Case No. D13/07

Profit tax – whether assessor had power to make the assessments – service companies – whether commercially unrealistic and artificial – Inland Revenue Ordinance ('IRO') sections 60 & 61.

Panel: Kenneth Kwok Hing Wai SC (chairman), Mark R C Sutherland and David Yip Sai On.

Dates of hearing: 14 and 15 May 2007.
Date of decision: 10 August 2007.

For the 1991/92 – 1994/95 years of assessment, the appellant in BR100/06 (the solicitor) carried on a sole proprietorship practice. For the year of assessment 1995/96, he also carried on a partnership practice with another (the firm). The firm is the appellant in BR99/06.

For these years of assessment, the solicitor and the firm claimed deduction of management fees said to have been incurred and payable to several service companies.

Broadly speaking, the assessor disallowed the deduction of management fees to these three service companies and the Acting Deputy Commissioner of Inland Revenue agreed with the assessor. The assessor considered that the management fees charged in the practice's accounts should only be allowed for deduction to the extent that they reflected those costs directly attributable to the operations of the practice plus an appropriate mark up of 12.5%. The assessor therefore on divers dates raised the following profits tax assessments/additional profits tax assessments in respect of the profits made by the practice.

The solicitor and the firm objected to the profits tax assessment raised on it, claiming that in computing the assessable profits made by the firm, the management fee expenses should be allowed in full. They mainly contented that the assessor had no power to make the subject assessments, and deduction of the management fees should be allowed in full.

Held:

1. For BR100/06 and BR99/06, the Board found that all the subject assessments were issued within six year of the respective years of assessment and within the time limit under section 60. Thus, the assessor clearly had authority to make the assessments.

2. The transaction in this case is the entering into the agreements between the solicitor (and the firm) and the service companies, the carrying out of the agreements and the charging of management fees by the them in computing his profits. The Board found the agreements are commercially unrealistic and artificial, in particular there is no evidence on how the monthly sums were arrived at (Seramco Trustees v ITC; CIR v Howe; Cheung Wah Keung v CIR applied). The Board was of the view that section 61 applies and the transaction shall be disregarded and the solicitor and the firm shall be assessable accordingly. Thus, the whole of the management fees charged shall be disregarded. It is not necessary to examine the expenses incurred by service companies to consider the extent to which any of its expenses should be allowed as deduction for the solicitor and the firm. The Acting Deputy Commissioner erred in being too generous in favour of them.

Both appeals dismissed and costs orders each in the sum of $5,000 imposed.

Cases referred to:

R v Sussex Justice, ex parte McCarthy [1924] 1 KB 256
Ng Yat Chi v Max Share Ltd & another (2005) 8 HKCFAR 1
CIR v Common Empire Limited [2007] 1 HKRLD 679
Nina T H Wang v Commissioner of Inland Revenue [1994] 1 WLR 1286, PC.
Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7
Mok Tsze Fung v Commissioner of Inland Revenue 1 HKTC 166
Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224
All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKRLD 773, CA
Li Tin Sang v Poon Bun Chak & others, unreported, CACV 153 of 2002, 18 November 2002, the Court of Appeal
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 1 HKRLD 172
Seramco Trustees v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436

Taxpayer in person.
Tsui Nin Mei and Tang Hing Kwan for the Commissioner of Inland Revenue.

Decision:

TABLE OF CONTENTS **Paragraphs**

INTRODUCTION

1. From 15 June 1989 to 31 March 1995, a solicitor, the appellant in BR100/06 ('the Solicitor'), carried on a sole proprietorship practice.

2. So far as the 1995/96 year of assessment was concerned, the Solicitor carried on a sole proprietorship practice from 1 April 1995 to 25 February 1996 and from 26 February 1996 to 31 March 1996, he had a salaried 'partner' (the sole proprietorship practice and the 'partnership' practice in the 1995/96 year of assessment are referred to collectively as 'the Firm'). The Firm is the appellant in BR99/06.

3. For the 1991/92 – 1994/95 years of assessment, the Solicitor claimed deduction of management fees said to have been incurred and payable to two service companies ('ServiceCo1' and 'ServiceCo2').

4. For the 1995/96 year of assessment, the Firm claimed deduction of management fees said to have been incurred and payable to ServiceCo1, ServiceCo2 and a third service company ('ServiceCo3').

5. The appellant was married to his wife ['the Wife'] prior to 1991. His three younger brothers and his late father are referred to below as 'Brother1', 'Brother2', 'Brother3' and 'the Father' respectively.

6. Broadly speaking, the assessor disallowed the deduction of management fees to these three service companies and the Acting Deputy Commissioner of Inland Revenue agreed with the assessor.

7. By letters dated 10 February 2007, the Solicitor and the Firm appealed against the Acting Deputy Commissioner's Determinations. The case number assigned to the Solicitor's appeal is BR100/06 and the case number assigned to the Firm's appeal is BR99/06.

THE GROUNDS OF APPEAL

Grounds of appeal in BR100/06

8. The grounds of appeal in BR100/06 read as follows (written exactly as in the original):

> '1. Unless otherwise indicated, references to appendix, paragraph and/or page numbers refer to those in the purported Written Determination and references to section numbers refer to those in the Inland Revenue Ordinance.

2. The Commissioner has no jurisdiction to issue the present assessment as there has been undue delay contrary to common law. Under Section 51C, the taxpayer is only required to maintain its business records for 7 years.

3. The Commissioner has no jurisdiction to issue what is in substance a reassessment.

4. The Commissioner has no jurisdiction to issue the purported Written Determination whether under Section 64 or at all as inter alia, Section 64(4) provides:- "In the event of the Commissioner failing to agree with any person assessed, who has validly objected to an assessment made upon him, the Commissioner shall, within 1 month after his determination of the objection (emphasis added), transmit in writing to the person objecting to the assessment his determination together with the reasons therefore and a statement of facts upon which the determination was arrived at, and such person may appeal therefrom to the Board of Review as provided in Section 66." The purported Written Determination on its face reads:-

"Date of Issue: 27th October 2006
Redirected on 24/11/2006
Redirected on 21/12/2006
By Hand on 11/1/2007"

Without admitting that the purported service is good or valid, Section 64(4) has patently not been followed. Further, the Taxpayer respectfully suggests that the purported service is simply bad in the eyes of the law.

5. The Commissioner is estopped/barred by his letter dated 27/2/2001. The Firm has in its letter dated 9/2/2006 in a clear cut manner informed the Commissioner as regards this position. The Commissioner has not in our view adequately addressed this issue. Moreover, as a result of the said letter, all the records have been destroyed or discarded and in any event could not be located by now. As there is never any qualification or reservation in the said letter, the Commissioner is barred from further pursuing with this exercise.

6. a. The Commissioner seems to be adopting a test which is wrong.

b. Nor does the factual matrix of the present case passed such a test (Paragraph 3(3) at Page 16).

c. In particular, the Commissioner erred in concluding that the arrangements were artificial or fictitious transactions.

d. The Commissioner has never adduced any evidence (admissible or otherwise) that the arrangement between the Firm and the Service Companies was a sham. The word was not even used by the Commissioner.

e. If it is not a sham, then it could not be artificial or fictitious in the eyes of the law.

f. This is not the case where only intangible assets (say goodwill) were involved.

g. Likewise, this is not a case where "advice" was provided by the Service Companies.

h. The present arrangement has been in place since in or about 1989. The Commissioner erred in failing to assess the fact that management fees have been paid since then (Page 1). The Firm paid management fees to [ServiceCo1] which in turn paid rental to the [landlord's] Group in respect of the Firm's office premises at [Property A].

i. It is in subsequent years that the Service Companies began to acquire real properties. At the time of acquisition of the relevant real properties, banks insisted on income proofs of both directors which include those of the printing factory owned by the directors, otherwise they would not approve the mortgage applications based on [the Solicitor's] income. It is commercial reality that the Service Companies have to be used to acquire the real properties.

j. This is not a case of "blatant or contrived tax avoidance arrangements".

7. The Commissioner erred in failing to consider that the more offices of the Firm there were, the more management fees have to be paid. As the market gets more and more competitive, more branch offices have to be opened. Premises were as a matter of fact acquired by the Service Companies and used as branch offices by the Firm. Accordingly, the Commissioner attaches the wrong weight to the fact that management fee was paid by way of "fixed annual fee". The Commissioner also misdirects himself as regards the absence of specified terms of payment for the management fee. (Paragraph (4)(b) on Page 17). The Commissioner never properly addresses his mind to the fact that the management fees for [ServiceCo2] smaller than the management fees for [ServiceCo1] because services provided by [ServiceCo2] are narrower in

scope than that of [ServiceCo1]. This is not a case where real properties owned by the Firm were transferred to the Service Companies and management fees were paid by the Firm to the Service Companies. The Service Companies in this case in fact have to pay mortgage installments. The Firm accordingly has to pay management fees to the Services Companies, so that installments or expenses can be paid.

8. Further, the real properties being acquired by the Service Companies would in a sense be sheltered from professional malpractice or negligence claim. They are accordingly based on real commercial consideration(s). Further the present arrangement was analogous to leasing of photocopiers, office machines and decoration expenses.

9. The Commissioner has also misdirected himself and erred as a matter of law that there is no evidence to substantiate that the management fees were ever paid. On the contrary, there are amply evidences that payments were paid to various accounts of the Service Companies "on and as the occasions arise" basis. Further, there is no rule of law whether in revenue law or law of restitution or other areas that money must be paid physically to one party but not to its or his directions. How the management fees were paid could not and should not be the determining or the sole determining factor in deciding whether the arrangements were artificial or fictitious transactions. Otherwise, when audits are being carried out, there should be strict law or regulation or guidelines mandating auditors to disallow expenses or payments which are not paid out directly from the bank accounts of the company concerned.

10. The Commissioner erred in adopting what is in essence the "12.5%" mark-up guideline in DIPN No.24 which was issued in August 1995 subsequent to the subject years of assessment. (Paragraph (14) on page 11) and which should not and could not be applied retrospectively. We do not contend that DIPN No.24 changed the law. Rather, we contend that "It was totally unfair, unjust and misconceived." (Paragraph (14)(a) on page 11).

11. The Commissioner erred in adopting a double standard (it is discriminative) as regards [ServiceCo4] on the one hand and [ServiceCo1] and [ServiceCo2] on the other hand (Paragraph (12)(f) on Page 10): – the Commissioner apparently accepted the consultancy fees paid to [ServiceCo4] was bona fide whereas it is not so in this case. It is submitted that there is no difference between the two (Paragraph (18) on Page 13). Paragraph (18) on Page 13 appears to be suggesting a reassessment which the Commissioner has no jurisdiction, in our respectful submission (Please see Paragraph 3 hereinabove). We suggest that such differential treatment constitutes a breach of Articles 1

and 22 respectively of Section 8 of the Bill of Rights Ordinance. Accordingly, the Commissioner's stance as regards the management fee disallowed is wrong and unsustainable.

12. The Commissioner again took into account irrelevant factors, i.e. the date of birth or age, academic and professional qualification and working experience of [Brother2, Brother3 and the Father] (Paragraph (16(a)(v) on Page 13). The Taxpayer has not provided the same only because it is time consuming to retrieve the records, in particular as [the Father] has already passed away. As they worked as clerks for the Firm and not as high level personnel in the Firm, the information in respect of their professional qualification and working experience sought by the Commissioner would appear to be irrelevant.

13. As regards paragraph (4)(c) on Page 17, the Taxpayer has informed the Commissioner in his letter dated 1st August 2006 that Property F was provided to [a named person, "the named person"] as his residence in return for carrying out refurbishing works for the Firm from time to time at its request. Contrary to the Commissioner's assertion in Paragraph (4) (c) on Page 17, copies of some of the old invoices from [the named person] to our Firm as examples of the types of refurbishing works he did has hitherto been enclosed for the Commissioner's reference.

14. The Commissioner erred in taking into account the sale of [Property E] for this assessment. The sale is accordingly not relevant to the present issues. Whether it is a product of speculation or whether it is a long term investment does not seem to be able to shed any light in the present context.

15. The Commissioner wrongly addresses his mind to the "fact" that the Firm and the Service Companies were closely connected. The fact is that [the Solicitor] is not the sole director of the Service Companies.

16. The Commissioner has omitted to take into consideration or inadequately take into consideration or on the wrong basis/in the wrong perspective the business nature of [ServiceCo1].

17. The Commissioner misdirected himself as regards the service agreements which have been provided to him at his request. The chart setting out the details of the service agreements in Paragraph (8) (c) on Page 6 is misleading in that the new agreements do not supersede the old one. The new ones are additional/supplemental agreements necessitated by the additional provision of office premises or staff quarters by [ServiceCo1] to the Firm. Further, the Commissioner has misdirected himself as regards the accounts of the Firm, e.g.

telephone and paging, salaries, stationery, cleaning, traffic and traveling, postage, printing, messing, insurance, repair and maintenance (Paragraph (4) (b) on Page 17). There is no evidence that those accounts are duplication of those appearing in the audited accounts of [ServiceCo1]. [ServiceCo1] has its own business and is not in existence for the sole purpose of serving the Firm. Further in the beginning of 1992, as the Firm is expanding, both [ServiceCo1] and the Firm agree that for ease of keeping separate their respective office outgoing expenses, the Firm bears its own office outgoing expenses.'

Grounds of appeal in BR99/06

9. The grounds of appeal in BR99/06 read as follows (written exactly as in the original):

'1. Unless otherwise indicated, references to appendix, paragraph and/or page numbers refer to those in the purported Written Determination and references to section numbers refer to those in the Inland Revenue Ordinance.

2. The Commissioner has no jurisdiction to issue the present assessment as there has been undue delay contrary to common law. Under Section 51C, the taxpayer is only required to maintain its business records for 7 years.

3. The Commissioner has no jurisdiction to issue what is in substance a reassessment.

4. The Commissioner has no jurisdiction to issue the purported Written Determination whether under Section 64 or at all as inter alia, Section 64(4) provides:- "In the event of the Commissioner failing to agree with any person assessed, who has validly objected to an assessment made upon him, the Commissioner shall, <u>within 1 month after his determination of the objection</u> (emphasis added), transmit in writing to the person objecting to the assessment his determination together with the reasons therefore and a statement of facts upon which the determination was arrived at, and such person may appeal therefrom to the Board of Review as provided in Section 66." The purported Written Determination on its face reads:-

"Date of Issue: 27th October 2006
Redirected on 24/11/2006
Redirected on 21/12/2006
By Hand on 11/1/2007"

Without admitting that the purported service is good or valid, Section 64(4) has patently not been followed. Further, the Taxpayer respectfully suggests that the purported service is simply bad in the eyes of the law.

5. The Commissioner is estopped/barred by his letter dated 27/2/2001 (Appendix 10.1 and 10.2). The Firm has in its letter dated 9/2/2006 in a clear cut manner informed the Commissioner as regards this position. The Commissioner has not in our view adequately addressed this issue. Moreover, as a result of the said letter (Appendix 10.1), all the records have been destroyed or discarded and in any event could not be located by now. As there is never any qualification or reservation in the said letter, the Commissioner is barred from further pursuing with this exercise.

