Case No. D34/10

Profits tax – solicitor firm – deductions of expenses – sections 16(1), 17(1), 61, 66(3), 68(4) & 68(9) of Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Kai Chung Thomas Lo and Ng Man Sang Alan.

Dates of hearing: 30 July, 22 September and 22 October 2010.
Date of decision: 24 December 2010.

The Taxpayer was the sole proprietress of a firm of solicitors ('the Firm'). She claimed that various expenses should be allowed for deduction in the computation of the assessable profits, which included (a) delegation and litigation support expenses payable to Company Q allegedly pursuant to an agreement made by Company Q with the Taxpayer and the Firm to provide administration and support; (b) consultancy fees payable to Company C allegedly pursuant to an agreement made by Company C with the Firm to provide corporate secretarial-related services and information technology support etc; (c) medical allowances for the Taxpayer and her family; and (d) miscellaneous subscription fees.

During the course of the hearing, various adjournments were allowed due to the unsatisfactory way in which the appeal was conducted. Despite so, the Taxpayer through her representative still failed to provide any satisfactory evidence save some vague assertions to support the alleged expenses payable to Company Q and Company C. In the submissions of the Taxpayer's representative, he further requested the Board to rule that the interest income from client's account should not be chargeable to profits tax, which ground, however, was not contained in the Taxpayer's notice of appeal.

Held:

1. The claims for deduction of the delegation and litigation support expenses payable to Company Q and the consultation fees payable to Company C were rejected for lack of evidence.

2. The medical allowances were paid to the Taxpayer and her family. It is clear that they were in essence private and domestic in nature and are not deductible. The miscellaneous subscription fees were all paid for the benefit of the Taxpayer's spouse and family. No evidence was adduced before the Board showing that they were not private or domestic in nature.

3. The Taxpayer is not allowed to rely on a new ground which was not contained in the notice of appeal, given her representative has not sought the

Board's consent under section 66(3) of the IRO during the hearing. (China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486 applied)

4. The purported agreements between the Taxpayer and Company C/Company Q and the alleged consulting fees/delegation and litigation support expenses paid and payable thereunder are relevant transactions for the purpose of section 61 of the IRO and are unrealistic. (Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773 applied)

5. The purported agreements between the Taxpayer and Company Q are commercially unrealistic and artificial for the purposes of section 61 of the IRO. Hence, the Taxpayer should be treated as not having entered into any agreement with Company Q and not having incurred any delegation and litigation support expenses.

Appeal dismissed and costs order in the amount of $5,000 imposed.

Cases referred to:

Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] STC 366
D94/99, IRBRD, vol 14, 603
So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416
Anthony Patrick Fahy v Commissioner of Inland Revenue [1992] 3 HKTC 695
CIR v Mitsubishi [1996] AC 315 (PC)
China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773

AB Nasir of Messrs Nasirs for the taxpayer.
Ong Wai Man Michelle, Yip Chi Yuen and Chan Siu Ying for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by the Taxpayer who has objected to profits tax assessments for the years of assessment 2001/02 to 2004/05 which were raised on her. The Taxpayer was the sole proprietress of a firm of solicitors known as Company A ('the Firm') up to 12 August 2005.

2. By virtue of a Determination dated 26 February 2010, the Acting Deputy Commissioner of Inland Revenue upheld the relevant profit assessments for the years

2001/02, 2002/03, 2003/04 and 2004/05 ('the Determination).

The issue

3. The issue for the Board to decide was whether various expenses should be allowed for deduction in the computation of the assessable profits of the Taxpayer. There were four categories of expenses:

(a) delegation and litigation support expenses;

(b) a consulting fee to Company C;

(c) medical allowances for the Taxpayer and her family; and

(d) miscellaneous subscription fees.

Grounds of appeal

4. The grounds of appeal were as follows:

'1. The Commissioner of Inland Revenue has erred in law and in fact in his determination. The Commissioner's assessment of Profits Tax for the Tax Years Assessed is incorrect by raising Profits Tax on my expenditure which was, for the purpose of S.16 Inland Revenue Ordinance, incurred by me in the production of assessable profits.

2. The Commissioner has declared that, in particular, payments by me to [Company C] were unsubstantiated but has not indicated why in his assessment nor has the Commissioner turned his mind to this point. Accordingly the assessments cannot be stand.

3. All tax returns for the Tax Years Assessed are supported by profit and loss statements audited for The Hong Kong Law Society purposes and which have been accepted. The Commissioner however is not allowing the deductibility, on the grounds of non-production of vouchers. The Commissioner is therefore at variance with the accounts incorrect but without specifying his grounds either in the Assessments or in his determination.

4. The Commissioner's opinions, are not supported. Consequently the assessments for the Tax years Assessed must be vacated and the expenditures should be allowed as stated.'

The hearing dates

(A) 30 July 2010

5. This appeal first came before the Board on 30 July 2010. Mr Nasir who was instructed on behalf of the Taxpayer advised the Board that the Taxpayer would not be giving evidence nor would she be calling any witnesses. He indicated to the Board that he will be relying on the documentary evidence set out in the relevant documents that have been adduced. However, the Board drew to Mr Nasir's attention section 68(4) of the Inland Revenue Ordinance ('IRO') which provides that:

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

6. The Board made it perfectly clear to Mr Nasir that unless he was in a position to adduce evidence to deal with the relevant deductions and issues that were needed to be determined by the Board, the Taxpayer would be facing obvious difficulties in pursuing her appeal. Mr Nasir asked the Board for a short adjournment.

