appellant had not discharged the onus under section 68(4) of proving that the assessment appealed against was excessive or incorrect.

12. This appeal was wholly unmeritorious. The Agreement was patently artificial. Pursuant to section 68(9) of the IRO, the Board ordered the appellant to pay a sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.

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

Cases referred to:

Seramco Trustee v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436

Cheung Mei Fan 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 3 August 2001 confirming the profits tax assessment for the year of assessment 1998/99 dated 16 May 2001 with assessable profits of $290,020.

2. In the year of assessment 1998/99, the Appellant received commission from two companies, $433,912 from an insurance company (' InsuranceCo') and $1,118 from an insurance services company, totalling $435,030.

3. The Appellant' s case was that she paid $435,030 (' the Expense') to Company A (' the Company') and that the sum should be deducted as an expense.

4. The assessor and the Commissioner were both of the view that the Expense was not deductible. The Commissioner also relied on section 61 of the IRO.

5. In the absence of any information from the Appellant on any other alleged expense, the assessor estimated that expenses amounted to $145,010 (one third of $435,030) and issued the profits tax assessment with assessable profits at $290,020. By his determination, the Commissioner agreed with the assessor.

6. Miss Cheung Mei-fan who represented the Respondent at the hearing of the appeal undertook on behalf of the Respondent to make consequential amendments to the statement of loss of the Company for the year of assessment 1998/99 in the event of our dismissal of the appeal under section 61 of the IRO.

7. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

8. 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.'*

9. 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.

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

11. 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' .

12. The Appellant relied on an alleged agreement (' the Agreement') alleged to have been signed on 6 February 1998 and made between the Appellant and the Company.

13. The Agreement contained the following terms:

(a) The validity period was from 9 February 1998 to 8 February 2001.

(b) The Company was responsible for providing and introducing insurance customers to the Appellant.

(c) For commission income exceeding $500,001, 40% goes to the Appellant and 60% goes to the Company. When commission income is less than $500,000, the whole goes to the Company, but the Company undertakes to pay the Appellant $3,000 each month.

14. The Appellant called a Mr B to give oral evidence. He claimed to be the beneficial owner of 50% of the shares of the Company. In our assessment, the only truth in his testimony was his assertion of his belief that to a certain extent there might be a tax benefit 「**某一程度上可以係稅務得益**」in that all the expenses might perhaps be juggled 「**所有嗰啲** expenses **或者可以篤晒落去**」.

15. The Appellant also gave evidence herself. In our assessment, she was also not a credible witness and we disbelieve her.

16. We are not satisfied that there is any connection between the payments made by the Appellant to the Company totalling $403,900 and the amounts totalling $414,970.82 received by the Appellant from InsuranceCo.

Payments by Appellant to Company		**Payments by InsuranceCo to Appellant**	
Date	Amount $	Date	Amount $

1-5-1998 9-5-1998	11,000 51,000	8-5-1998	44,086.50
26-6-1998	10,000	8-6-1998	55,101.31
17-7-1998 21-7-1998	40,000 19,000	9-7-1998	28,078.44
6-8-1998 26-8-1998	10,000 26,000	8-8-1998	14,010.36
8-9-1998	23,000	8-9-1998	13,807.96
9-10-1998 13-10-1998 16-10-1998	11,900 36,000 6,000	12-10-1998	36,364.02
6-11-1998 16-11-1998 28-11-1998	12,000 15,000 13,000	9-11-1998	14,490.41
30-12-1998	13,500	8-12-1998	35,797.09
16-1-1999 30-1-1999	8,000 25,000	9-1-1999 23-1-1999	75,941.80 13,618.37
24-2-1999	28,500	9-2-1999 24-2-1999	15,141.68 7,040.76
4-3-1999	15,000	9-3-1999 12-3-1999 24-3-1999	10,726.28 570.74 26,119.73
12-4-1999	30,000	10-4-1999	24,075.37
Total:	403,900	 Add: Savings deducted Total:	414,970.82 18,941.00 433,911.82

17. We are not satisfied that the Appellant had incurred the Expense, whether in the sum of $435,030 or at all.

18. We are also not satisfied that the Appellant had been paid $3,000 each month under the Agreement. The sum of $36,000 received by the Appellant from the Company was reported in the Appellant's tax return as her salary or wages from her employment in her capacity as 'Director', a word written by the Appellant herself in English. The sum was described in the Company's detailed profit and loss account as 'Directors salaries'. The Appellant had been receiving salary as a director and no explanation had been offered why she should cease to receive any director's salary for the year of assessment 1998/99.

19. Further, we are not satisfied that even if (contrary to our findings) the Appellant had incurred the Expense, any of it was incurred in the production of the profits in respect of which she

was chargeable to profits tax. In our decision, she is not precluded by the PD(P)O from disclosing data about her insurance customers, see section 58(1)(c) and (2) and principle 3.

20. It follows that the Expense is not deductible under section 16(1) of the IRO and her appeal must fail.

21. Further and in any event, we are also of the view that the Agreement is artificial within the meaning of section 61 and should be disregarded.

22. The Agreement is commercially unrealistic from the Appellant's point of view. The Agreement is silent on whether the $500,000 limit is a monthly limit, an annual limit or a limit for the three-year period under the agreement. Assuming that it is an annual limit, it seems to be a figure chosen after the year of assessment to cover the profits of $435,030. It is commercially unrealistic because the Agreement contains no requirement on the part of the Company to provide sufficient insurance customers to enable the Appellant to earn commission in excess of $500,000. It is also commercially unrealistic having regard to the following requirements:

(a) Under the letter of appointment by InsuranceCo dated 20 February 1998 appointing the Appellant as a marketing executive, the Appellant was required to produce an annualised first year commission net of lapses of not less than $49,600 within a six-month probation period from February 1998 to August 1998.

(b) As a marketing executive, the Appellant was expected by InsuranceCo to meet an annual production quota of $118,000.

(c) In October 1998, the Appellant was promoted by InsuranceCo to be a unit manager. As a unit manager, the Appellant was expected by InsuranceCo to meet an annual production quota of $220,000. Up to two direct agents under her may be included in computing the annual production figures.

23. The Agreement is also commercially unrealistic from the Company's point of view. With commission up to $500,000, the whole of the commission (less $36,000 each year) goes to the Company. At $500,000, the Company's share would be $500,000 - $36,000 = $464,000. If the Company should introduce more business to the Appellant so that commission exceeds $500,000 but is less than $773,333, the Company's share at 60% of the commission is less than $464,000. This is clearly commercially unrealistic. It is only where commission exceeds $773,333 will the Company's share exceed $464,000.

24. We have assumed that the Agreement was a contemporaneous document when in fact we are not satisfied that it was.

(a) It was alleged to have been signed at the Kowloon office of InsuranceCo on 6 February 1998. We do not consider it probable that the Agreement came into existence **before** there was any documentation of the Appellant's appointment by InsuranceCo. The Appellant's appointment as a marketing executive did not take effect until 9 February 1998 and InsuranceCo's letter of appointment was dated 20 February 1998 and the agent's agreement between InsuranceCo and the Appellant was also dated 20 February 1998.

(b) The Appellant received $20,669 from InsuranceCo for the period from 9 February 1998 to 31 March 1998 but the Company reported no 'Agency Commission' for the year of assessment ended March 1998.

25. For reasons given above, the Appellant has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment as confirmed by the Commissioner.

26. We are of the opinion that this appeal is wholly unmeritorious. The Agreement is patently artificial. 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.