6. a. The Commissioner seems to be adopting a test which is wrong.

b. Nor does the factual matrix of the present case passed such a test (Paragraph 3(2) at Page 12).

c. In particular, the Commissioner erred in concluding that the arrangements were artificial or fictitious transactions.

d. The Commissioner has never adduced any evidence (admissible or otherwise) that the arrangement between the Firm and the Service Companies was a sham. The word was not even used by the Commissioner.

e. If it is not a sham, then it could not be artificial or fictitious in the eyes of the law.

f. This is not the case where only intangible assets (say goodwill) were involved.

g. Likewise, this is not a case where "advice" was provided by the Service Companies.

h. The present arrangement has been in place since in or about 1989. The Commissioner erred in failing to assess the fact that management fees has been paid since then (Page 7). The Firm paid management fees to [ServiceCo1] which in turn paid rental to the [the landlord's] Group in respect of the Firm's office premises at [Property A].

i. It is in subsequent years that the Service Companies began to acquire real properties. At the time of acquisition of the relevant real properties, banks insisted on income proofs of both directors which include those of the printing factory owned by the directors, otherwise they would not approve the mortgage applications based on [the Solicitor' s] income. It is commercial reality that the Service Companies have to be used to acquire the real properties.

j. This is not a case of "blatant or contrived tax avoidance arrangements".

7. The Commissioner erred in failing to consider that the more offices of the Firm there were, the more management fees have to be paid. As the market gets more and more competitive, more branch offices have to be opened. Premises were as a matter of fact acquired by the Service Companies and used as branch offices by the Firm. Accordingly, the Commissioner attaches the wrong weight to the fact that management fee was paid by way of "fixed annual fee". The Commissioner also misdirects himself as regards the absence of specified terms of payment for the management fee. (Paragraph 3(4)(b) on Page 13). The Commissioner never properly addresses his mind to the fact that the management fees for [ServiceCo2] are smaller than the management fees for [ServiceCo1] because services provided by [ServiceCo2] are narrower in scope than that of [ServiceCo1]. This is not a case where real properties owned by the Firm were transferred to the Service Companies and management fees were paid by the Firm to the Service Companies. The Service Companies in this case in fact have to pay mortgage installments. The Firm accordingly has to pay management fees to the Services Companies, so that installments or expenses can be paid.

8. Further, the real properties being acquired by the Service Companies would in a sense be sheltered from professional malpractice or negligence claim. They are accordingly based on real commercial consideration(s). Further the present arrangement was analogous to leasing of photocopiers, office machines and decoration expenses.

9. The Commissioner has also misdirected himself and erred as a matter of law that there is no evidence to substantiate that the management fees were ever paid. On the contrary, there are amply evidences that payments were paid to various accounts of the Service Companies "on and as the occasions arise" basis. Further, there is no rule of law whether in revenue law or law of restitution or other areas that money must be paid physically to one party but not to its or his directions. How the management fees were paid could not and should not be the determining or the sole determining factor in deciding

whether the arrangements were artificial or fictitious transactions. Otherwise, when audits are being carried out, there should be strict law or regulation or guidelines mandating auditors to disallow expenses or payments which are not paid out directly from the bank accounts of the company concerned.

10. The Commissioner has wrongly addressed his mind under the reasons set out in paragraph (7) on page 14 in suggesting that the taxpayer argues that DIPN No.24 could not be applied retrospectively. We do not contend that DIPN No.24 changed the law. Rather, we contend that "It was totally unfair, unjust and misconceived." (Paragraph (15)(a) on page 9).

11. The Commissioner erred in commenting and suggesting that [the Solicitor] and [the Wife] have travelled those trips together (Paragraph (13)(c) on Page 8). During the year 95/96, [the Solicitor] and [the Wife] have not made all of the trips together. In fact, depending on work schedule and work load, [the Solicitor] sometimes had to travel alone, i.e. to [a named city] and to [another named city]. (Paragraph (17)(C) on Page 11). The two specific trips as mentioned in this point were undertaken by [the Solicitor] only for business.

12. The Commissioner erred in adopting a double standard (it is discriminative) as regards [ServiceCo4] on the one hand and [ServiceCo1] and [ServiceCo2] on the other hand (Paragraph (13)(d) on Page 8): – the Commissioner apparently accepted the consultancy fee of HK$280,160.00 paid to [ServiceCo4] was bona fide whereas it is not so in this case. It is submitted that there is no difference between the two (Paragraph 19 on Page 11). The comment of the Assessor (Commissioner) is simply incoherent and inherently inconsistent and could not be understood properly. Further, Paragraph 19 on page 11 is contradictory to Paragraph 14 on Page 9. Paragraph 19 appears to be suggesting a reassessment which the Commissioner has no jurisdiction, in our respectful submission (Please see Paragraph 3 hereinabove). We suggest that such differential treatment constitutes a breach of Articles 1 and 22 respectively of Section 8 of the Bill of Rights Ordinance. Accordingly, the Commissioner' s stance as regards the management fee disallowed is wrong and unsustainable.

13. The Commissioner again took into account irrelevant factors in that Paragraph (17)(a)(v) on Page 10 contains a gross mistake in that [Brother2] data was never asked. To that extent the reference to [Brother2] was irrelevant, ungrounded and inapposite. On the other hand, the relevant information of [Brother1] has been provided as requested by the Commissioner (Paragraph 1 of Appendix 11). The Commissioner failed to consider the professional

marketing qualification of [Brother1] and the fact that he through [ServiceCo1] provides advice to the Firm on marketing of legal services.

14. As regards paragraph (18) on Page 11 of the Determination, the subject quarters are provided to the employees on either need basis or as holiday house, not as quarters of a permanent or fixed nature. They are comparatively low or average quality housing. The [Property F] property is a 50 year old property. If they were to be reflected in the return by applying the 10% rule (which applicability is not admitted), they would constitute a very small amount. Those quarters' values should not affect the situation at all. Accordingly, they were not included in the employees' returns. The reference to the same and the absence of the same from the employees' returns was simply insignificant (Paragraph 3(4)(c) at Page 13).

15. The Commissioner erred in taking into account the sale of [Property E] for this assessment. The sale is accordingly not relevant to the present issues. Whether it is a product of speculation or whether it is a long term investment does not seem to be able to shed any light in the present context.

16. The majority of comments of the Commissioner did not relate to the year of assessment of 1995/1996. The Commissioner seems to have adopted the approach that issues or facts outside the assessment year 95/96 would be ignored if they are beneficial to the Taxpayer' s case and included if they are malignant to the Taxpayer' s case. At page 6 of the draft Statement of Facts, the allegations therein are totally irrelevant to the present assessment year. The Commissioner has accordingly taken into account grossly irrelevant factors.

17. The Commissioner wrongly addresses his mind to the "fact" that the Firm and the Service Companies were closely connected. The fact is that [the Solicitor] is not the sole director of the Service Companies. Further, [the Solicitor] is not the sole proprietor of the Firm throughout the whole of the assessment year.

18. The Commissioner has misdirected himself as regard the "discrepancy" between the management fee income in the financial statements of [ServiceCo2] and the amount stated in the service agreement entered between the Firm and [ServiceCo2]. The discrepancy might have been due to the fact that the bookkeeping of the accounts of the Firm and the Service Companies was handled by different persons. Such discrepancy was never drawn to our attention until more than 10 years later by the Commissioner whether deliberate or otherwise. As a result, the Taxpayer and the relevant Service Company were prevented from taking appropriate measure to amend the accounts.

19. The Commissioner has omitted to take into consideration or inadequately take into consideration or on the wrong basis/in the wrong perspective the business nature of [ServiceCo1]. (Page 10 of the draft Statement of Facts).

20. The Commissioner has wrongly failed to tender the draft Statement of Facts to us in the light of our reservation of rights and remedies vide our letter dated 1/8/2006 (Appendix 11).'

PRELIMINARY MATTERS RAISED BY THE APPELLANTS

Consolidation of the appeals and composition of the hearing panel

10. As some common question of law or fact arises in both appeals and the rights to deduction claimed therein are in respect of or arise out of the same transaction or series of transactions, it appeared to the Board of Review ('the Board') that it might be appropriate to have the two appeals consolidated and heard at the same time, compare Order 4 rule 9 of The Rules of the High Court, Chapter 4, which apply to High Court proceedings.

11. The Solicitor and the Firm (collectively 'the appellants') were consulted. The appellants responded by letter dated 22 March 2007 as follows (written exactly as in the original):

'Re: 1) NOTICE OF OBJECTION DATED 7th April 2000

AGAINST PROFITS TAX ASSESSMENT FOR THE YEAR OF ASSESSMENT 1995/96

2) NOTICES OF OBJECTION DATED 2 APRIL 1998, 28 APRIL 1999 AND 7 APRIL 2000 AGAINST ADDITIONAL PROFITS TAX ASSESSMENTS FOR THE YEARS OF ASSESSMENT 1991/92 AND 1992/93 AND PROFITS TAX ASSESSMENTS FOR THE YEARS OF ASSESSMENT 1993/94 AND 1994/95

We ... should be obliged if you would kindly fix separate hearing dates for the captioned matters for the following reasons:-

1. The constitution of our Firm during the relevant years are not entirely the same;

2. It is important for the Board of Review to rule on the effect of the letter from the Commissioner of Inland Revenue dated 27/2/2001

before the Board of Review hears the appeal in respect of the Notices of Objection for the previous years. Further, there may be consequences for these years' assessment accordingly depending on the Board of Review's ruling on this.

Accordingly, we would respectfully ask that a hearing date for the appeal in respect of the 1st matter be fixed before the hearing date for the appeal in respect of the 2nd matter as listed in the caption.'

12. By letter dated 23 March 2007, the Clerk to the Board informed the appellants as follows:

'I refer to your letter dated 22 March 2007. Please quote our reference B/R99/06 and B/R 100/06 in all your future correspondence with us.

I have scheduled BR100/06 (on 1991/92 to 1994/95 years of assessment) to be heard on 14 and 15 May 2007 and BR99/06 (on 1995/96 year of assessment) to be heard on 16 and 17 May 2007. Both appeals will be heard by the same panel. Formal notices of hearing will be issued at a later stage.

Any submission on the need to rule on any matter as a preliminary point should be made to the hearing panel at the hearing of the relevant appeal.'

13. The appellants responded by letter dated 27 March 2007, without quoting the Board's reference and stating that (written exactly as in the original):

'…

We are surprised that the hearing (on 1991/92 to 1994/95 years of assessment) was fixed before the hearing (on 1995/96 year of assessment) notwithstanding our request in our letter dated 23rd March 2007. The reason for such request is simply that if the ruling on the effect of the letter from the Commissioner of Inland Revenue dated 27/2/200 is in our favour, it would, in our view, enhance our chance of success in the appeal hearing in respect of previous years of assessment. We take objection that you are depriving us the chance or making it difficult for us to advance or argue our appeal in the order as requested. In the interest of justice and fairness, we should be obliged if you would kindly re-fix the abovesaid hearings.

In any event, in order that justice be seen to be done, we would respectfully apply for Mr. Kwok to disqualify himself in this case as our senior partner [the Solicitor] has acted against one of his clients in a Landlord and Tenant case before [a named District Court Judge] in January 1984 in Victoria District Court. Mr. Kwok was instructed

by [a named solicitor] of [a named firm] (then). The Plaintiff in that case was the Landlord who was a surveyor. Our senior partner acted for the Defendant who was the Tenant in that case.

Meanwhile we reserve all our rights and remedies.

Thank you for your kind attention.'

14. By letter dated 2 April 2007, the Clerk to the Board wrote to the appellants as follows:

' I refer to your letter dated 27 March 2007.

As stated in my letter dated 23 March 2007, any submission on the need to rule on any matter as a preliminary point should be made to the hearing panel at the hearing of the relevant appeal. This includes any application which may be made to as to the composition of the hearing panel.'

First preliminary matter raised by the appellants – application to adjourn

15. On 11 May 2007, the Solicitor furnished the Clerk' s Office with a copy of his written 'Skeleton Submission' and a copy of the following authorities for BR100/06:

' 1. Inland Revenue Board of Review Decisions

a. BR23/75

b. D11/91

c. D61/91

d. D133/98

e. D17/99

f. D19/99

g. D57/99

h. D142/99

i. D53/00

j. D142/01

2. Encyclopaedia of Hong Kong Taxation Vol. 3: Issue II pp. 905 – 955

3. Hong Kong Tax Law, 4th Edition, pp. 357 – 364

4. Hong Kong Taxation Law and Practice 2005-06 Edition, pp. 320 – 325, 564

5. Hong Kong Bill of Rights Ordinance, Cap. 383, Section 8'

16. There was no indication before the hearing of the appeal commenced on 14 May 2007 that the Solicitor was said to be sick.

17. At the hearing on 14 May 2007, the Solicitor turned up with the Wife who was also a practising solicitor. The respondent was represented by Ms Tsui Nin-mei.

18. The Solicitor raised two preliminary matters at the beginning of the hearing in BR100/06. The first was an application to adjourn and the second was an application to ask the chairman of the hearing panel to disqualify himself.

19. On the application to adjourn, the Solicitor produced two documents in support of his application. The first was a receipt from a doctor dated 11 May 2007 acknowledging receipt of $260 and stating that the diagnosis was 'URTI'. The second was a note from the same doctor dated 11 May 2007 stating that:

' To whom it may concern

Re: [the Solicitor] M/Ad

The above named was seen on 7/5/07 and 11/5/07 for upper respiratory tract infection with severe cough. He has been treated with medicine including antibiotics.'

20. The Solicitor claimed that he had been suffering from influenza over the past two weeks and that the medicine made him extremely drowsy and dizzy. He went on to allege that the Wife also 'gets influenza'. In answer to the question whether there was any medical evidence in respect of the Wife, he said that there was no medical evidence and that she had yet to seek medication consultation. After raising the second preliminary matter (see paragraph 21 below), he added that:

' [The Solicitor]: ... I must apologise for not being able to take you further into the area because over the last few weeks it has been a

difficult time for me. Whenever I took the medicine I feel drowsy, etc, and I have to run the office as well.

CHAIRMAN: So you have been running your office in the meantime?

[The Solicitor]: Yes, of course, I have to attend the office.'

In reply to the submission of Ms Tsui Nin-mei on the first two preliminary matters, the Solicitor added that:

' [The Solicitor]: ... Just in case I have unconsciously misled the board, when I said I attended the office I was still drowsy. Whenever I take this medicine I simply feel drowsy. But, of course I have to sign documents now and then and as I wake up of course they pass me documents to sign. That is what I meant by running the office. In the same period of course I did not attend court mainly.'

In answer to the questions on the length of adjournment asked for and what he meant by 'mainly', he said that:

' [The Solicitor]: I don' t want to make an unduly optimistic estimate. I gather I need one more consultation with the doctor in this aspect, in respect of the influenza, and I think, with the medication, I believe I would be able to recover, say, in two weeks time, but of course that is my estimate. To that extent, I am asking in fact for the case to be refixed. Last time, the unenviable position was that it was not fixed in accordance with the parties' diaries and hence caused a lot of difficulties. We are still practising and we will not abscond, so there is no reason why that could not be done in consultation with the parties' diaries.