7. After considering matters, Mr Nasir then asked the Board for an adjournment to allow him time to take further instructions and to consider whether or not he would wish to adduce evidence to support the appeal. Having taken instructions, Mr Nasir wished to call one witness, Mr E and asked for an adjournment.

8. In the light of his submissions, in order to ensure that Mr Nasir and the Taxpayer had ample opportunity to present their case properly, an adjournment was allowed and the Board made the relevant directions in respect of the resumed hearing in respect of filing of witness statements, agreed facts and documents.

(B) 22 September 2010

9. The hearing was resumed on 22 September 2010. At that hearing, Mr Nasir called Mr E as his witness. During the course of his evidence, Mr E referred to various documents that he had not produced (despite the previous Order made by the Board). These were documents in respect of various invoices that he said were provided to the Taxpayer. Mr E believed that he had other documents in his possession. Mr Nasir then asked that a further adjournment be allowed to enable Mr E to produce these documents.

10. Miss Ong Wai-man ('Miss Ong') objected to the adjournment. However, the Board took the view that in the interest of ensuring the Taxpayer had the opportunity to have her appeal properly presented allowed a further adjournment and made a direction that all documents which Mr E wished to rely on should be disclosed to the Board before the adjourned hearing.

(C) 22 October 2010

11. The hearing was resumed on 22 October 2010 and after the conclusion of the hearing, the Board allowed the parties to file further written submissions in support of their respective arguments.

12. The Board wishes to comment at this stage as to the unsatisfactory way in which this appeal was conducted. The Taxpayer is a solicitor and was represented. That being the case, it is quite clear that the Taxpayer should have been fully aware as to the burden of proof in respect of this matter and should have been in a position to ensure that the case was properly prepared, this would in our view have avoided the need for the various adjournments.

The relevant statutory provisions

13. Section 16(1) of the IRO 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'*.

14. Section 17(1) of the IRO provides that:

> '*For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of-*
>
> *(a) domestic or private expenses …..*
>
> *(b) ….. any disbursements or expenses not being money expended for the purpose of producing such profits;'*

The relevant principles

Deductibility of expenses

15. Deductible expenses are not limited to payments actually made. It is clear that expenses do include an undischarged accrued liability. We refer to Commissioner of Inland Revenue v Lo and Lo (a firm) [1984] STC 366 whereby Lord Brightman at page 370b stated as follows:

> '*In construing s 16, weight must be given to the fact that deductions are not confined to sums actually paid by the taxpayer. Such sums would be covered by the word "outgoings" standing alone.'*

At page 370h, he stated as follows:

> '*….. "an expense incurred" is not confined to a disbursement, and must at least include a sum which there is an obligation to pay, that is to say an accrued liability which is undischarged.'*

16. We also have no hesitation in accepting that when expenses are incurred and producing chargeable profits, this is clearly a question that has to be decided objectively taking into account all surrounding circumstances.

17. In D94/99, IRBRD, vol 14, 603 which was a case that dealt with deductibility of consultancy and service fees that were paid to a service company. The Board stated as follows:

> '*24. Mr B [i.e. the Taxpayer] said that it was solely a matter for the Taxpayer and Company D [i.e. his service company] as to what the fair and reasonable service would be. We accept the Revenue's submission that the matter had to be assessed objectively. That is not to say that we are lifting the corporate veil. Nor are we saying that the Taxpayer is not free to decide its own affairs. The Taxpayer is free to give away part of its income as it so wishes to a related company or to a relative or indeed to any third party. The question here is whether that payment is a deductible expense in law when computing the chargeable profits. This question must be answered objectively. The agreement between the Taxpayer and Company D does not preclude us from examining whether the payment is or is not a deductible expense incurred in the production of profits.*
>
> *25. Such expense must have been bona fide incurred in the production of profits. We must look at all surrounding circumstances. For example, the relation between the payer and the payee is a relevant circumstance. So is the purpose or the reason of the payment. The basis and the breakdown of the amount are also important. The lack of a rational basis may lead us to the conclusion that the amount is wholly arbitrary, lacking in commercial reality, and thus not bona fide incurred.*'

18. In So Kai Tong v Commissioner of Inland Revenue [2004] 2 HKLRD 416 where Chu J stated as follows:

> '*6. ….. The Board accepted the approach in Case No D94/99 (1999) 14 IRBRD 603, paras.24-25 at p.612, and considered that each item of expense should be approached objectively to see to what extent, if any, it is incurred in the production of chargeable profits.*
>
> …..
>
> *26. ….. The objective test simply requires all circumstances to be looked at in deciding whether an item is a deductible expense. The Board may conclude that the item is or is not a deductible expense, and if it is, the extent to which it is deductible in accordance with the plain words of s.16(1).*'

19. Hence, section 16 clearly provides that outgoings and expenses can be deducted from assessable profits '*to the extent to which they are incurred ….. in the production of profits'*.