CHAIRMAN: You say you did not attend court "mainly". What do you mean by "mainly"?

[The Solicitor]: By now I could not recall exactly but –

CHAIRMAN: I think that is what you said just now.

[The Solicitor]: I mean I could not recall whether throughout the whole 14 days or 15 days I have not attended even once by now, but mainly I was staying in the office.

MR SUTHERLAND: You don't remember if you were in court in the last two weeks?

[The Solicitor]: I think probably I have been in court once, but I can't be sure. If I did appear at all, in any case at all, it must be a short simple duty lawyer case or something like that. Apart from that, I have no court attendance at all throughout the whole period.

MR SUTHERLAND: Your clients would come and see you at your office, would they?

[The Solicitor]: Of course they would come, but I didn't see them. Mainly it is my partner who did all that consultation work.'

Second preliminary matter raised by the appellants – application to disqualify the panel Chairman

21. On the second preliminary matter, the Solicitor said:

' [The Solicitor]: The second application is, as I have corresponded with the Board of Review hitherto, I would respectfully ask you, sir, to disqualify yourself as indicated in my letter. We have written on 27 March 2007 to the clerk of the Board of Review. I have a receipt chop of the Board of Review dated 30 March.

[The Solicitor read the second paragraph of the passage quoted in paragraph 13 above.]

Sir, that being the case, I think in order that justice be seen to be done it would be in the interests of justice that you disqualify yourself. Justice must not only be done but it must manifestly and undoubtedly be seen to be done and I think that is common ground, R v Sussex Justices ex parte McCarthy.

CHAIRMAN: Anything else?

[The Solicitor]: Not at this stage.

CHAIRMAN: Do you wish to cite any authority on the second application as to the criteria for disqualifying oneself or recusing oneself?

[The Solicitor]: I think R v Sussex Justices ex parte McCarthy is already sufficient. That was the classic case. In this case, justice must not only be done but must manifestly and undoubtedly be seen to be done.

I must apologise for not being able to take you further into the area because over the last few weeks it has been a difficult time for me. Whenever I took the medicine I feel drowsy, etc, and I have to run the office as well.'

22. That was all that the Solicitor said on the second preliminary matter.

23. Ms Tsui Nin-mei said she did not think it should be an issue of conflict of interest for the panel chairman to continue to chair the hearing. She did not cite any authority on the second preliminary matter.

The Board's decision on the first two preliminary matters

24. After a short adjournment, the chairman announced that:

'On the application to adjourn the hearing on what I will say in brief are health grounds, we are not persuaded that the appellant has made out a case for adjournment and, in the exercise of our discretion, we decline to adjourn on that ground.

On the application for me to recuse myself, on the basis of the material provided by the appellant, I see no reason to do so, in accordance with the principles which are laid down by the Court of Final Appeal. The board is unanimous on this point as well. We will give our reasons in writing at a later stage.'

25. Our reasons follow.

Reasons for declining to grant an adjournment

26. Significantly, there was no mention of sick leave in the doctor's note. If the Solicitor was sufficiently unwell, the doctor should and would have granted sick leave.

27. We observed the Solicitor and the Wife carefully in the course of the hearing on the first two preliminary matters raised by the Solicitor. Despite his claim that he had not taken any of the prescribed medicine on the first day of hearing and the day before, the Solicitor's voice was clear and audible and there was no coughing. Both were alert and the Solicitor's presentation and submission made as much, or as little, sense as he did when he wrote his grounds of appeal, his correspondence with the Clerk and his correspondence with the Revenue.

28. We attach no weight to the assertion that the Wife was sick. She had not sought medical advice/treatment and there was no medical evidence in support of the assertion.

29. The Solicitor was less than candid and forthcoming in his application to adjourn. His submission and replies to our questions were vague and evasive. He volunteered the information that he had been running the office and tried to resile from it later. If he were really ill, he should have rested at home instead of returning to his office(s) to sleep or doze off as he claimed he did. More importantly, he was sufficiently well to attend at least one court hearing during the period of alleged sickness. If he were really unwell, he should have rested at home and should not have put his clients' freedom and liberty at risk by attending the Magistracy.

30. We were not satisfied that the Solicitor had made out a case for adjournment and, in the exercise of our discretion, declined to do so.

Reasons for the panel chairman not disqualifying himself

31. The panel chairman had no recollection of the case mentioned by the Solicitor and no recollection if he had been involved in that case. The panel chairman proceeded on the footing of what the Solicitor wrote and said.

32. The Solicitor did not give the citation of the case he mentioned. Nor did he produce a copy of the judgment. If he meant to refer to R v Sussex Justice, ex parte McCarthy [1924] 1 KB 256, the facts of that case bore no resemblance to this case at all. We need go no further than quoting from the headnote which reads as follows:

> '*Arising out of a collision between a motor vehicle belonging to the applicant and one belonging to W., a summons was taken out by the police against the applicant for having driven his motor vehicle in a manner dangerous to the public. At the hearing of the summons the acting clerk to the justices was a member of the firm of solicitors who were acting for W. in a claim for damages against the applicant for injuries received in the collision. At the conclusion of the evidence the justices retired to consider their decision, the acting clerk retiring with them in case they should desire to be advised on any point of law. The justices convicted the applicant, and it was stated on affidavit that they*

> *came to that conclusion without consulting the acting clerk, who in fact abstained from referring to the case:-*
>
> *Held, that the conviction must be quashed, as it was improper for the acting clerk, having regard to his firm's relation to the case, to be present with the justices when they were considering their decision.'*

33. In Ng Yat Chi v Max Share Ltd & another (2005) 8 HKCFAR 1 at paragraph 122, Ribeiro PJ said the test for disqualification is:

> '*whether the circumstances are such as would lead a reasonable, fair-minded and well-informed observer to conclude that that there is a real possibility that the judge would be biased in dealing with the matter: see Deacons v White & Case Ltd Liability Partnership (2003) 6 HKCFAR 322; and Financial Secretary v Wong (2003) 6 HKCFAR 476 at pp.496-497, §48'.*

34. The mere fact that about 23 years ago the panel chairman represented one party in an action against an opponent represented by the Solicitor could not possibly and would not lead a reasonable, fair-minded and well-informed observer to conclude that there was a real possibility that the panel chairman would be biased in dealing with this appeal and with BR99/06.

35. Applying the test laid down by the Court of Final Appeal, the panel chairman declined to disqualify himself. The other panel members agreed for the same reasons.

Third preliminary matter raised by the appellants– application to adjourn BR100/06 until after the result of appeal BR99/06 was known

36. After we had announced our decision on the first two preliminary matters raised by the appellants, the Solicitor raised the third preliminary matter and this was how we dealt with it:

> ' [The Solicitor]: ... we were asking for the 1995/96 matter to be heard first, so that, if need be, the matter could be taken further, without any further ado, before the other matters are dealt with at all. We thought there was some bearing on the ruling in that case in any event. So may I again apply for that case to be heard before the case No. 100?
>
> …
>
> CHAIRMAN: Is there any argument which you may have on the effect of this letter? This is actually not a letter, this document at page [B1] 198. Is there anything to prevent you from

raising the same argument in this appeal? You wish to have separate hearings so –

[The Solicitor]: I don't really see how I could raise this issue in this present appeal.

CHAIRMAN: If you can't raise this issue in this appeal, why should we adjourn the case? Either this issue affects the outcome of your appeal in this case, in which event the question is, is there any good reason why you don't raise the argument here, or if it doesn't affect this case, then this is an irrelevant matter. Make up your mind what you are trying to say.

[The Solicitor]: A moment of indulgence. Sir, as I have said earlier, I have not been able to do research in this area properly. That being the case, I do need some time. If you are not with me on the adjournment as such, then maybe some indulgence would be granted to us to consider these various issues and dig out authorities.

CHAIRMAN: When were you told the hearing dates?

[The Solicitor]: According to the file, it should be 9 May 2007.

CHAIRMAN: It can't be 9 May 2007.

[The Solicitor]: A moment of indulgence. 2 April 2007.

CHAIRMAN: 2 April?

[The Solicitor]: 27 March 2007.

CHAIRMAN: So you were told of these appeal hearing dates on 27 March?

[The Solicitor]: According to the file, yes.

CHAIRMAN: [The Solicitor], what we propose to do is to hear your submission, if you wish to make any, on the relevance, if any, of this letter, as well as your appeal on the merits and give our decision in writing after hearing both parties on this matter.

> We are going to have a short break before we start hearing this matter. We are not going to adjourn for you to prepare your case. You have been told before April of the hearing dates. We will take the morning break ...'

37. In the event, the Solicitor made no submission at any time during the rest of the hearing in BR100/06 on the relevance of the document dated 27 February 2001.

THE APPEAL HEARINGS

Appeal hearing in BR100/06

38. The respondent furnished us with a bundle of the following authorities, item 16 of which was supplied on our request:

1. Inland Revenue Ordinance (Chapter 112)
   - (a) section 16(1)
   - (b) section 17
   - (c) sections 51C & 51D
   - (d) section 61
   - (e) section 64
   - (f) section 68
   - (g) Schedule 5
   - (h) Inland Revenue Rule 2A
2. Seramco Trustees v Income Tax Commissioner [1977] AC 287
3. Commissioner of Inland Revenue v D H Howe [1977] HKLR 436
4. Cheung Wah Keung v CIR [2002] 3 HKLRD 773
5. So Kai Tong v CIR [2004] 2 HKLRD 416

6. D44/92, IRBRD, vol 7, 324

7. D110/98, IRBRD, vol 13, 553

8. D94/99, IRBRD, vol 14, 603

9. D107/00, IRBRD, vol 15, 923

10. D56/01, IRBRD, vol 16, 480

11. Extramoney Limited v CIR [1997] HKLRD 387

12. Interasia Bag Manufacturers Limited v CIR [2004] 3 HKLRD 881

13. CIR v The Hong Kong Bottlers Ltd [1970] 1 HKTC 497

14. Wang v CIR [1994] STC 753

15. CIR v Common Empire Ltd [2007] 1 HKLRD 679

16. Commissioner of Inland Revenue v Nina T H Wang [1993] HKLR 7 (CA)

39. The Solicitor furnished us with a copy of the authorities referred to in paragraph 15 above.

40. The Solicitor called the Wife to give evidence. Ms Tsui Nin-mei did not adduce any oral testimony.

41. After the Solicitor and the respondent had closed their respective cases on 14 May 2007, the hearing was adjourned to the following day at the Solicitor' s request.

42. On 15 May 2007, the Solicitor told us about the extent of his agreement with the facts in paragraph 1 of the Determination in BR100/06.

43. He gave us a copy of his 'Written Submission' on both BR100/06 and BR99/06. In respect of paragraph 3 under the hearing of 'Substantive' which was the only paragraph dealing with the document dated 27 February 2001, he said that:

> ' Sir, may I come to the next point at paragraph 3, a letter from the CIR dated – paragraph 3 relates to 99, so I will leave it till the next time, sir.'

Appeal hearing in BR99/06

44. The hearing commenced on 16 May 2007.

45. The respondent furnished us with a bundle of the following authorities:

1. Inland Revenue Ordinance (Chapter 112)
    (a) section 16(1)
    (b) section 17
    (c) sections 22 & 22A
    (d) sections 51C & 51D
    (e) section 61
    (f) section 63
    (g) section 64
    (h) section 68
    (i) section 70
    (j) Schedule 5
    (k) Inland Revenue Rule 2A
2. Seramco Trustees v Income Tax Commissioner [1977] AC 287
3. Commissioner of Inland Revenue v D H Howe [1977] HKLR 436
4. Cheung Wah Keung v CIR [2002] 3 HKLRD 773
5. So Kai Tong v CIR [2004] 2 HKLRD 416
6. D44/92, IRBRD, vol 7, 324
7. D110/98, IRBRD, vol 13, 553

8. D94/99, IRBRD, vol 14, 603

9. D107/00, IRBRD, vol 15, 923

10. D56/01, IRBRD, vol 16, 480

11. CIR v Chan Tin-Chu [1966] 1 HKTC 284

12. Extramoney Limited v CIR [1997] HKLRD 387

13. Hong Kong Flour Mills Ltd v CIR [2002] 2 HKLRD 121

14. Interasia Bag Manufacturers Limited v CIR [2004] 3 HKLRD 881

15. CIR v Common Empire Ltd [2007] 1 HKLRD 679

16. CIR v The Hong Kong Bottlers Ltd [1970] 1 HKTC 497

17. Wang v CIR [1994] STC 753

46. Neither the Solicitor nor the Firm furnished us with any authority in BR99/06 apart from the authorities listed in paragraph 15 above.

47. The Solicitor told us about the extent of his agreement with the facts in paragraph 1 of the Determination in BR99/06.

48. Both parties agreed to treat the oral evidence in BR100/06 as given in BR99/06. Neither party adduced any further oral evidence.

49. The parties also agreed to adopt their respective submissions made in BR100/06. Further submissions were made in respect of BR99/06.

THE SOLICITOR' S APPEAL IN BR100/06

Agreed facts in BR100/06

50. This is an appeal against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 27 October 2006 whereby:

(a) Additional profits tax assessment for the year of assessment 1991/92 under charge number 2-5014905-92-3, dated 31 March 1998, showing additional

assessable profits of $1,045,269 with tax payable thereon of $156,791 was increased to additional assessable profits of $1,856,662 with additional tax payable thereon of $278,499.

(b) Additional profits tax assessment for the year of assessment 1992/93 under charge number 2-5022713-93-0, dated 29 March 1999, showing additional assessable profits of $563,188 with tax payable thereon of $84,478 was increased to additional assessable profits of $1,862,100 with additional tax payable thereon of $279,315.

(c) Profits tax assessment for the year of assessment 1993/94 under charge number 3-2934242-94-8, dated 31 March 2000, showing assessable profits of $1,556,423 with tax payable thereon of $233,463 was [reduced] to assessable profits of $1,546,170 with tax payable thereon of $231,925.

(d) Profits tax assessment for the year of assessment 1994/95 under charge number 3-2873108-95-3, dated 31 March 2000, showing assessable profits of $516,897 with tax payable thereon of $77,534 was increased to assessable profits of $1,177,948 with additional tax payable thereon of $176,692.

51. The parties agreed the following facts and we find them as facts.

52. The Solicitor has objected to the additional profits tax assessments for the years of assessment 1991/92 and 1992/93 and the profits tax assessments for the years of assessment 1993/94 and 1994/95 raised on him, claiming that in computing the assessable profits from his legal service business in the name of his legal practice ('the Practice'), the management fee expenses should be allowed in full.

53. During the period from 15 June 1989 to 25 February 1996, the Solicitor was the sole proprietor of the Practice. During the years of assessment 1991/92 to 1994/95, the Practice maintained, inter alia, three places of business:

(a) 'Property A';

(b) 'Property B'; and

(c) 'Property C'.

54. The Practice' s profit and loss accounts for the years ended 31 March 1992 to 1995 showed the following particulars:

	1991/92	**1992/93**	**1993/94**	**1994/95**

		$	$	$	$
(a)	Professional fees received	3,535,459	3,849,090	3,871,778	3,087,592
(b)	Interest and sundry income	76,958	29,556	18,585	22,129
		3,612,417	3,878,646	3,890,363	3,109,721
	Less: Expenses				
(c)	Management fees	2,872,168	3,046,750	2,928,060	2,777,855
(d)	Travelling	8,809	-	21,846	85,882
(e)	Salaries and allowances	-	84,075	121,213	172,993
(f)	Depreciation	6,096	6,184	8,565	5,913
(g)	Other expenses	130,094	356,899	801,235	655,482
Profit/(loss) per accounts		595,250	384,738	9,444	(588,404)

55. The management fees in paragraph 54(c) were said to be paid to the following companies:

	Recipient	**1991/92**	**1992/93**	**1993/94**	**1994/95**
		$	$	$	$
(a)	ServiceCo1	2,872,168	3,046,750	2,928,060	2,649,400
(b)	ServiceCo2	-	-	-	200,000
	Total	2,872,168	3,046,750	2,928,060	2,849,400

56. Information about ServiceCo1

(a) ServiceCo1 was a private company incorporated in Hong Kong on 3 June 1988.

(b) At all relevant times, the Solicitor and his brother, Brother1, were the only two shareholders and directors of the company.

(c) (i) By notice dated 30 May 1990, ServiceCo1 reported to the Companies Registry that its registered office was situated at Property A.

(ii) By notice dated 20 February 1992, ServiceCo1 reported to the Companies Registry that its registered office was situated at Property B.

(iii) By notice dated 7 December 1992, ServiceCo1 reported to the Companies Registry that its registered office was situated at Property C.

(d) ServiceCo1 had acquired, inter alia, the following properties:

		Date of	

	Location of property	**purchase**	**Date of sale**
(i)	'Property D'	04-07-1988	-
(ii)	'Property E'	08-04-1991	11-06-1992 [see note below]
(iii)	'Property F'	08-11-1991	-
(iv)	'Property G'	28-02-1992	01-05-1992
(v)	'Property C'	30-09-1992	-

Note: At the time of purchase by ServiceCo1, Property E was still under construction. Before the purchase of the property was completed, ServiceCo1 as confirmor entered into a sale and purchase agreement on 11 June 1992 to sell the property.

(e) ServiceCo1 reported in its Profits Tax returns that it carried on the business of management services and property investment. Its financial statements for the years ended 31 March 1992 to 1995 showed the following particulars:

Profit and loss accounts

		1991/92	**1992/93**	**1993/94**	**1994/95**
		$	$	$	$
(i)	Management fees	2,872,168	3,046,750	2,877,560	2,649,400
(ii)	Profit on disposal of fixed assets	461,787	1,039,482	-	-
(iii)	Rental income	-	-	67,500	168,000
(iv)	Other income	-	-	19,997	4,870
		3,333,955	4,086,232	2,965,057	2,822,270
	Less:				
(v)	Total expenses	2,453,197	3,248,251	3,259,557	3,451,609
Profit/(loss) per accounts		880,758	837,981	(294,500)	(629,339)

Balance sheets

		1991/92	**1992/93**	**1993/94**	**1994/95**
		$	$	$	$
(vi)	Amount due from [the Practice]	396,820	296,632	296,632	304,232
(vii)	Amount due to directors	1,481,774	2,542,590	3,242,584	3,775,509

(f) The Practice advised that the other income set out in sub-paragraph (e)(iv) above was possibly income from sale of books.

57. Information about ServiceCo2

(a) ServiceCo2 was a private company incorporated in Hong Kong on 31 March 1994.

(b) At all relevant times, the Solicitor and the Wife were the only two shareholders and directors of the company.

(c) At all relevant times, the registered office of ServiceCo2 was situated at Property C.

(d) ServiceCo2 reported in its Profits Tax return for the year of assessment 1994/95 that it received overseas rental income and consultancy income. Its financial statements for the period ended 31 March 1995 showed the following particulars:

Profit and loss account		$
(i)	Consultancy fee	200,000
(ii)	Rental income	63,717
(iii)	Interest income	195
		263,912
	Less:	
(iv)	Subscription of reference book	131,249
(v)	Other expenses	223,787
	Loss for the year	(91,124)
Balance Sheet		$
(vi)	Fixed assets – Investment properties	1,211,406

58. Subject to enquiries to be issued, the assessor raised the following profits tax assessments in respect of the profits made by the Practice:

(a) **1991/92 Profits Tax Assessment**
Assessable profits per return $599,613
Tax payable thereon $89,941

(b) **1992/93 Profits Tax Assessment**
Assessable profits per return $389,218
Tax payable thereon $58,382

The Solicitor did not object to the above assessments.

59. In reply to the assessor's enquiries, the Practice and/or ServiceCo1 put forward the following assertions in respect of the management fee expenses in paragraph 55 above:

In relation to ServiceCo1

(a) On divers dates the Practice entered into service agreements with ServiceCo1 whereby ServiceCo1 agreed, inter alia, to provide to the Practice office premises, office machines, consultancy advices and staff quarters and to pay all the office expenses incurred by the Practice.

(b) In consideration of the services provided by ServiceCo1, the Practice agreed to pay to the company management fees.

(c) Some details of the agreements are set out below:

Date of agreement	1-7-1989	1-4-1990	1-4-1991	1-11-1991
Period covered	1-7-1989 to 31-6-1994	With effect from 1-5-1990	-	With effect from 1-12-1991
Provision of				
- office premises at	Property A	Property B	[see note below]	-
- office machines	Yes	Yes		-
- office expenses	Yes	Yes		-
- staff	Yes	-		-
- consultancy advice	-	-	Yes	-
- staff quarters at	-	-	-	Property F
Management fee payable by [the Practice]	$145,000 per month	$38,000 per month	$237,300 per month	$6,142 per month

Note: This agreement was a revision of the first and the second agreements whereby the monthly management fee was increased from $183,000 [that is, $145,000 + $38,000] to $237,300 and the provision of consultancy advice was added.

(d) In support of its assertions, ServiceCo1 furnished copies of its directors' minutes resolving the entering into of the various agreements with the Practice.

In relation to ServiceCo2

(e) By agreement dated 1 April 1995, ServiceCo2 agreed to provide to the Practice a library of law books and other related publications for one year commencing from 1 April 1995.

(f) In consideration of the services provided by ServiceCo2, the Practice agreed to pay to the company an annual management fee in the amount of $200,000.

60. In support of the claim for deduction of management fees, the Practice through his then representatives, supplied copies of 12 receipts issued by ServiceCo1 which showed the following particulars:

	Date of receipt	**Amount received**
(a)	30-5-1992	$80,000
(b)	12-6-1992	124,000
(c)	1-7-1992	44,900
(d)	11-7-[note]	140,000
(e)	27-8-[note]	120,000
(f)	30-9-1992	79,000
(g)	7-10-1992	175,000
(h)	31-10-1992	86,000
(i)	30-11-1992	71,000
(j)	10-12-1992	46,000
(k)	19-2-1993	102,000
(l)	[note]	58,000
	Total	$1,125,900

Note: The date/year was not shown on copies of the receipts

61. With regard to the business premises, that is, Property A, Property B and Property C, and the alleged staff quarters, that is, Property F, the Practice put forward the following assertions and documents:

Property A

(a) The gross floor area of Property A was about 1,500 square feet. The total amount of rent, rates and management fee in respect of the property for the month March 1992 was $17,003. A copy of the relevant debit note issued by the property management company was provided.

Property B

(b) The gross floor area of Property B was about 700 square feet. ServiceCo1 had entered into tenancy agreements to rent the property at the following charges:-

Period covered	**Monthly rent**	**Monthly air-conditioning charges**	**Total**
1-4-1990 – 31-3-1992	$23,522	$928	$24,450

1-4-1992 – 31-3-1994	$21,046	$1,238	$22,284

Copies of the two undated and unstamped tenancy agreements were provided. The tenancy agreements did not bear the signatures of the landlord of the property.

Property C

(c) The gross floor area of Property C was about 1,500 square feet. '[the Practice] had entered into the service company arrangement with [ServiceCo1] well before 1995. As far as [the Practice is] aware, such arrangement began in or about 1991/1992. According to [the Practice's] record, [the Revenue] has never requested for copies of the service agreement for the relevant years.'

Property F

(d) 'The property was made available to the staff members of [the Practice] [during the period from 1 January 1994 to 31 March 1996] for housing accommodation, but no detailed records were kept as to who at what time occupied the property.'

(3) 'From the end of 1991 to sometime around 1994, [Property F] was occupied by [the named person] who, in return for the accommodation, do refurbishment and decorative work for [the Practice].' The named person carried out refurbishing works at Property A, Property B, Property D and Property F from time to time during the period from the end of 1991 to sometime in 1994. No detailed records of the dates on which the refurbishing works were carried out by the named person were kept.

62. In response to the assessor's enquiries, ServiceCo1 supplied information in respect of the expenses charged in its accounts. The assessor has incorporated the information in the seven schedules.

63. ServiceCo1 put forward the following assertions in respect of some of the expenses charged in its accounts:

(a) Property D was used as residence for the Solicitor who was the company's director.

(b) The domestic helpers worked at the Solicitor's residence. They provided services to the Solicitor and Brother1.

(c) 'The business nature of [ServiceCo1] is that of general investment in particular real properties. Our director [the Solicitor] and his assistant, [the Wife] often made overseas trips to look for investment opportunities, i.e. purchasing real properties and contacting overseas developers to see if they are interested in retaining the company to sell their properties in Hong Kong on their behalf. Accordingly (overseas travelling expenses) were incurred in the production of the chargeable profits. During the year 93/94, [the Solicitor and the Wife] have travelled to [5 named places]. During the year 94/95, [the Solicitor and the Wife] have travelled to [5 named places].'

(d) Property E was intended to be used as the staff quarters for Brother1. It was sold because there was a delay in the date of completion of construction of the property.

(e) Property G was intended to be used as quarters for the Solicitor' s late father, the Father. It was sold because of the illness and death of the father.

(f) ServiceCo4 provided legal services to ServiceCo1. The amount of consultancy fees paid to ServiceCo4 depended on the number of cases that ServiceCo4 took up. The following consultancy fees were paid to the company:

Year of assessment	**Amount**
1992/93	$268,790
1993/94	$342,000
1994/95	$241,000

64. The assessor considered that the management fee charged in the Practice' s accounts should only be allowed for deduction to the extent that they reflected those costs directly attributable to the operations of the Practice plus an appropriate mark up of 12.5%. The assessor therefore on divers dates raised the following profits tax assessments/additional profits tax assessments in respect of the profits made by the Practice:

(a) **1991/92 additional profits tax assessment**

Additional assessable profits being management fee disallowed	$1,045,269
Additional tax payable thereon	$156,791

(b) **1992/93 additional profits tax assessment**

Additional assessable profits being management fee disallowed	$563,188
Additional tax payable thereon	$84,478

(c) **1993/94 profits tax assessment**

Profit per return	$8,349
Add: Management fee disallowed	1,548,074
Assessable profits	$1,556,423
Tax payable thereon	$233,463

(d) **1994/95 profits tax assessment**

Loss per return	($586,064)
Add: Management fee disallowed	1,102,961
Assessable profits	$516,897
Tax payable thereon	$77,534

65. The Solicitor objected against the above assessments in paragraph 64 on the ground that he should be allowed deduction of the management fee expenses in full. He put forward the following assertions and arguments:

(a) Departmental Interpretation & Practice Notes No 24 ('DIPN No 24') was issued in August 1995. It 'was totally unfair, unjust and misconceived' if the Revenue applied it on [the Practice] for the years of assessment 1991/92 to 1994/95;

(b) 'the use of service company is a widely used and accepted mode of practice prior to the issue of your DIPN No 24; in particular it is lawful and is not a tax avoidance device;'

(c) 'the transaction between the service company and [the Practice] is supported by Service Agreements and Board Minutes;'

(d) 'your proposed mark up of 12.5% is also without basis;'

(e) '[ServiceCo1] was incorporated on 3/6/1988 whereas [the Practice] only commenced business on 7/1989. [ServiceCo1] was not set up solely for the purpose of providing tax benefit to our firm. [ServiceCo1] was not set up to provide tax benefit at all. In addition to providing management service to our firm, [ServiceCo1] provides consultancy service, in particular legal and marketing advices, to (inter alios) [the Practice].'

(f) 'Further, [ServiceCo1] carries on the business of general investment in Hong Kong as well as in other countries. [ServiceCo1] publishes books.'

(g) If the transactions entered into between ServiceCo1 and [the Practice] are genuine commercial decisions supported by documentation, the Revenue cannot disregard the transactions or apply DIPN No 24 with retrospective effect. In any event, '"revenue legislation" would not apply retrospectively, not to say departmental practice.'

66. By letter dated 16 December 2004 the assessor invited the Solicitor to provide further information and documents in relation to his objections.

67. By letter dated 1 August 2006, the Solicitor put forward the following assertions and arguments in reply to the assessor' s letter:

(a) Due to lapse of time, he was not able to furnish, inter alia, the following information and documents:

(i) documentary evidence in respect of the payment of the management fees set out in paragraph 55, which were said to be paid by transfer or by cheques;

(ii) copies of the current accounts maintained by [the Practice] with ServiceCo1 and ServiceCo2;

(iii) lists of office machines, furniture, fixtures and fittings provided by ServiceCo1 to [the Practice];

(iv) details of education fee, entertainment expenses, travelling expenses, salaries and allowances;

(v) the date of birth [or age], academic and professional qualification, and working experience of Brother2, Brother3 and the Father.

(b) All items in Appendix P6 are usual and ordinary business expenditure items necessarily incurred to generate profit.

(c) The Solicitor did not make all of those trips mentioned in paragraph 62(c) above with the Wife together.

(d) 'In view of our letter dated 9 February 2006 enclosing your letter dated 27 February 2001 … [the Revenue] is estopped from taking further action in the [objections] and/or denying that the service company arrangement in this case is a lawful and legitimate and more importantly accepted tax arrangement.'

68. The assessor has since ascertained that the employer's returns in respect of the employees of [the Practice] did not show the provision of quarters to any employee. Upon review, the assessor agreed that the consultancy fee set out in paragraph 63(f) above paid to ServiceCo4 were incurred in the production of the assessable profits of the Practice.