20. Section 17(1)(a) and (b) disallows domestic or private expenses and expenses not being expended for the purpose of producing such profits. Again, we would refer to Anthony Patrick Fahy v Commissioner of Inland Revenue [1992] 3 HKTC 695 whereby Godfrey J said at page 701 as follows:

> '*But where the expenditure has a dual purpose, partly of a domestic or private nature, and partly for the purposes of the preservation of the Taxpayer of his own person as an asset to his business, to the extent that the expenditure is a domestic or private character, in my judgment it is not allowable.*
>
> *It seems to me that the appeal of the Taxpayer here must fail at this hurdle.*
>
> *In my judgment, the requirement for this operation was as much for domestic or private as it was for business purposes. I cannot believe (although I think at one stage the Taxpayer was inclined to suggest it) that the Taxpayer would not have had this operation at all but for the purpose of earning or continuing to earn the profits of his profession. Nor can I see any way of distinguishing between those elements of the purpose which are domestic and private and those which are business. It seems to me to be one indivisible matter; there cannot be any sensible apportionment.'*

21. As can be seen from the above, the law is settled and clear in this particular area and indeed, Mr Nasir did not quarrel nor did he challenge any of the above either in his oral or in his series of written submissions.

Agreed facts

22. The parties helpfully following the directions given by the Board were able to agree certain facts. We find these as facts and now set them out as follow:

> ' (1) [The Taxpayer] has objected to the profits tax assessments for the years of assessment 2001/02 to 2004/05 raised on her. The Taxpayer claims that certain expenses should be deductible in computing the assessable profits.
>
> (2) (a) For the period up to 11 August 2005, the Taxpayer was the sole-proprietress of [Company A] in Hong Kong. On 12 August 2005, [Mr F] was admitted as a partner of the Company.

(b) In late 2000, the Company changed its business address from [Address G] to [Address H]. In late 2003, the Company moved to [Address J].

(c) The Company closed its accounts on 30 April annually.

(3) (a) [Company C] was a private company incorporated in Hong Kong on 18 November 1988. At all relevant times, the registered office of [Company C] was at [Address K]. The directors of [Company C] were:

[Company L]
[Company M]
[Company N]

(b) -

(c) -

(d) On 30 June 2004, the Court ordered that [Company C] was to be wound up. On 29 November 2005, [Company C] was dissolved.

(4) [Company N] was a private company incorporated in Hong Kong on 20 February 1990. At all relevant times, the Taxpayer and [Mr P] were the shareholders of [Company N].

(5) In her Tax Return for the year of assessment 2001/02, the Taxpayer declared that the Company's assessable profits for the year ended 30 April 2001 were $163,862. In arriving at the assessable profits, the Taxpayer deducted, inter alia, the following:

	$
Consulting fee to [Company C]	2,167,232
Non-taxable bank interest income	207,011
Depreciation allowance*	131,374
Rebuilding allowance*	19,605
Medical allowances	23,205
Subscription fee	78,354

* including allowances claimed on the following assets ("the Assets") with total value of $672,193 acquired during the year:

	$
Second hand equipment	163,909
Second hand furniture and fixtures	18,154
Used decoration	490,130

672,193

(6) The Assessor asked the Taxpayer for details on certain items, including consulting fee paid to [Company C], shown in the Company's profit and loss account for the year ended 30 April 2001. In reply, the Taxpayer put forth the following assertions:

Non-taxable bank interest income

(a) The non-taxable bank interest income included interest income of $181,248 generated from the clients' trust bank account under the Company.

Medical allowances

(b) Medical allowances included a sum of $17,004 which belonged to the Taxpayer and her family.

Subscription fee

(c) Subscription fee included a miscellaneous sum of $37,695.

The Assets

(d) The Assets were transferred from [Company N] to the Company at net book value on 1 May 2000.

(e) The Assets were located at [Address H].

(f) No formal agreement had been prepared for the transfer. No cash payment was made in the transaction as bank indebtedness was assumed.

(7) -

(8) The Assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 2001/02 in respect of the Company:

	$
Profits per return [Fact (5)]	163,862
Add: Consulting fee to [Company C] [Fact (5)]	2,167,232
Interest income from clients' account [Fact (6)(a)]	181,248
Medical allowances to proprietor and her family [Fact (6)(b)]	17,004
Subscription fee – miscellaneous [Fact (6)(c)]	37,695

Rebuilding allowance and depreciation allowance on the Assets	143,408
Assessable Profits	2,710,449
Tax Payable thereon	406,567

(9) The Taxpayer objected against the assessment at Fact (8) in the following terms:

> ". . . the assessment is incorrect because all expenses incurred by [the Taxpayer] were based on actual basis. The amount excluded from calculation by [the Inland Revenue Department ("the Department")] is not correct."

(10) In support of her objection, the Taxpayer claimed in respect of the consulting fee to [Company C] that:

(a) [Company C] provided comprehensive consulting services including corporate secretarial services, technological consulting services, human resources management, electrical, mechanical and building services repair support, renovation and carpentry services, janitorial services, legal research marketing, management and client liaison.

(b) To her knowledge, [Company C] employed a staff of 6 to 10 people.

(c) The consulting fee was computed on the basis of services delivered. Payments were made when requested by [Company C]. The Taxpayer had requested [Company C] to provide a breakdown of payment but [Company C] had failed to do so.

(d) -

(e) The liquidators of [Company C] claimed control over all books and records of that company. It followed that to the extent that the Department's request covered [Company C]'s records, the Department should approach the liquidators.