The Determination in BR100/06

69. The assessor, however, maintained the view that the management fees allegedly incurred by the Practice were excessive and were not wholly incurred in the production of its assessable profits. She was prepared to allow the expenses set out in Appendix T to the determination with a mark-up of 12.5% in accordance with DIPN No 24. Accordingly, the assessor considered that the profits tax assessments/additional profits tax assessments in dispute should be increased/reduced as follows:

(a)	**1991/92 additional profits tax assessment**	
	Assessable profits per return	$599,613
	Add: Management fee disallowed	1,856,662
	Assessable profits	2,456,275
	Less: Profits already assessed	599,613
	Additional assessable profits	$1,856,662
	Additional tax payable thereon	$278,499
(b)	**1992/93 additional profits tax assessment**	
	Assessable profits per return	$389,218
	Add: Management fee disallowed	1,862,100
	Assessable profits	2,251,318
	Less: Profits already assessed	389,218
	Additional assessable profits	$1,862,100
	Additional tax payable thereon	$279,315
(c)	**1993/94 profits tax assessment**	
	Profit per return	$8,349
	Add: Management fee disallowed	1,537,821
	Assessable profits	$1,546,170
	Tax payable thereon	$231,925
(d)	**1994/95 profits tax assessment**	
	Loss per return	($586,064)
	Add: Management fee disallowed	1,764,012
	Assessable profits	$1,177,948
	Tax payable thereon	$176,992

70. The Acting Deputy Commissioner agreed with the assessor and by his Determination in BR100/06 increased or reduced, as the case may be, the assessments objected against (see paragraph 50 above).

BOARD' S DECISION IN BR100/06

71. The grounds of appeal (see paragraph 8 above) are verbose and convoluted. Some of them are unintelligible, illogical and non-sequitur.

72. They fall into two broad groups. The first, grounds 2 – 5, is on the power of the assessor to issue assessments and the power of the Commissioner to increase them in determining objections. The second, grounds 6 – 17, is on deduction of the management fees and the section 61 point.

Power of assessor to assess and power of Commissioner to increase

73. Apart from the power to assess a taxpayer to additional (or penalty) tax under section 82A, neither the Commissioner nor the Deputy Commissioner has power to assess a taxpayer to tax.

74. Assessments are made by assessors under section 59. Section 3(4) provides that all powers conferred upon an assessor by the Ordinance may be exercised by an assistant commissioner.

75. The Commissioner gives notice of assessment under section 62.

76. Section 60(1) provides that:

> '*Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, and the provisions of this Ordinance as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to the tax charged thereunder:*
>
> ...
>
> *(b) where the non-assessment or under-assessment of any person for any year of assessment is due to fraud or wilful evasion, such assessment or*

additional assessment may be made at any time within 10 years after the expiration of that year of assessment.'

77. The assessor assessed the Solicitor to profits tax assessments per return for 1991/92 and 1992/93 and there was no objection against (and thus no appeal from) these assessments (see paragraph 58 above). Significantly, these assessments were agreed by the Solicitor to be subject to enquiries to be issued.

78. The four assessments, forming the subject matter of objection and appeal, are as follows:

Year of assessment	**Date**	**Description**
1991/92	30-3-1998	Additional profits tax assessment
1992/93	29-9-1999	Additional profits tax assessment
1993/94	31-3-2000	Profits tax assessment
1994/95	31-3-2000	Profits tax assessment

79. By the time of issue of the first subject assessment on 30 March 1998, more than six years had elapsed from the 1990/91 and 1989/90 years of assessment and the assessor had no authority to proceed under section 60 in the absence of fraud or wilful evasion.

80. All four subject assessments were issued within six years of the respective years of assessment and within the time limit under section 60. It is an agreed fact that the assessor considered that the management fee charged in the Practice' s account should only be allowed for deduction to the extent that they reflected those costs directly attributable to the operations of the Practice plus an appropriate mark up of 12.5% (see paragraph 64 above), it must have appeared to the assessor that the Solicitor had not been assessed for 1993/94 and 1994/95 and had been assessed at less than the proper amount for 1991/92 and 1992/93. In these circumstances, the assessor clearly had authority under section 60 to make the four subject assessments.

81. The reference in ground 2 to section 51C is misconceived. Section 51C does not override section 60. Further, as the Court of Appeal pointed out in CIR v Common Empire Limited [2007] 1 HKRLD 679 at paragraph 11, the statutory requirements imposed on taxpayers to keep records are for minimum periods. The four subject assessments were issued within seven years and it behoved the appellants to keep the records until the ultimate determination of their objections and appeals. If they should discard any document or record relevant to the objections and appeals, they did so at their own peril.

82. The assertion of destruction and discardment of records in ground 5 was calculated to mislead the Board. On the Wife' s own testimony, no one had ever made a decision to throw away any document or any book and record and the books and records were probably somewhere in

the storage go-down. The appellants have only themselves to blame for making no attempt to retrieve any of the books and records.

83. By virtue of section 64(2), the Commissioner must determine the objection within a reasonable time. A failure to act within a reasonable time (had it occurred) would not have deprived the commissioner of jurisdiction or made any determination by him null and void, Nina T H Wang v Commissioner of Inland Revenue [1994] 1 WLR 1286, PC.

84. The Commissioner, in determining an objection under section 64, and the Board, in deciding an appeal under section 68, perform the same ultimate function, that is, to confirm, reduce, increase or annual the assessment, Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7 at page 23, CA. The Commissioner has power under section 64 (2) to increase an assessment and this is what the Acting Deputy Commissioner did in relation to three of the four subject assessments.

85. Grounds 2 and 3 fail.

86. Ground 4 is unintelligible and illogical. The word 'issue' does not appear in section 64. The Commissioner must determine an appeal before his duty to transmit can arise. No argument was advanced on how jurisdiction to determine is contingent on subsequent transmission on time.

87. The Acting Deputy Commissioner made his Determination on 27 October 2006.

88. Three unsuccessful attempts were made by the Revenue to send the Determination to the Solicitor by registered post.

(a) The Determination was sent on 27 October 2006 by registered post to the Solicitor at Property C. The postal packet was returned to the Revenue unclaimed.

(b) The Determination was sent on 24 November 2006 by registered post to the Solicitor at Property C. The postal packet was again returned unclaimed.

(c) The Determination was sent on 21 December 2006 by registered post to the Solicitor at the first address shown on the appellants' letterhead in their notices of appeal dated 10 February 2007 and in their letter dated 1 August 2006. The postal packet was refused and was returned by the postal authority to the Revenue.

(d) The Determination was sent by hand on 11 January 2007.

89. Property C was shown on the appellants' letterhead in 2006 and 2007 as their 'Library and Digital Information Centre'.

90. We interpose here to record that the same happened to the Revenue's attempts to send to the Firm by registered post the Determination in BR99/00.

91. In our decision, the two Determinations had been transmitted twice to the Solicitor and the Firm, as the case may be, within one month of the Determinations. The Revenue cannot be held responsible for the appellants' failure/refusal to receive and read them. The Commissioner did not lose jurisdiction to determine the objections by reason of the appellants' attempts to evade service of the Determinations.

92. Adopting the reasoning of the Privy Council in the Nina Wang case (at page 1296), in the present case the legislature did intend that the Commissioner should transmit his determination within one month. At the same time it is no less plain that the legislation imposed on the Inland Revenue authorities, including the Commissioner, the duty of assessing and collecting profits tax from 'every person carrying on a trade, profession or business in Hong Kong', section 14. It does not follow that his jurisdiction to make a determination disappears the moment one month has elapsed from the date of his determination if the determination has not been transmitted. We do not consider that that is the effect of a failure to comply with the obligation to transmit within one month in the present legislation. Such a result would not only deprive the government of revenue, it would also be unfair to other taxpayers who need to shoulder the burden of government expenditure; the alternative result (that the Commissioner continues to have jurisdiction) does not necessarily involve any real prejudice for the taxpayer in question by reason of the delay. We would add that the result of losing jurisdiction is unfair to taxpayers in cases where the Commissioner agrees with the taxpayers' objections.

93. Ground 4 fails.

94. When asked whether he had any argument on the effect of the document dated 27 February 2001 on the appeal in BR100/06, the Solicitor said:

> 'I don't really see how I could raise this issue in this appeal.'

He made no submission at any time during the hearing in BR100/06 on the relevance of the document.

95. Ground 5 fails.

Burden of proof

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

97. As the onus of disturbing the assessment lies on the appellant, failure to discharge the onus may be decisive against the appellant.

98. In Mok Tsze Fung v Commissioner of Inland Revenue 1 HKTC 166 {also reported in [1962] HKLR 258}, Mills Owens J said (at page 183 of the HKTC report and page 281 of the HKLR report) that:

> *'It was for the appellant to adduce evidence before the Board of Review in order to discharge the onus resting upon him, and on his failure to do so the Board was entitled, indeed bound, to reject his appeal (vide* ***Pyrah v. Amis****).'*

99. In Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224 Blair Kerr J said that:

> *'According to section 68(3) the assessor attends the hearing before the Board "in support of the assessment", but the onus of proving that "the assessment as determined by the Commissioner .... is excessive" is placed fairly and squarely on the appellant by section 68(4).' (at page 229)*
>
> *'The question for the Board of Review is not whether the Commissioner erred in some way, but whether the assessment is excessive. As Mr. Sneath so aptly put it:*
>
> > *'The question is: "Did the Commissioner get the correct answer'; not 'did the Commissioner get the correct answer by the wrong method".'*
>
> *And the onus of proving that the assessment is excessive lies on the taxpayer-appellant.' (at page 237)*

100. In All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750 at page 772, Mortimer J (as he then was) said that:

> *'It must be remembered that the burden of disturbing the assessment, rests upon the taxpayer.'*

101. In Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKRLD 773, CA, at paragraph 43, Woo JA made it clear that the method by which an assessment was made by the Revenue is quite irrelevant at the stage of proceedings before the Board:

> '*43. Nothing that Mr Thomson has shown to us persuades us that the determination or the Board's decision was wrong. Mr Cooney points out that the method by which an assessment was made by the Revenue is quite irrelevant at the stage of proceedings before the Board, and that the crux is whether the assessment is correct. He refers us to CIR v Board of Review, ex p Herald International Ltd [1964] HKLR 224 as to how the Board should deal with an appeal against an assessment. Blair-Kerr J in the Full Court said at p.237:*
>
> > *The question for the Board of Review is not whether the Commissioner erred in some way, but whether the assessment is excessive. As Mr Sneath so aptly put it:*
> >
> > > *The question is: "Did the Commissioner 'get the correct answer'; not 'did the Commissioner get the correct answer by the wrong method.'"*
> > >
> > > *And the onus of proving that the assessment is excessive lies on the taxpayer-appellant.'*

102. In Li Tin Sang v Poon Bun Chak & others, unreported, CACV 153 of 2002, 18 November 2002, the Court of Appeal held that a judge is not bound always to make a finding one way or the other and may decide the case on the burden of proof.

> '*I agree with Cheung JA and Stone J that the answer lies in Rhesa Shipping Co. S.A. v Herbert David Edmunds (The "Popi M") [1985] 1 WLR 948, 955H-956A, [1985] 2 Lloyd's Rep. 1 at 6, where Lord Brandon observed that the judge is not bound always to make a finding one way or the other with regard to the facts averred by the parties and may decide the case on the burden of proof. This was what happened below: the judge found that the plaintiff had failed to prove his case", per Le Pichon JA, at paragraph 3.*
>
> *"A judge is not bound always to make a finding one way or the other with regard to facts averred by the parties. While the court does not generally favour deciding a case on the basis of burden of proof, a judge has open to him this third alternative of saying that the party on whom the burden of proof lies in relation to any averment made by him has failed to discharge that burden : Rhesa Shipping Co. S.A. v. Herbert David Edmunds, ("The Popi M.") [1985] 2 Lloyd's Law Report 1", per Cheung JA at paragraph 63.*
>
> *"A trial judge is not bound to find one way or the other, and it is open to the court to decide the case on the burden of proof: see here the observations of*

Lord Brandon in The "Popi M" [1985] 2 Lloyd's LR 1, at p.6', per Stone J at paragraph 77

103. The Commissioner does not have the burden of proving that a case had been made out for invoking section 61 or section 61A. The burden of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer: section 68(4) and the burden rests with the taxpayer, to prove that the Commissioner was wrong, Cheung Wah Keung v Commissioner of Inland Revenue [2002] 1 HKRLD 172, Deputy Judge Poon, at paragraphs 15(e) and 29.

104. It is clear from the above that the approach in grounds 6 – 17 is wholly misconceived.

Deduction of management fees and the section 61 point

105. Section 16(1), the provision on deduction of expenses for profits tax purposes, provides that:

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

106. Section 17(1)(a) provides that for the purpose of ascertaining profits in respect of which a person is chargeable to tax under Part IV no deduction shall be allowed in respect of domestic or private expenses.

107. Section 61 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.'*

108. 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 pp. 297-8 in relation to section 10(1) of the Jamaican Income Tax Law 1954, in similar terms to our section 61:

'*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.'*

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

110. In Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441 [(1977) 1 HKTC 936 at page 952], Cons J (as he then was) considered whether the impugned transaction was 'commercially unrealistic':

> *'What then are the arrangements and the circumstances in which they were made and carried out that I must examine in order to see whether or not they are artificial? Simply they are these. By two separate agreements the taxpayer effectively transferred all his existing and future earnings as an author to a limited company. The consideration in each case was valuable in the technical sense but by no stretch of the imagination otherwise. If that were all, the agreements would have been, as counsel for the Commissioner suggests, in the words of their Lordships (p. 294) quite "unrealistic from a business point of view". But there is one other circumstance to consider. The limited company which is the beneficiary of the taxpayer's apparent generosity is controlled by the taxpayer himself. That was a fact found by the Board of Review and I assume it to mean that the taxpayer holds all or substantially all of the shares therein. In this situation it does not necessarily follow that the transactions are commercially unrealistic. The overall position remains the same. What the*

taxpayer loses on the roundabouts he makes up on the swings. Looked at purely from the aspect of gross income the transactions seem unnecessary and unproductive. But the taxpayer may well have other matters in mind. I find nothing on the face of things that makes the agreements artificial in the way that their Lordships approached the Seramco situation. To my mind they are artificial only in the sense e.g. that a limited company is artificial. It is not the product of nature, it is the outcome of man's inventive mind. I am satisfied that the Board of Review came to a correct conclusion on this question.'

111. In Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKRLD 773, CA, at paragraph 41, Woo JA said whether a commercially unrealistic transaction must necessarily be regarded as being 'artificial' depends on the circumstances of each particular case and that commercial realism can be one of the considerations for deciding artificiality:

'The term "commercially unrealistic" appears in CIR v Howe (1977) 1 HKTC 936 at p.952 in the sense of "unrealistic from a business point of view". We are of the view that whether a transaction which is commercially unrealistic must necessarily be regarded as being "artificial" depends on the circumstances of each particular case. We agree with the submission of Mr Cooney, however, that commercial realism or otherwise can be one of the considerations for deciding artificiality. In the present case, the Board found as a fact that there was no "commercial reality in the transaction" and that there "simply was no commercial sense in the transaction"; thus it was open to the Board to reach the conclusion that the transaction was artificial under s.61.'