(11) The Taxpayer furnished a schedule showing the details of miscellaneous subscription fee paid of $37,695.

(12) In response to the Assessor's request for the terms of purchase of the Assets in the absence of a written agreement [Fact (6)(f)], the Taxpayer supplied a copy of bill of sale dated 30 April 2001 and a breakdown of the Assets. The bill of sale was signed by the Taxpayer on behalf of

[Company N] and provided that the consideration for the Assets was payable in cash.

(13) In respect of the consulting fee paid to [Company C], the Assessor requested the Taxpayer to provide further information such as the relationship between the Taxpayer and [Company C], exact details of services rendered by [Company C], calculation of the consulting fee and evidence of payment to [Company C]. In reply, the Taxpayer supplied some copies of the Company's payment vouchers and contended the following:

(a) The consulting fee of $2,167,232 represented a global sum of all payments made to [Company C] directly or indirectly. The figure was "obtained by the auditors' reconciliation, in turn from their sighting of and passing of all the relevant vouchers".

(b) The vouchers represented evidence of the Company's expenses irrespective of to whom the expenses were paid.

(c) An analysis of the payment vouchers demonstrated that [Company C]'s obligations were either identical to those of the Company or else represented the receipt of money from the Company to have been applied for the use of the Taxpayer or [Mr P]. It should have made no significant difference if the payments had been made directly by the Company.

(14) On divers dates, the Taxpayer filed Tax Returns for the years of assessment 2002/03 to 2004/05. The Taxpayer declared in the returns that the Company's assessable profits/adjusted losses were as follows:

Year of Assessment	2002/03	2003/04	2004/05
Year ended	30-4-2002	30-4-2003	30-4-2004
	$	$	$
Assessable Profits/(Adjusted Losses)	(410,759)	(115,111)	1,163,209

The figures were arrived at after deducting of, inter alia, the following amounts:

Year of Assessment	2002/03	2003/04	2004/05
	$	$	$
Consulting fee to [Company C]	2,104,618	2,374,020	1,879,673
Delegation and litigation support	-	-	1,818,500

(15) The Assessor was not satisfied that the consulting fee to [Company C] should be allowed. She raised on the Taxpayer the following profits tax assessments in respect of the Company:

Year of Assessment	2002/03	2003/04	2004/05
	$	$	$
Profits/(Losses) per return [Fact (14)]	(410,759)	(115,111)	1,163,209
Add: Consulting fee to [Company C] [Fact (14)]	2,104,618	2,374,020	1,879,673
Assessable Profits	1,693,859	2,258,909	3,042,882
Tax Payable thereon	254,078	350,130	486,861

(16) The Taxpayer objected against the assessments for the years of assessment 2002/03 and 2003/04 at Fact (15) in the following terms:

"My objection is that there are no grounds that payments to [Company C] were:-

(i) "unsubstantiated;"

(ii) in their entirety not incurred for the production of assessable profit.

You will please note the same accounts have been prepared for the Law Society under its statutory rules and have been found unexceptional and acceptable by them.

Your assessor seems to think that an absence of invoices for every single payment to [Company C] is fatal to a claim for deduction when the payments claimed have been substantiated via an audit of my client and office accounts. In other words, the test of deductibility in section 16 Inland Revenue Ordinance is met and it is mandatory to deduct the expenses. Please also refer to the leading Privy Council judgment CIR v Mitsubishi [1996] AC 315(PC) on the meaning of "incurred"."

(17) The Taxpayer objected against the profits tax assessment for the year of assessment 2004/05 and claimed that the consulting fee to [Company C] should be deductible.

(18) For the relevant years of assessment, the Assessor requested the Taxpayer to provide, inter alia, details of the services rendered by [Company C], the basis of calculation of the consulting fee, supporting evidence to show the payments of fee and reasons to justify that the fee was commercially realistic and incurred in the production of chargeable profits.

(19) In response, the Taxpayer contended the following:

(a) The liquidation of [Company C] was closed and its books and records were disposed of. These matters were out of her control.

(b) As a matter of principle, given that [Company C] provided corporate and business secretarial services to a large number of firms and businesses both in and outside Hong Kong and employed its own staff, she could not imagine that the auditors and liquidators would think that [Company C] was not charging the Company proper fees for its services.

(c) She was further relying on the accountants' report required by and accepted by the Law Society. She was of the view that to deny the validity of such reports prepared by Hong Kong professional accountants/auditors was irrational and could not be the basis for an assessment.

(d) She observed that [Company C] brought the consulting fee to its accounts when it was assessed to profits tax. The usual principle to follow was that a payment was either deductible or assessable. The principle also said that a payment could not be taxed twice unless there were exceptional circumstances which re-characterised the payment's legal nature for tax purposes. It followed that if she was to be assessed to tax on the payment to [Company C], then [Company C] could not be liable to tax on the same payment. The Department had deemed the payment to [Company C] to be both her income and [Company C]'s at the same time. In her view, this could not be right.

(20) -

(21) The Assessor set out the facts as above for the Taxpayer's comment and requested her to provide, inter alia, auditors' reconciliation on the consulting fees paid to [Company C], accountants' reports accepted by the Law Society and details of the delegation and litigation support expenses for the year of assessment 2004/05.

(22) -'

The evidence

23. The Taxpayer was not called to give evidence and hence, we were not able to hear from her as to any of the issues that were to be dealt with and determined by the Board.