112. At paragraphs 60 – 61, Woo JA held that once the interposition of the service company was disregarded, it was open to the revenue to assess the taxpayer on the basis as if the remuneration paid by the employer to the taxpayer's service company had been received by the taxpayer as an employee of the employer:

'60 The relevant word used in s.61 is "disregard" and not "annihilate", "avoid" or "annul". Where a transaction is found by the assessor to contravene s.61, he may "disregard" it and "the person concerned shall be assessable accordingly". The "person concerned", as can be seen in the earlier part of the section, is the person "the amount of tax payable by" whom is reduced or would be reduced by the transaction. We think the meaning of "accordingly" is clear enough, which is the situation where the transaction is disregarded. The taxpayer in the present case is the person whose tax was reduced by intervention of the contracts and the interposition of First-Rate. When the transaction was disregarded by the assessor pursuant to s.61, the real nature of the remuneration that had been paid by Sun Ling to First-Rate was exposed. The remuneration

was paid for the provision of the services that the taxpayer, and he alone to the exclusion of First-Rate and anyone else, made to Sun Ling, and as such, is assessable as his own income. Indeed, the transaction apart, the real relationship between Sun Ling and the taxpayer in the circumstances of this case has been well demonstrated to be that between employer and employee. It is unnecessary to deem the remuneration as the taxpayer's income. It suffices where the transaction has been disregarded to look at the reality of the remuneration and the relationship. Mr Cooney draws our attention to passages in the judgments of the judges in the majority in Bunting v Commission of Taxation (1989) 20 ATR 1579 at p.1585 per Beaumont J and at p.1590 per Gummow J. The judges were considering what the Revenue was entitled to do where arrangements that offended s.260 of the Income Tax Assessment Act had been annihilated. They held that "the exercise is necessarily a hypothetical one" and the fact was exposed that the income had been earned by the appellant's own exertions and that the Revenue was entitled to "treat the taxpayer as having derived the income which was the return from his own activities." Support can also be found in Seramco Superannuation Fund Trustees v Income Tax Commissioners [1977] AC 287 at p.300 where a similar method was employed by Lord Diplock.

61. Once the transaction in the present case was disregarded by the Revenue, it was open to the Revenue to assess the taxpayer on the basis as if the remuneration paid by Sun Ling to First-Rate had been received by him as an employee of Sun Ling.'

Application of section 61

113. One must go through a four stage process in the application of section 61 to transactions:

(a) Identify/define the transaction.

(b) Consider whether the transaction reduces or would reduce the amount of tax payable by any person.

(c) If it does, consider whether the transaction is artificial or fictitious.

(d) If it is, the transaction may be disregarded and the person concerned shall be assessable accordingly.

114. A transaction is defined in the Oxford English Dictionary, 2nd edition, as 'the action of transacting or fact of being transacted; the carrying on or completion of an action or course of action'.

115. The transaction in this case is the entering into of the agreements between the Solicitor and ServiceCo1, the carrying out of the agreements and the charging of management fees by the Solicitor in computing his profits.

116. Charging of management fees reduces or would reduce the amount of the Solicitor's profits, and thus the amount of tax payable by the Solicitor. That the transaction reduces or would reduce the amount of tax payable by the appellants does not seem to be disputed by the appellants. In her examination in chief, the Wife said this in relation to ServiceCo1:

> 'Q. To your knowledge – I am watching your pen, sir – was it set up as a tax avoidance scheme at all?
>
> A. Of course it does have some bearing, but the main purpose is not for that.'

117. In respect of ServiceCo1, the Solicitor relied on four agreements summarised in paragraph 59(c) above.

118. The first one is dated 1 July 1989 and it provides that (written exactly as in the original):

> '1. The first party [i.e. ServiceCo1] will provide the second party [i.e. the Solicitor] for office use the premises at [Property A].
>
> 2. The first party will also provide for all the office machines needed by the second party.
>
> 3. The first party will further provide for staff of the Second party.
>
> 4. The first party will pay for all office expenses incurred by the second party including telephone and paging, salaries, stationery, utilities, cleaning, traffic and travelling, postage, printing, messing, Insurance, membership fee, repair and maintenances and such other items as the First party may deem fit to provide.
>
> 5. In return for the services of the First party, the Second party will pay the First party a monthly management fee of HK$145,000.00, the amount of which will be subject to revision as such situation may arise.

6. This agreement will be effective for a period of five years starting from 1/7/89 and ending on 31/6/1994.'

119. In our decision, the first agreement is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) There is no evidence on how the monthly sum of $145,000 was arrived at.

(b) In the absence of any evidence on the reasonableness of the sum to him and in the absence of any evidence on his ability to pay, it was commercially unrealistic for the Solicitor to make an ongoing commitment of annual management fee of $1,740,000 for five years about half month after he had just commenced his sole proprietorship practice.

(c) The services provided were wide ranging. It was likely that there would be material changes in the costs of providing the services over a five-year period, but there was no agreed mechanism for adjustment without consent of the other party. The phrase 'subject to revision' must mean 'subject to revision by mutual consent'.

(d) There is no evidence that ServiceCo1 would be able to provide Property A for five years.

(e) There is no evidence that ServiceCo1 had any experience or expertise in providing the services stipulated under the agreement. ServiceCo1 had no track record. There is no allegation that Brother1 was a lawyer and there is no evidence that Brother1 had any experience in running a law firm.

120. The second one is dated 1 April 1990 and it provides that (written exactly as in the original):

' 1. The first party [i.e. ServiceCo1] will provide the second party [i.e. the Solicitor] for office use the premises at [Property B] with effect on the 1st day of May 1990.

2. The first party will also provide for all the office machines needed by the second party.

3. The first party will pay for office expenses incurred by the second party including telephone, stationery, utilities, cleaning, postage, printing, repair and maintenances and such other items as the First Party may deem fit to provide.

5.[1] In return for the services of the First Party, the Second Party will pay the First Party a monthly management fee of HK$38,000.00, the amount of which will be subject to revision as such situation may arise.'

121. In our decision, the second agreement is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) There is no evidence on how the monthly sum of $38,000 was arrived at.

(b) In the absence of any evidence on the reasonableness of the sum to him and in the absence of any evidence on his ability to pay, it was artificial for the Solicitor to make an ongoing commitment of annual management fees of $2,196,000.00 (under the first two agreements) within about 9 ½ months after the commencement of his sole proprietorship practice.

(c) The agreement is not for a fixed term and contains no provision for termination.

(d) There was no agreed mechanism for adjustment of the amount of the management fee without consent of the other party.

(e) There is 9-month period between the dates of the first and second agreements. That apart, there is no evidence that ServiceCo1 had any experience or expertise in providing the services stipulated under the agreement. ServiceCo1 had no track record. There is no allegation that Brother1 was a lawyer and there is no evidence that Brother1 had any experience in running a law firm.

122. The third one is dated 1 April 1991 and it provides that (written exactly as in the original):

' 1. The total monthly management fee of HK$183,000.00 payable by the Second Party [i.e. the Solicitor] pursuant to the said service agreements [i.e. the first and second ones] shall be increased to HK$237,300.00, the amount of which will be subject to revision as such situation may arise.

2. In consideration of the Second Party agreeing to revision of the said total monthly management fee, the First Party [i.e. ServiceCo1] shall provide consultancy advice, in particular legal and marketing advices to the Second Party.

[1] There is no clause 4.

3. This Agreement may be terminated by either party by giving one month notice in advance.'

123. In our decision, the third agreement is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) There is no evidence on how the increase of $54,300 each month, representing a 29.67% increase, was arrived at.

(b) There is no evidence on any or any pending increase in rent for Property A or Property B. On the contrary, the rent for Property B was reduced with effect from 1 April 1992.

(c) ServiceCo1 is to provide 'legal advices'. There is no allegation that Brother1 was a lawyer. On the Wife's own testimony, she took her PCLL full time course in 1994/95 and CPE part time course two years before that, obtained her PCLL in 1995 and completed her trainee contract and was admitted as a solicitor in 1997. The only person in ServiceCo1 qualified to give legal advice from 1 April 1991 to 31 March 1995 (or 31 March 1996) was the Solicitor himself. In our decision, it was plainly artificial for the Solicitor to pay ServiceCo1 for legal advices to be rendered by the unqualified to the qualified or for legal advices to be rendered by the Solicitor himself on behalf of ServiceCo1 to himself on behalf of his sole proprietorship practice.

(d) There is no evidence of any marketing advice given or to be given by ServiceCo1 from 1 April 1991 to 31 March 1995 (or 31 April 1996).

124. The fourth one is dated 1 November 1991 and it provides that (written exactly as in the original):

' 1. The First Party [i.e. ServiceCo1] shall provide the Second Party [i.e. the Solicitor] a fully furnished flat at [Property F] to be used as staff quarter with effect from 1st December 1991.

2. The First Party shall pay for all outgoing expenses including but not limited to rates, management fees, gas and electricity, water and telephone expenses.

3. The First Party shall also provide housekeeping service to the premises.

4. In return for the abovesaid services of the First Party, the Second Party shall pay the First Party a monthly service fee of HK$6,142.00, the amount of which will be subject to revision as such situation may arise.

5. This agreement may be terminated by either party by one month advance notice.'

125. In our decision, the fourth agreement is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) The Wife' s own testimony was that she could not help us on how the monthly sum of $6,142 (which is not a round figure) was arrived it.

(b) There is no evidence on the furnishing or the housekeeping services provided or to be provided under the agreement.

(c) We reject the allegation that the named person resided at Property F. Even if the named person did reside at Property F, he was not a 'staff' and would not explain the commercial realism of the Solicitor entering into the agreement to provide quarters for 'staff'.

126. We are not satisfied on a balance of probabilities that the Wife is a reliable or credible witness. We find the evidence of the Wife vague and evasive. She did not give a time frame on matters dealt with in her evidence. On more than one occasion, she was asked about the time and it then became clear from her answers that she was referring to matters after the subject years of assessment. The Solicitor was questioned about relevance but he made no attempt to argue that it was. Such evidence is, up to a point, calculated to mislead.

127. Information supplied by ServiceCo1 and incorporated by the assessor in the seven schedules referred to in paragraph 62 above shows, inter alia, the following about Property A and Property B:

	1991/92	**1992/93**	**1993/94**	**1994/95**
	$	$	$	$
Rent and rates: Property A	195,000	29,958	-	-
Building management fee: Property A	7,596	-	-	-
Utility charges: Property A	7,390	169	-	-
Rent and rates: Property B	299,520	258,783	281,424	-
Building management fee: Property B	-	22,921	-	-
Utility charges: Property B	6,586	4,575	-	-

128. Ms Tsui Nin-mei has helpfully extracted from the profits and loss accounts of the Solicitor and the profits and loss accounts of ServiceCo1 the following particulars:

Profits and loss accounts of the Solicitor for the years ended 31 March 1992 to 1995

For the year ended	31-3-1992 $	31-3-1993 $	31-3-1994 $	31-3-1995 $
Income				
Professional fees	3,535,459	3,849,090	3,871,778	3,087,592
Interest income	76,958	29,556	18,585	20,829
Sundry income	-	-	-	1,300
Total Income	3,612,417	3,878,646	3,890,363	3,109,721
Less: Expenses -				
Management fee ['the Fee']	2,872,168	3,046,750	2,928,060	2,777,855
Audit fee	6,000	7,000	8,000	8,800
Bank interest and charges	2,622	2,015	2,030	2,022
Business registration fee	-	1,415	1,250	2,250
Cleaning	2,914	5,139	12,125	1,018
Depreciation	6,096	6,184	8,565	5,913
Entertainment	1,220	34,725	182,231	215,675
Insurance	28,596	53,429	55,021	51,831
Land and company search fee	44,078	54,458	59,263	54,397
Legal and professional fee	-	500	21,594	9,825
Medical expenses	-	-	9,699	6,161
Messing	6,266	74,579	145,435	53,403
Postage	6,131	9,412	8,143	4,674
Printing and stationery	13,413	12,871	41,007	22,378
Repairs and maintenance	200	1,060	19,161	4,409
Salaries	-	84,075	121,213	172,993
Staff welfare	-	-	40,839	69,212
Subscription	7,169	14,725	33,803	9,860
Sundry expenses	10,685	32,527	63,410	29,828
Tax fee	500	600	1,000	1,100
Telephone	300	600	1,481	-
Traffic fee	-	-	95,743	108,639
Travelling expenses	8,809	51,844	21,846	85,882
Total Expenses	3,017,167	3,493,908	3,880,919	3,698,125
Profit/(Loss) for the year	595,250	384,738	9,444	(588,404)

Profits and loss accounts of ServiceCo1 for the years ended 31 March 1992 to 1995

For the year ended	31-3-1992 $	31-3-1993 $	31-3-1994 $	31-3-1995 $

Income				
Management fee	2,872,168	3,046,750	2,877,560	2,649,400
Profit on disposal of fixed assets	461,787	1,039,482	-	-
Rental income	-	-	67,500	168,000
Other income	-	-	19,996	4,870
Total Income	3,333,955	4,086,232	2,965,056	2,822,270
Less: Operation expenses				
Advertising	300	80,927	19,354	4,984
Audit fee	5,000	7,000	7,700	8,500
Bank interest and charges	21,839	83,423	82,113	145,181
Bank loan interests	374,276	491,819	579,691	729,132
Books and magazines	-	-	56,485	-
Building management fee	24,343	104,198	54,183	48,629
Business registration fee	1,000	1,150	1,250	2,250
Commission	8,900	-	-	-
Cleaning	-	-	19,312	13,500
Consultancy fee	25,300	306,017	342,001	241,000
Rent and rates	524,044	312,511	329,406	42,250
Depreciation	319,223	500,880	467,032	562,547
Directors' emoluments	57,500	48,000	48,000	65,000
Education fee	-	-	23,013	90,556
Entertainment	156,787	216,265	174,706	281,268
Gas, electricity and water	24,040	34,918	34,797	36,396
Hire charges	44,270	32,914	-	-
Insurance	10,115	16,796	18,132	13,557
Legal and professional fee	5,915	31,162	-	-
Interest on finance lease	-	-	27,962	-
Medical expenses	44,651	18,811	5,744	9,402
Motor vehicle expenses	18,456	48,345	990	-
Office refreshment	-	-	-	62,204
Other interest paid	-	-	43,110	37,710
Paging (& telephone)	4,284	16,323	72,824	28,947
Printing and stationery	8,815	30,414	38,683	22,203
Repair and maintenance	4,908	24,369	27,106	38,560
Salaries and allowances	600,680	574,501	463,847	531,917
Staff messing	38,838	25,589	5,473	9,531
Sundry expenses	43,537	105,945	92,382	89,388
Travelling - local	-	-	11,809	51,927
Travelling - overseas	-	-	212,453	285,070
Tax fee	500	-	-	-
Telephone	31,802	35,293	-	-

Travelling expenses	53,874	100,671	-	-
Total Expenses	2,453,197	3,248,251	3,259,557	3,451,609
Profit/(Loss) for the year	880,758	837,981	(294,501)	(629,339)

129. Under the four agreements, the total amount of management fee payable to ServiceCo1 for 1991/92 was $2,847,600[2] + $30,710[3] = $2,878,310; for 1992/93 $2,921,304[4]; for 1993/94 $2,921,304[5]; and for 1994/95 substantially less than $2,921,304 because of the expiry by effluxion of time of the first agreement on 31 June 1994 which meant that at least $145,000[6] per month would have ceased to be payable for the nine month period from July 1994 to March 1995.