24. The Board on several occasions asked Mr Nasir as to whether the Taxpayer would be called, however, he submitted that she could not add anything nor assist the Board.

We were, in his submission, to rely on the relevant documents that have already been submitted for the Board's review and consideration.

25. However, in respect of the delegation and litigation support expenses payable to Company Q, Mr Nasir called Mr E.

Mr E's evidence

26. Mr E filed a witness statement dated 14 September 2010 and attended before the Board on 22 September 2010 and 22 October 2010.

27. Mr E is the Manager of Company Q which operates a broad-based corporate support and secretarial services business in Hong Kong. Company Q was established on 1 September 2003 and has been carrying on business since that date.

28. He informed us that Company Q provides support for over 100 companies carrying on business in Hong Kong in addition to the Firm. The Taxpayer and the Firm focused on the delivery of legal services and decided to expend as little time as possible on non-legal matters such as support and administration bearing in mind the role of a solicitor, their rules of conduct and confidentiality.

29. Therefore, there were, as he pointed out, various aspects of business support side of the Firm which the Taxpayer had determined to delegate and sub-contract. He drew to our attention the fact that such services included corporate secretarial back-up, telephone answering support, translation support, litigation support, document and file management support and storage, forensic accounting and like administrative related matters that have been delegated in whole or in part to other service providers and for the most part, to Company Q under his management.

30. He told us that these services were typically provided in a 'bundle and charged for by [Company Q] as a bundled cost, due to the difficulty and time cost to be wasted to do otherwise'. He asserted that those costs paid to Company Q were incurred as expenses by the Firm as a necessary part of their pursuit of income.

31. He also drew to our attention that from 1 September 2003, Company Q entered into an agreement with the Taxpayer and the Firm to provide administration and support. He drew our attention to a document dated 1 September 2003 that was entered into between himself and the Taxpayer. Clause 2 provided as follows:

> ' <u>Fees</u>
>
> For the provision of the administration and management services contemplated in clause 1, [Company A] shall pay [Company Q] fees at such rate or rates and payable on such dates as the parties mutually agree from time to time'.

32. He also drew our attention to a letter dated 15 May 2004 from the Taxpayer

addressed to Company Q. That letter stated as follows:

> '….. this letter will serve to confirm that we will engage [Company Q] on an extended basis continued to provide the services as set out in the Agreement as below.
>
> ….
>
> In consideration of the expansion and the delivery of the above support to our office, we agree to pay the sum of HK$300,000.00 per month through the period 1st April 2004 to 31st March 2005;'.

33. Mr E advised us that he is a solicitor and a barrister admitted in the New South Wales and in New Zealand. However, he does not hold any practicing certificates.

34. In cross-examination by Miss Ong, Mr E when asked as to the amount of bills paid to Company Q by the Taxpayer from 1 September 2003 to 30 April 2004, he answered:

> 'I will have to look it up. I am sorry. I just didn't anticipate ..…'

35. When asked by the Board for a rough estimate, he stated as follows:

> 'I will have to-, I will really just have to look it up. I mean, it is will be given in the agreement there. We have changed that agreement. Where are we? What did we say there? We started off by saying from time to time, I think we fixed on 300,000 a month, from memory. I think it was 300. I am sorry to be vague but I will just have to look it up. But in the original agreement I do remember we did it on a case-by-case basis.'

36. He also drew to our attention that he would render on an ad hoc basis various bills. He stated:

> 'But it evolved into a quarterly billing usually although the law firm would make instalment payments. It would depend on my needs for cash flow because I would be engaging other people.'

37. He started off by saying that payment was made on a case by case basis and thereafter, he drew to our attention by virtue of a letter dated 15 May 2004, Company Q would be paid on a monthly basis of $300,000. When asked by the Board whether he is in a position to produce any such invoices or produce any evidence to show the extent of the work done, he indicated that he would be able to produce documents. He confirmed in his evidence that he was able to illustrate that he did specific work regarding specific items.

38. However, when it was drawn to his attention that in his witness statement, there is no particularity of any invoices or documents supporting the specific cases, he indicated that he would be able to go through his records and try to identify the work done. He stated:

> ' We did render invoices there and that can be shown in [Company A]'s own client invoices itself.'

39. He drew our attention to a specific item whereby he provided assistance and advice in a section 45 stamp duty relief case. Again, when asked whether or not there was any invoice for this work done, he said

> ' There will be, sure'.

40. In light of the cross-examination and the questioning by the Board, Mr E assured that he did deliver the invoices, the Board was prepared to grant an adjournment to allow him to locate the relevant invoices to support the various matters he was putting to us.

41. After granting an adjournment, Mr E was in a position to provide us with some further documents. In particular, he provided to us with an invoice dated 31 March 2004 from Company Q addressed to the Taxpayer which stated as follows:

'INVOICE

To our fees as scheduled and adjusted,
1 September 2003 to 31 March 2004

Say: HK$1,830,190.00'

42. It is clear that this invoice on the face of it showed that Company Q invoiced the Taxpayer a lump sum of $1,830,190 on 31 March 2004.

43. When Mr E gave evidence before us on 22 October 2010, he also produced a schedule of the relevant documents attached to 31 March 2004 invoice entitled 'Records of issued invoices and payments from clients'.

44. In his evidence, he asserted that these were all the clients shown in the 'records of issued invoices and payments from clients of [Company Q]' and in turn, Company Q issued a global invoice to cover all the transactions. He asserted the invoice records were scheduled attached to the invoice and that a fee of HK$1,830,190 was arrived at by adding up the invoice amount in the invoice records.

45. It was put to him that there was clearly double invoicing. He then tried to suggest to the Board that the fee in the invoices was the total sum of unpaid invoices computed from the invoice records and that the Taxpayer agreed to take up the liability of such outstanding debts that were owed.

46. However, after being drawn to his attention that the fee in the invoice could not be reconciled to a total of the invoiced amount and that the unpaid amount in the invoice records, he then changed his position to suggest that the fee of HK$1,830,190 in the invoice

included certain litigation support fee of disbursement which was not set out in the invoice records.

47. In cross-examination, he admitted that the invoice records which were attached to the schedule which he submitted to the Board on 30 September 2010 were exactly the same as were submitted to the Inland Revenue Department ('IRD') on 15 November 2005 in response to an inquiry dated 28 September 2005.

48. The relevant inquiries that were being raised with him were in respect of Company Q's bad debts claimed for the year of assessment 2003/04.

49. Therefore, it was clear that the invoice records that were prepared by Company Q were for the purpose of supporting its bad debts claim.

50. We have no hesitation in accepting that it is clear that by Mr E trying to attach to the invoice dated 31 March 2004 the same schedule he previously submitted to the IRD to reflect various bad debts, raises serious question marks on the authenticity and indeed, the status of the invoice dated 31 March 2004.

51. Again, we note that Mr E has not provided any evidence whatsoever regarding the amount, basis and computation and timing of payment in respect of the Litigation Support Agreement dated 1 September 2003. Again, no breakdown or basis of computation of the delegation support expenses which have been claimed by the Taxpayer have been submitted.

52. Having carefully considered and reviewed Mr E's evidence, having looked carefully at the documents he provided and having regard to the fact that he has shifted his stance and position on various occasions, we find his evidence unacceptable and indeed, unbelievable. He has not been in a position to provide any evidence to illustrate or support that the relevant work that was purportedly done in respect of the Agreement as well as the letter dated 15 May 2004. All we have had are mere assertions as to the extent of the services that have been provided.

53. We have no hesitation in accepting the submissions of Miss Ong that serious questions can be raised as to the contemporaneous nature of the invoice dated 31 March 2004. We accept the submissions made by Miss Ong:

(a) Mr E did not produce this until repeatedly asked by the Board for documentary evidence to support his evidence.

(b) In the Invoice, he used the words '…… as scheduled and adjusted …..', yet there were no schedules showing any details of calculation and adjustment that resulted in a computation of HK$1,830,190. We accept Miss Ong's submissions that the Invoice neither set out the basis of computation of the fees charged nor the nature of services rendered.

(c) We also note that the sum of HK$1,830,190 which was charged in the Invoice against the Taxpayer is exactly the same amount of the 'HK$ gross invoices including disbursements' reported in the 2004 account. We accept Miss Ong's submission that it is highly unlikely that Company Q's entire turnover in HKD in the 2004 account came from the Taxpayer. Indeed, this is obviously inconsistent with Mr E's evidence whereby he stated that Company Q provided support for over 100 companies in addition to the Taxpayer and the details shown in the invoice records.

(d) Miss Ong also very helpfully provided a summary of the details shown in the invoice records by way of appendix to her written submissions. We accept that accordingly to the invoice records, the total amounts invoiced by Company Q in USD and HKD for the period from 10 February 2003 to 29 March 2004 are as follows:

	USD	HKD Equivalent [1] (a)	HKD (b)	Total (HKD) (a)+(b)
Total invoiced amount	57,250.50	446,553.90	917,650.60	1,364,204.50
Total amount invoiced to [the Company]	1,200.00	9,360.00	103,117.00	112,477.00
Total amount invoiced to other companies	56,050.50	437,193.90	814,533.60	1,251,727.50

Note
[1] USD1=HK$7.8

54. Therefore, we have no hesitation in accepting that the invoice records could at most show that Company Q had billed the Taxpayer fees of approximately HK$112,477 (US$1,200 + HK$103,117). It clearly does not support the fact that the Taxpayer had incurred delegation and litigation expenses to the extent of HK$1,818,500.

55. Again, the Taxpayer has not provided any evidence to show that the sum of HK$112,477 is a deductible expense pursuant to section 16 of the IRO.

56. At this stage, we again note that the Taxpayer herself decided not to give evidence. Therefore, we have not had any evidence before us from the Taxpayer as to the circumstances that led to the litigation support offered by Company Q to the Taxpayer and the Firm.

57. We have heard no evidence whatsoever from the Taxpayer or any member of the Firm which could help us to consider whether or not such services were indeed rendered

and to the extent of those services.

58. That being the case, in our view, it is quite clear that the Taxpayer has come nowhere near to overcoming the burden of proof that is imposed upon the Taxpayer pursuant to section 68(4) of the IRO.

59. Indeed, no evidence has been drawn to our attention to prove the actual payments made and Mr E never adduced any evidence such as attendance notes of meetings or discussions, written confirmation documents or date that could support the various services that were stipulated in the Agreement and the 2004 Letter.