130. In our decision, the carrying out of the agreements and the charging of management fees by the Solicitor in computing his profits is also commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) It is commercially unrealistic and artificial within the ordinary meaning of the word to carry out agreements which were commercially unrealistic.

(b) It is commercially unrealistic and artificial within the ordinary meaning of the word to charge management fees under agreements which were commercially unrealistic.

(c) The amounts of management fees charged by the Solicitor in his profits and loss accounts are different from the amounts payable under the four agreements. There is no explanation for the discrepancy.

(d) The amounts of management fees shown in ServiceCo1's profits and loss accounts are different from the amounts payable under the four agreements. There is no explanation for the discrepancy.

(e) The amounts of management fees shown in ServiceCo1's profits and loss accounts for 1993/94 and 1994/95 were less than the amounts charged by the Solicitors in his profits and loss accounts for 1993/94 and 1994/95. There is no explanation for the discrepancy.

(f) ServiceCo1 was bound under the four agreements to provide Property A and Property B for the Solicitor's use. The last (or only) receipt for Property A

[2] $237,300 x 12
[3] $6,142 x 5
[4] $2,847,600 + $6,142 x 12
[5] $2,847,600 + $6,142 x 12
[6] Part of the increase of $54,300 per month under the third agreement should also cease to be payable.

produced was for March 1992 and there is no evidence that Property A was available for the Solicitor's use in 1992/93 – 1994/95. Information supplied by ServiceCo1 on rent and rates, building management fee and utility charge in respect of Property A support our decision that it is more probable than not that Property A ceased to be used by the Solicitor in the early part of 1992/93. Property A was clearly not available in 1993/94 and 1994/95. This notwithstanding, there is no allegation of or evidence on any variation of the first three agreements to deal with the change and no explanation for the absence of any variation.

(g) The second of the two tenancies for Property B expired by effluxion of time on 31 March 1994. By 1 April 1994, neither Property A nor Property B was available. It is clearly artificial for the Solicitor to perform the four agreements in 1994/95 and incur and charge management fees in his accounts despite the material change in circumstances. No parties dealing at arms length would do so. Again, there is no allegation of or evidence on any variation of the first three agreements to deal with the change and no explanation for the absence of any variation.

(h) The artificiality increased because of the expiry by effluxion of time of the first agreement on 31 June 1994. There is no allegation of or evidence on any variation to deal with the expiry of the first agreement. No parties dealing on arms length basis would have failed to enter into a new agreement to deal with the expiry of the first agreement and the expiry of the tenancy for Property B.

(i) ServiceCo1 was bound under the first three agreements to provide all office machines, staff, and pay for all office expenses including telephone and paging, salaries, stationery, utilities, cleaning, traffic and travelling, postage, printing, messing, insurance, membership fee, repair and maintenance. However, the Solicitor's profits and loss accounts for the four years show substantial amounts being charged for cleaning, insurance, messing, postage, printing and stationery, repairs and maintenance, salaries, staff welfare, telephone, traffic fee and travelling expenses. Apart from bare general assertions with neither particulars nor evidence in support, no attempt has been made to explain how or why any of these expenses was incurred despite the first three agreements.

131. Section 61 applies and the transaction shall be disregarded and the Solicitor shall be assessable accordingly. Thus, the whole of the management fees charged shall be disregarded. In our decision, it is not necessary to examine the expenses incurred by ServiceCo1 to consider the extent to which any of its expenses should be allowed as deduction for the Solicitor. The Acting Deputy Commissioner erred in being too generous in favour of the Solicitor.

132. Even if, contrary to our decision, it is necessary to do so, the Solicitor has not discharged the onus of showing that the total deductible expenses in respect of any of the four years of assessment exceeded:

(a) the total amount of expenses, other than management fees, shown in the Solicitor's tax computations; and

(b) the total amount of management fees allowed under the Determination.

The Solicitor has failed to discharge the burden of showing that any of the assessments appealed against is incorrect or excessive.

133. We turn now to the management fee in respect of ServiceCo2.

134. The only agreement produced is an agreement dated 1 April 1995 which provided as follows (written exactly as in the original):

'1. The First Party [i.e. ServiceCo2] will provide the Second Party [i.e. the Firm] for the use of a library of law books and other related publications.

2. In return for the abovesaid services of the First party, the Second party will pay the First party an annual management fee of HK$200,000.00, the amount of which will be subject to revision.

4.[7] This agreement will be effective for a period of one year starting from 1/4/1995 and ending on 31/3/1996.'

135. This agreement was made after the last of the four years of assessment and was not effective for 1994/95. There is no evidence that the Solicitor had incurred any management fee in respect of ServiceCo2 for 1994/95 and the appeal on this item fails.

136. For reasons given above, grounds 6 – 17 fail. The only comment we would add is that the 12.5% mark up is a concession by the Revenue. Once the transaction is disregarded by reason of section 61, there is no basis for any profit by any service company or any mark up. If the appellants are truly unhappy about the concession, the Board can easily correct the Revenue's error by increasing the assessments appealed against to cancel the 12.5% mark up.

Conclusion and disposition of appeal in BR100/06

137. The Solicitor has failed to discharge his burden of showing that any of the assessment appealed against is incorrect or excessive.

[7] There is no clause 3.

138. We dismiss the appeal in BR100/06 and confirm the assessments appealed against.

Costs orders

139. This is a thoroughly unmeritorious appeal. For reasons which we give below, BR99/06 is also a thoroughly unmeritorious appeal.

140. The appellants made one frivolous interlocutory application after another, calculated to waste the Board' s time and resources and to delay the resolution of the appeals.

141. They wrote and talked nonsense in two unmeritorious appeals. The Solicitor and the Firm will each be ordered to pay costs of $5,000, making a total of $10,000 for costs.

Costs order in BR100/06

142. Pursuant to section 68(9), we order the Solicitor 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.

THE FIRM' S APPEAL IN BR99/06

Agreed facts in BR99/06

143. This is an appeal against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 27 October 2006 whereby the profits tax assessment for the year of assessment 1995/96 under charge number 3-4079013-96-A, dated 31 March 2000, showing assessable profits of $486,713 with tax payable thereon of $73,006 was increased to assessable profits of $757,664 with tax payable thereon of $113,649.

144. The parties agreed the following facts and we find them as facts.

145. The Firm has objected to the profits tax assessment for the year of assessment 1995/96 raised on it, claiming that in computing the assessable profits made by the Firm, the management fee expenses should be allowed in full.

146. The appellants have carried on a legal service business since 15 June 1989. They closed their accounts on 31 March annually. During the year ended 31 March 1996, the legal practice was run by the following persons:

	Profit sharing

	Period	Name	Capital	ratio
(a)	1-4-1995 to 25-2-1996	The Solicitor	$80,000	100%
(b)	26-2-1996 to 31-3-1996	The Solicitor	$80,000	100%
		The salaried 'partner'	-	-

147. During the year of assessment 1995/96, the Firm maintained a place of business at Property C. The property had been the appellants' place of business since 1992.

148. The Firm' s profit and loss accounts for the year ended 31 March 1996 showed the following particulars:

(a)	Professional fees received	$3,371,340
(b)	Interest and sundry income	32,814
		$3,404,154
	Less: Expenses	
(c)	Management fees	1,351,000
(d)	Building management fee	54,680
(e)	Travelling	97,452
(f)	Salaries	596,932
(g)	Depreciation	3,356
(h)	Other expenses	1,092,437
	Profit for the year	$208,297

149. The management fees in paragraph 148(c) above were said to be paid to the following companies:

	Recipient	
(a)	ServiceCo1	$828,000
(b)	ServiceCo2	200,000
(c)	ServiceCo3	323,000
	Total	$1,351,000

150. Information about ServiceCo1

(a) ServiceCo1 was a private company incorporated in Hong Kong on 3 June 1988.

(b) At all relevant times, the Solicitor and Brother1 were the only two shareholders and directors of the company.

(c) By notice dated 7 December 1992, ServiceCo1 reported to the Companies Registry that its registered office was situated at the Property C.

(d) ServiceCo1 had acquired, inter alia, the following properties:

	Location of property	**Date of purchase**
(i)	Property D	4-7-1988
(ii)	Property F	8-11-1991
(iii)	Property C	30-9-1992

(e) ServiceCo1 reported in its profits tax return for the year of assessment 1995/96 that it carried on the business of management services and property investment. Its financial statements for the year ended 31 March 1996 showed the following particulars:

Profit and loss account

(i)	Management fee	$828,000
(ii)	Rental income	357,000
		$1,185,000
	Less:	
(iii)	Total expenses	2,778,031
Loss per accounts		($1,593,031)

Balance sheet

(iv)	Amount due from the Firm	$1,009,931
(v)	Amount due to a director	$5,786,562

151. Information about ServiceCo2

(a) ServiceCo2 was a private company incorporated in Hong Kong on 31 March 1994.

(b) At all relevant times, the Solicitor and the Wife were the only two shareholders and directors of the company.

(c) At all relevant times, the registered office of ServiceCo2 was situated at Property C.

(d) There was an expense of $131,249 for the 'subscription of reference book' charged in the profit and loss account of ServiceCo2 for the period ended 31 March 1995.

(e) No financial statements were filed by ServiceCo2 for the year of assessment 1995/96. However, the financial statements filed by the company for the year of assessment 1996/97 showed the following comparative figures in respect of the year ended 31 March 1996:

Profit and loss account

(i)	Management fee income	$30,000
(ii)	Rental income	113,766
(iii)	Interest income	648
(iv)	Exchange difference	4,380
		$148,794
(v)	Less: Expenses	153,332
	Loss for the year	($4,538)

Balance Sheet

(vi)	Fixed assets - Investment properties	$1,211,406
(vii)	Current assets	
	- Accounts receivable	9,480
	- Cash on hand	2
	- Bank balances	11,895
	Total assets	$1,232,783

152. Information about ServiceCo3

(a) ServiceCo3 was a private company incorporated in Hong Kong on 6 November 1990.

(b) At all relevant times, the Solicitor and the Wife were the only two shareholders and directors of the company.

(c) By notice dated 5 January 1993, ServiceCo3 reported to the Companies Registry that its registered office was situated at Property C.

(d) ServiceCo3 had acquired, inter alia, the following properties:

		Purchase		**Sale**
		Date of sale and purchase agreement	Date of assignment	Date of assignment
(i)	Property H	2-12-1993	30-7-2001	29-9-2001 [sold to ServiceCo1]

(ii)	Property I	10-12-1993	28-2-1994	18-6-1996

(e) No financial statements were filed by ServiceCo3 for the year of assessment 1995/96.

153. In reply to the assessor's enquiries, the Firm and/or ServiceCo1 put forward the following assertions in respect of the management fee expenses in paragraph 149 above:

In relation to ServiceCo1

(a) On 1 April 1995 the Solicitor entered into a service agreement with ServiceCo1 whereby ServiceCo1 agreed to provide to the Firm for the year ended 31 March 1996 the following:

(i) an office premises at the Property C or such other premises where appropriate;

(ii) staff quarters at the Property F; and

(iii) all the office machines, furniture, fixtures and fittings required by the Firm.

(b) In consideration of the services provided by ServiceCo1, the Firm agreed to pay to the company an annual management fee in the amount of $828,000.

(c) In support of its assertions, ServiceCo1 furnished a copy of its directors' minutes dated 1 April 1995 resolving the entering into of the service agreement with the Firm.

In relation to ServiceCo2

(d) By agreement dated 1 April 1995, ServiceCo2 agreed to provide to the Firm a library of law books and other related publications for one year commencing from 1 April 1995.

(e) In consideration of the services provided by ServiceCo2, the Firm agreed to pay to the company an annual management fee in the amount of $200,000.

In relation to ServiceCo3

(f) By agreement dated 1 March 1995 ServiceCo3 agreed to provide to the Firm Property H and/or such other premises for the use as a godown, and Property

I for the use as fully furnished staff quarters for one year commencing from 1 April 1995. It was provided in the agreement, inter alia, that ServiceCo3 was responsible for the rates, management fees and utility charges in respect of both Property H and Property I.

(g) In consideration of the services provided by ServiceCo3, the Firm agreed to pay to the company an annual management fee in the amount of $323,000.

154. With regard to the business premises [that is, Property C], the alleged staff quarters [that is, Property F and Property I] and the godown [that is, Property H], the Firm put forward the following assertions and documents:

Property C

(a) The gross floor area of Property C was about 1,500 square feet. '[The Firm] had entered into the service company arrangement with ServiceCo1 well before 1995. As far as [the Firm is] aware, such arrangement began in or about 1991/1992. According to [the Firm's] record, [the Revenue] has never requested for copies of the service agreement for the relevant years.'

Property F

(b) 'The property was made available to the staff members of [the Firm] [during the period from 1 January 1994 to 31 March 1996] for housing accommodation, but no detailed records were kept as to who at what time occupied the property.'

Property I

(c) The property 'is required as holiday house for staff members of [the Firm] as fringe benefit.'

(d) The property was occupied by the Solicitor, the Wife, Brother1 and Brother2 during the period from April 1994 to June 1996.

Property H

(e) Property H was used as the godown of the appellant during the period from 2 December 1993 to 1 April 1995[8].

[8] The Firm would like to amend this sub-paragraph to up to the time of hearing of the appeal but the Revenue did not signify its agreement to the amendment. Paragraph 154 sets out the assertions previously made by the Firm. By letter dated 16 December 2004, the assessor asked the Solicitor about the ' usage of Property H during the

155. In reply to the assessor's enquiries, the Firm advised that the building management fee of $54,680 in paragraph 148(d) above comprised building management fees of $28,236 for Property C and $26,444 for the Property D.

156. In response to the assessor's enquiries, ServiceCo1 supplied information in respect of the expenses charged in its accounts. The assessor has incorporated the information in the four schedules.

157. ServiceCo1 put forward the following assertions in respect of some of the expenses charged in its accounts:

(a) Property D was used as residence for the Solicitor who was the company's director.

(b) The domestic helpers set out in Appendix 8.2 worked at the Solicitor's residence. They provided services to the Solicitor and Brother1.

(c) 'The business nature of [ServiceCo1] is that of general investment in particular real properties. Our director [the Solicitor] and his assistant, [the Wife] often made overseas trips to look for investment opportunities, i.e. purchasing real properties and contacting overseas developers to see if they are interested in retaining the company to sell their properties in Hong Kong on their behalf. Accordingly [overseas travelling expenses] were incurred in the production of the chargeable profits … During the year 95/96, [the Solicitor and the Wife] have travelled to [4 named places].'

(d) The consultancy fee of $280,160 was paid to ServiceCo4 for its provision of legal services to ServiceCo1. The amount of consultancy fee paid to ServiceCo4 depended on the number of cases that ServiceCo4 took up.