60. Therefore, we have no hesitation in concluding that the sum of HK$1,818,500 is not a deductible expense.

Consulting fee to Company C

61. The Taxpayer has claimed consulting fees payable to Company C in the sum of HK$2,167,232 for the year of assessment 2001/02, HK$2,104,618 for the year of assessment 2002/03, HK$2,374,020 for the year of assessment 2003/04 and HK$1,879,673 for the year of assessment 2004/05 should be deductible. The Taxpayer asserts that Company C had provided to the Firm 'comprehensive consulting services including corporate secretarial services, technological consulting services, human resources management, electrical, mechanical and building services repair support, renovation and carpentry services, janitorial services, legal research marketing, management and client liaison'. The Taxpayer provided copy of Company C's letter dated 21 April 2000 addressed to the Firm ('the Letter') which states as follows:

> ' Dear Sir,
>
> Re : Corporate Secretarial and Support Services
>
> We confirm our recent meetings and agreement to provide [Company A] a range of services around the delivery of corporate secretarial-related services for your clients. We also indicate that we can provide information technology support as well as work for most corporate commercial-related matters.
>
> We will bill on a project basis or as may be determined from time to time between the parties.
>
> Please execute a copy of this agreement signifying your agreement to the terms.
>
> Yours truly,
> Signed [Company C]
>
> We do accept the above terms

Signed [Company A]'

62. Various copy vouchers were also provided in support. However, the Taxpayer nor did any representative give any evidence whatsoever to throw any light or assist the Board with regard to such payments.

63. Indeed, if one looks carefully at the relevant vouchers, they do not set out any detail as to any specific services that were rendered. The Letter also talks about billing on a project basis or may be determined from time to time. No evidence was drawn to the Board's attention illustrating and showing as to what work was done nor providing us with any calculation as to the timing of such payments.

64. Miss Ong in her written submissions also drew to the Board's attention the fact that Company C's address was stated as '[Address R]' whilst its reported business was located at Address K. The Letter which was signed had no chop nor was there any mention of the person who actually signed the Letter. Indeed, no coherent and considered evidence was produced to us showing how each particular payment was made. Although the Taxpayer provided various vouchers covering the relevant periods, those vouchers only show the following:

Year of Assessment	Amount ($)
2001/02	575,729.00
2002/03	159,336.00
2003/04	96,780.50

65. It can be seen that these payments are far less than the respective consulting fees that were claimed for each relevant year of assessment. For the year of assessment 2004/05, the Taxpayer has not adduced any evidence in respect of the payment of a consulting fee of $1,879,673.

66. With the exception of the six vouchers which show payments for Club S, none of the remaining vouchers have specified the nature of the payment.

67. The Taxpayer has claimed all along that she could not obtain any further information from Company C and that the books of Company C were under the control of its provisional liquidators.

68. In July 2010, various spreadsheets showing the purported profit and loss accounts of Company C for the years 1999 to 2003 and the various balance sheets were provided. However, there is no evidence showing the person, date or source documents which illustrates as to how the two spreadsheets were compiled.

69. Moreover, Company C had not filed any profits tax returns for the relevant years. Again, we repeat that no evidence was called by the Taxpayer to address or deal with any of these issues nor did the Taxpayer appear before us to explain exactly how such payments were made.

70. We have no hesitation in rejecting the claim for these consulting fees to be deductible pursuant to sections 16(1), 17(1)(a) and 17(1)(b) of the IRO. We also refer to the written submissions of Mr Nasir dated 22 and 29 October 2010. Again, in his written submissions, he has failed to show and produce any evidence to support that the consulting fees are deductible nor has he been in a position to set out in any detail exactly what comprehensive services were prepared. The mere assertion that such services were provided does not assist. Indeed, in paragraph 22 of his written submissions, he says as follows:

> ' 22. Given the fact that the appellant was a sole practitioner she would not be able to provide quality service without delegating such work to other persons or entities. Where the work/services were not strictly legal services (which could be undertaken by non-lawyers) it was easier/cost effective to delegate such work out to other entities, such as secretarial services, administrative work, trust work, as well as matters set out in the agreement with [Company C]. Given the nature of the work varied from time to time the agreement with [Company C] had to be broad and flexible.'

71. With respect, it seems as if Mr Nasir is giving evidence on behalf of his client in his written submissions. The Taxpayer sought fit not to appear before the Board or to give evidence to support any of the contentions in Mr Nasir's written submissions.

Medical allowances to the taxpayer and her family and miscellaneous subscription fees

72. Again, the Taxpayer has admitted that the medical allowances of HK$17,004 were paid to her and her family, it is quite clear that this sum was in essence a private and domestic nature and is not deductible. We also note that the miscellaneous subscription fees regarding membership of Club T, Club U, credit card subscription fees to Bank V and alumni membership fee to Society W on behalf of Mr P, which amounted to HK$10,355, are all expenses that were paid for the benefit of the Taxpayer's spouse and family.

73. Again, no evidence was adduced before the Board showing that these were not private or domestic in nature. In Mr Nasir's written submissions, paragraphs 78 – 91, he attempts to give evidence. Again, these are not supported by any evidence before the Board. Hence, we reject his submissions.

Interest income from clients' account HK$181,248 for the year of assessment 2001/02

74. We have no hesitation in accepting the submissions put forward to us by Miss Ong in her further written submissions.

75. Section 66(3) of the IRO provides as follows:

> '*Save with the consent of the Board and on such terms as the Board may determine, an appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).'*

76. Again, we refer to China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486 where Mr Justice Bokhary PJ said as follows:

> '*….. If and whenever s.66(3) consent is sought, it should be sought fairly, squarely and unambiguously.'*

77. It is clear that Mr Nasir in his written submissions dated 22 October 2010 requested the Board to rule that the interest income from client's account of $181,248 should not be chargeable to profits tax for the year of assessment 2001/02. It is quite clear that Mr Nasir is introducing grounds of appeal that were not contained in the statement of appeal which we have already referred to in paragraph 4 above. Indeed, in a letter dated 21 March 2003, in objecting to the 2001/02 profits tax assessment, Accounting Firm X on behalf of the Taxpayer, referred to expenses only. There has never been any mention of the inclusion of interest income from client's trust bank account as chargeable income. The appeal to the Determination was only in respect of the deductibility of expenses. There has never been any mention of the inclusion of interest income.

78. Therefore, we accept that interest income has never been an issue before the hearing commenced. Mr Nasir, has not sought the Board's consent under section 66(3) of the IRO during the hearing on relying on the grounds other than as stated in the notice of appeal. Therefore, we reject the purported new ground put forward by Mr Nasir concerning interest income.

Section 61 of the IRO

79. Section 61 of the IRO provides as follows:

> '*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.'*

80. In Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773, Woo JA said at page 788 as follows:

> '*40. The meaning of "artificial or fictitious" has been dealt with in Seramco Superannuation Fund Trustees v Income Tax Commissioners [1977] AC 287, where Lord Diplock giving the judgment of the Privy Council stated at p.298:*

> *"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. ….. 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.'*

81. Woo JA went on to say at paragraph 41 as follows:

> *'41. 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 [counsel for the Commissioner], however, that commercial realism or otherwise can be one of the considerations for deciding artificially.'*

82. We have no hesitation in accepting the submissions put forward to us by Miss Ong that the purported agreements between the Taxpayer and Company C/ Company Q and the alleged consulting fees/delegation and litigation support expenses paid and payable thereunder are relevant transactions for the purpose of section 61.

83. We have no hesitation in accepting the submissions put forward to us by Miss Ong and accept they are unrealistic for the reasons put forward by her:

> <u>In respect of Company C's Letter to the Taxpayer dated 21 April 2000</u>
>
> ' (a) The anomalies as stated in paragraphs 7.2(a) to (e) in the main written submissions;
>
> (b) Absence of evidence of payment of the alleged consulting fees for each of the years of assessment 2001/02 to 2004/05;
>
> (c) Lack of justification of the substantial amount of total fees payable;
>
> (d) Irregular timing and amount of part of the alleged payments made to [Company C] (Appendices A, A1 and A2 to the main written submissions);
>
> (e) Lack of evidence of consulting services provided to the Company by [Company C];
>
> (f) Charging of consulting fees reducing the profits of the Company, and hence the tax which would otherwise have been payable by the

Appellant for the years of assessment 2001/02 to 2004/05 (Appendix 1);

(g) No evidence that [Company C] had any experience or expertise in providing the services as stipulated under the Letter; and

(h) The facts that [Company C] has not report its receipt of the consulting fees [Fact (3)(c)] and that [Company C] was dissolved on 29 November 2005 [Fact (3)(d)].'

In respect of the Taxpayer's Letter to Company Q dated 15 May 2004

' (a) The observations as stated in paragraphs 8.3 (a) to (c) in the main written submission;

(b) Absence of evidence of payment of the alleged delegation and litigation support expenses for the year of assessment 2004/05;

(c) No evidence on how the monthly sum of $300,000 was arrived at;

(d) Lack of evidence of litigation support services provided to the Company by [Company Q];

(e) Charging of delegation and litigation support expenses reducing the profits of the Company, and hence the tax which would otherwise have been payable by the Appellant for the year of assessment 2004/05 (Appendix 1); and

(f) No evidence that [Company Q] had any experience or expertise in providing the services as stipulated under the 2004 Letter.'

84. It is also quite clear that there is an absence of evidence of payment of the alleged delegation and litigation support expenses for the year of assessment 2004/05. We accept that there is a lack of justification of the essential amount of the total expenses payable and the lack of evidence of the alleged delegation and litigation support expenses provided by Company Q. It is also clear in our view that the charging of delegation and litigation support expenses which has the effect of reducing the profit of the Taxpayer and the tax which would otherwise have been payable by the Taxpayer for the year 2004/05 is further evidence to support the application of section 61.

85. We also accept the submissions of Miss Ong that the purported agreements between the Taxpayer and Company Q are commercially unrealistic and artificial for the purposes of section 61 of the IRO. Hence, the Taxpayer should be treated as not having entered into any agreement with Company Q and not having incurred any delegation and litigation support expenses.

Conclusions

86. We therefore conclude that we have no hesitation in dismissing the appeal for the reasons set out above.

87. We refer to section 68(9) of the IRO whereby there is power to this Board to make an order for costs.

88. Having regard to the way in which this appeal was conducted, we order that a sum of HK$5,000 should be awarded as costs and the sum is to be added to be tax charge and recovered accordingly.