158. The assessor considered that the management fee charged in the Firm's accounts should only be allowed for deduction to the extent that they reflected those costs directly attributable to the operations of the Firm plus an appropriate mark up of 12.5%. The assessor therefore raised the following profits tax assessment for the year of assessment 1995/96 in respect of the profits made by the Firm:

Profit per tax computations	$208,668

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period from 2 December 1993 to 1 April 1995 ...' and the ' name and correspondence address of the occupants who occupied Property H during the period from 2 December 1993 to 1 April 1995' . By letter dated 1 August 2006, the Firm replied stating that ' Property H was used as a storage godown for the Firm during the period.' This sub-paragraph is thus retained without amendment.

Add: Management fee disallowed	278,045
Assessable profits	$486,713
Tax payable thereon	$73,006

159. The Firm objected against the above assessment on the ground that it should be allowed deduction of the management fee expenses in full. He put forward the following assertions and arguments:

(a) Departmental Interpretation & Practice Notes No 24 (' DIPN No 24') was issued in August 1995. It 'was totally unfair, unjust and misconceived' if the Revenue applied it on the appellant for the year of assessment 1995/96;

(b) 'the use of service company is a widely used and accepted mode of practice prior to the issue of your DIPN No 24; in particular it is lawful and is not a tax avoidance device;'

(c) 'the transaction between the service company and [the appellant] is supported by Service Agreements and Board Minutes;'

(d) 'your proposed mark up of 12.5% is also without basis;'

(e) '[ServiceCo1] was incorporated on 3/6/1988 whereas [the Solicitor] only commenced business on 7/1989. [ServiceCo1] was not set up solely for the purpose of providing tax benefit to [the Firm]. [ServiceCo1] was not set up to provide tax benefit at all. In addition to providing management service to [the Firm], [ServiceCo1] provides consultancy service, in particular legal and marketing advices, to (inter alios) [the Firm].'

(f) 'Further, [ServiceCo1] carries on the business of general investment in Hong Kong as well as in other countries. [ServiceCo1] publishes books.'

(g) If the transaction entered into between ServiceCo1and the Firm is a genuine commercial decision supported by documentation, the Revenue cannot disregard the transaction and apply DIPN No 24. In any event, '"revenue legislation" would not apply retrospectively, not to say departmental practice.'

160. By letter dated 16 December 2004 the assessor invited the Solicitor to provide further information and documents in relation to his objection.

161. By letter dated 1 August 2006, the Firm put forward the following assertions and arguments in reply to the assessor' s letter:

(a) Due to lapse of time, he was not able to furnish, inter alia, the following information and documents:

(i) documentary evidence in respect of the payments of management fees to ServiceCo1, ServiceCo2 and ServiceCo3 [hereinafter collectively referred to as 'the Service Companies'] [see paragraph 149 above] which were said to be paid by transfer or by cheques;

(ii) copies of the current accounts maintained by the appellant with the Service Companies;

(iii) lists of office machines, furniture, fixtures and fittings provided by ServiceCo1 to the appellant;

(iv) details of education fee, entertainment expenses and travelling expenses; and

(v) the date of birth, academic and professional qualification and working experience of Brother2.

(b) 'All items in [Appendix 8.3] are usual and ordinary business expenditure items necessarily incurred to generate profit.'

(c) '[The Solicitor] did not make all of those trips mentioned [in paragraph 157(c) above] with [the Wife] together.'

(d) 'In view of our letter dated 9th February 2006 enclosing your letter dated 27th February 2001 … [the Revenue] is estopped from taking further action in the [objection] and/or denying that the service company arrangement in this case is a lawful and legitimate and more importantly accepted tax arrangement.'

162. The assessor has since ascertained that the employer' s return for the year ended 31 March 1996 in respect of the employees of the Firm did not show the provision of quarters. Upon review, the assessor agreed that the consultancy fee of $280,160 paid to ServiceCo4 [see paragraph 157(d) above] was incurred in the production of the assessable profits of the Firm.

The Determination in BR99/06

163. The assessor, however, maintained the view that the management fees allegedly incurred by the Firm were excessive and were not wholly incurred in the production of its assessable profits. She was prepared to allow the expenses set out in Appendix 12 to the Determination with a mark-up of 12.5% in accordance with the DIPN No 24. Accordingly, the

assessor considered that the profits tax assessment for the year of assessment 1995/96 should be increased as follows:

Profit per tax computations	$208,668
Add: Management fee disallowed	548,996
Assessable profits	$757,664
Tax payable thereon	$113,649

164. The Acting Deputy Commissioner agreed with the assessor and by his Determination in BR99/06 increased the assessment objected against (see paragraph 143 above).

BOARD' S DECISION IN BR99/06

165. The grounds of appeal (see paragraph 9 above) are verbose and convoluted. Some of them are unintelligible, illogical and non-sequitur.

166. They fall into two broad groups. The first, grounds 2 – 5, is on the power of the assessor to issue assessments and the power of the Commissioner to increase them in determining objections. The second, grounds 6 – 20, is on deduction of the management fees and the section 61 point.

Power of assessor to assess and power of Commissioner to increase

167. We repeat paragraphs 73 – 76 and 81 – 93 above.

168. The assessment, forming the subject matter of objection and appeal, is dated 31 March 2000.

169. The subject assessment was issued within six years of the 1995/96 year of assessment and within the time limit under section 60. It is an agreed fact that the assessor considered that the management fee charged in the Firm' s account should only be allowed for deduction to the extent that they reflected those costs directly attributable to the operations of the Firm plus an appropriate mark up of 12.5% (see paragraph 158 above). It must have appeared to the assessor that the Solicitor had not been assessed for 1995/96. In these circumstances, the assessor clearly had authority under section 60 to make the subject assessment.

170. Grounds 2 – 4 fail.

171. The document dated 27 February 2001 is addressed to the Firm at Property C and reads as follows:

'PROFITS TAX

YEAR OF ASSESSMENT 1995/96
(REVISED)

According to the Return and information submitted, there are no profits chargeable to Profits Tax for the above mentioned year of assessment.

Yours faithfully,
Commissioner of Inland Revenue

ASSESSOR'S NOTE: (FOR EXPLANATION OF CODES, PLEASE SEE OVERLEAF)
REVISED DUE TO CHANGE IN PERSONAL ASSESSMENT STATUS OF PARTNER WITH HKID CARD NO. [THE ID CARD NUMBER OF THE SALARIED "PARTNER"]'

172. To start with, no attempt has been made by the appellants to put the document dated 27 February 2001 in context.

173. It is clear from the assessor's note that the document was issued due to the change in personal assessment status of the salaried 'partner'.

174. The document had nothing to do with the management fee issue or the subject assessment.

175. The subject assessment (see paragraph 143 above) had already been made by the assessor and the Commissioner had already given notice to '[The Solicitor] trading as [the Firm]' on 31 March 2000 of the assessment of assessable profits of $486,713 with tax payable of $73,006. The Firm objected against this assessment by letter dated 7 April 2000 (see paragraph 159 above). By letter dated 25 May 2000, the assessor gave reasons for not agreeing to amend the assessment. By the time of the 27 February 2001 document, the subject assessment had been and was still being the subject matter on ongoing objection and the Commissioner was duty bound under section 64 to consider the objection.

176. More importantly, ground 5 raises an estoppel. The reliance alleged is that 'records have been destroyed or discarded and in any event could not be located by now'.

177. On the Wife's own testimony, no one had ever made a decision to throw away any document or any book and record and the books and records were probably somewhere in the storage go-down.

178. The factual basis of destruction and discardment of records is untrue.

179. The appellants have only themselves to blame for not having a proper system of storage (if such be the case) and for retrieval of books and records (if such be the case) and for making no attempt to retrieve any of the books and records.

180. No reliance has been proved and this is fatal against the estoppel point. Ground 5 fails.

Deduction of management fees and the section 61 point

181. We repeat paragraphs 96 – 114 above.

182. The transaction in this case is the entering into of:

(a) the agreement dated 1 April 1995 between the Firm and ServiceCo1;

(b) the agreement dated 1 April 1995 between the Firm and ServiceCo2; and

(c) the agreement dated 1 April 1995 and also dated 1 March 1993 between the Firm and ServiceCo3;

the carrying out of the agreements and the charging of management fees by the Firm in computing its profits.

183. Charging of management fees reduces or would reduce the amount of the Firm's profits, and thus the amount of tax payable by the Firm.

184. The agreement made between the Firm and ServiceCo1 provided as follows (written exactly as in the original):

'1. The first party [i.e. ServiceCo1] will provide the second party [i.e. the Firm] for office use the premises at [Property C] or such other premises where appropriate.

2. The first party will also provide for all the i) office machines and ii) furnitures, fixtures and fittings required by the second party.

3. The first party will provide the Second Party for the use of a staff quarter at [Property F].

3.[9] In return for the services of the First party, the Second party will pay the First party an annual management fee of HK$828,000.00, the amount of which will be subject to revision.

4. This agreement will be effective for a period of one year starting from 1/4/95 and ending on 31/3/1996.'

185. In our decision, the agreement made between the Firm and ServiceCo1, the carrying out of the agreement and the charging of management fees by the Firm in computing its profits is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) ServiceCo1 had hitherto been providing the sole proprietorship practice with staff. There is no explanation why ServiceCo1 ceased to do so with effect from 1 April 1995.

(b) ServiceCo1 had hitherto been providing the sole proprietorship practice with legal and marketing advices. There is no explanation why ServiceCo1 ceased to do so with effect from 1 April 1995.

(c) There is no evidence on how the sum of $828,000 was arrived at.

(d) It is unusual to contract for the use of business premises for only one year. It is all the more commercially unrealistic for ServiceCo1 to have the option of providing some 'other premises where appropriate'.

(e) The amounts of professional fees received by the legal practice for 1993/94 and 1994/95 were $3,877,778 and $3,087,592 respectively (see paragraph 54 above). The Firm's profits and loss account for 1995/96 showed that salaries amounted to $596,932.81. It was commercially unreal for such a small firm to contract for the provision of two staff quarters, one by ServiceCo1 and another by ServiceCo3. According to ServiceCo1, Property D was used by the Solicitor as his residence (see paragraph 157(a) above). There is no evidence who actually resided at Property F during 1995/96.

186. The terms of the agreement made between the Firm and ServiceCo2 were set out in paragraph 134 above.

187. In our decision, the agreement made between the Firm and ServiceCo2, the carrying out of the agreement and the charging of management fees by the Firm in computing its profits is

[9] This is the second clause 3.

commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) The financial statements of the Solicitor and ServiceCo1 for the years of assessment 1991/92 – 1994/95 do not show any expense on books. There is no explanation why, all of a sudden, the Firm would incur an annual sum of $200,000 on books.

(b) Clause 1 provides that ServiceCo2 'will provide [the Firm] for the use of a library of law books and other related publications'. This is no more than a licence to use the ServiceCo2's library. It is plainly artificial for such a small legal firm to agree to and pay $200,000 per annum for the licence to use ServiceCo2's 'library'.

(c) Even if ServiceCo2 was to transfer ownership of the books and publications, nobody dealing on arms length basis would agree to or pay $200,000 per annum to ServiceCo2. The appellants asserted that there was an expense of $131,249 for the 'subscription of reference book' charged in the profit and loss account of ServiceCo2 for the period ended 31 March 1995 (see paragraph 151(d) above). We have not been told what those 'reference book[s]' were. There is no allegation of the acquisition or subscription of any law or reference book or publication in 1995/96. Taking the appellants' assertions at their face value, it was plainly commercially unrealistic for the Firm to agree to pay $200,000 for books said to be acquired in the preceding year at $131,249. Law books do become out of date fairly quickly.

188. The date on the cover sheet of the agreement made between the Firm and ServiceCo3 is dated 1 April 1995. The date in the body of the agreement is dated 1 March 1995. It provided as follows (written exactly as in the original):

'1. The First Party [i.e. ServiceCo1] will provide the Second Party [i.e. the Firm] for the use of a godown at [Property H] and/or such other appropriate premises. The First Party will also provide for the storage medium needed by the Second Party.

2. The First Party will also provide the Second Party for the use of a fully furnished staff quarter at [Property I].

3. The First Party will be responsible for all the outgoings such as electricity, water, rates and management fees in respect of the above premises.

4. In return for the abovesaid services of the First party, the Second party will pay the First party an annual management fee of HK$323,000.00, the amount of which will be subject to revision.

4.[10] This agreement will be effective for a period of one year from 1/4/1995 and ending on 31/3/1996.'

189. In our decision, the agreement made between the Firm and ServiceCo3, the carrying out of the agreement and the charging of management fees by the Firm in computing its profits is commercially unrealistic and artificial within the ordinary meaning of the word for the following reasons:

(a) There is no evidence on how the sum of $323,000 was arrived at.

(b) The financial statements of the Solicitor and ServiceCo1 for the years of assessment 1991/92 – 1994/95 do not show any expense on any godown or storage facility. There is no explanation why, all of a sudden, the Firm would incur an annual sum of $323,000 on a godown and another staff quarters, and then only for one year.

(c) The amounts of professional fees received by the legal practice for 1993/94 and 1994/95 were $3,877,778 and $3,087,592 respectively (see paragraph 54 above). It was commercially unreal for such a small firm to contract for the provision of two staff quarters by ServiceCo1 and ServiceCo3. According to ServiceCo1, Property D was used by the Solicitor as his residence (see paragraph 157(a) above). There is no evidence who actually resided at Property I in 1995/96. There is no evidence that Property I was a 'holiday house' or had any 'holiday house' or resort facility. If it was a 'holiday house', it was all the more commercially unreal for such a small firm to contract for the provision of a 'holiday house'.

190. Section 61 applies and the transaction shall be disregarded and the Firm shall be assessable accordingly. Thus, the whole of the management fees charged shall be disregarded. In our decision, it is not necessary to examine the expenses incurred by any of the service companies to consider the extent to which any of its expenses should be allowed as deduction for the Firm. The Acting Deputy Commissioner erred in being too generous in favour of the Firm.

191. Even if, contrary to our decision, it is necessary to do so, the Firm has not discharged the onus of showing that the total deductible expenses in respect of the 1995/96 year of assessment exceeded:

[10] This is the second clause 4.

(a) the total amount of expenses, other than management fees, shown in the Firm' s tax computation; and

(b) the total amount of management fees allowed under the Determination.

The Firm has failed to discharge the burden of showing that the assessment appealed against is incorrect or excessive.

192. For reasons given above, grounds 6 – 20 fail.

Conclusion and disposition of appeal in BR99/06

193 The Firm has failed to discharge his burden of showing that the assessment appealed against is incorrect or excessive.

194. In our formal Decision in BR99/06, we will dismiss the appeal and confirm the assessment appealed against.

Costs order in BR99/06

195. BR99/06 is also a thoroughly unmeritorious appeal.

196. The appellants made one frivolous interlocutory application after another, calculated to waste the Board' s time and resources and to delay the resolution of the appeals. They wrote and talked nonsense.

197. In our formal Decision for BR99/06, pursuant to section 68(9), we will order the Firm 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.