Case No. D36/09

Salaries tax – mere assertions and sketchy evidence – sections 8(1), 9(1), 11B, 11D, 16(1), 17(1), 61, 66(3), 68(4), 70 and 70A of the Inland Revenue Ordinance ('IRO').

Panel: Chow Wai Shun (chairman), Lee Hung Chak and Miu Liong Nelson.

Date of hearing: 14 May 2009.
Date of decision: 16 October 2009.

This is an appeal against the determination of the Deputy Commissioner whereby (1) the assessor's notice of refusal to correct the salaries tax assessment for the year of assessment 2001/02 under section 70A was upheld and the salaries tax assessment thereof confirmed and (2) personal assessment for the year of assessment 2002/03 was confirmed. The Appellant did not object to the salaries tax assessment within the stipulated time period but subsequently wrote to the assessor alleging that, contrary to both the employer's and his returns he had not received ten months' salaries amounting to $2,000,000 out of the 13 months' pay. For the year of assessment 2002/03, the Appellant declared that he had sustained a net loss from his sole-proprietorship business. The Appellant elected for personal assessment for this year of assessment.

Held:

1. Since the Appellant did not object to the 2001/02 assessment in time, the assessment is final and conclusive unless it can be established that the tax charged for the year of assessment is excessive by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the assessable income or in the amount of the tax charged. The onus of proof is on the Appellant and he has hardly been able to substantiate his case over and above mere assertions as required by section 68(4).

2. Giving the Appellant the benefit of any doubt to the greatest extent, the Board would not agree that the Appellant had satisfied the burden of proof with such sketchy and scanty evidence and the Board found no justifiable reason to disturb the original assessment for the year of assessment 2002/03.

Appeal dismissed.

Cases referred to:

D31/87, IRBRD, vol 2, 409
Mok Tsze-fung v CIR (1962) 1 HKTC 166
D78/02, IRBRD, vol 17, 978
D57/06, (2006-07) IRBRD, vol 21, 1061
Strong & Co v Woodifield [1906] AC 448
CIR v Chu Fung Chee [2006] 2 HKLRD 718
So Kai Tong v CIR [2004] HKLRD 416
D94/99, IRBRD, vol 14, 603
Cheung Wah Keung v CIR [2002] 3 HKLRD 773
CIR v Swire Pacific Ltd (1979) 1 HKTC 1162

Taxpayer in person.
Chan Man On and Yip Chi Yuen for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 13 January 2009 ('the Determination') whereby:

(1) The assessor's notice of refusal dated 17 July 2007 to correct the salaries tax assessment for the year of assessment 2001/02 under section 70A of the Inland Revenue Ordinance (IRO) was upheld and the salaries tax assessment for the year of assessment 2001/02 under charge number X-XXXXXXX-XX-X dated 4 September 2002, showing net assessable income of $2,588,000 with tax payable thereon of $385,200 (after deduction of tax rebate) was confirmed.

(2) Personal assessment for the year of assessment 2002/03 under charge number X-XXXXXXX-XX-X dated 16 September 2003, showing reduced total income of $3,316,000 with tax payable thereon of $497,400 was confirmed.

2. The Appellant appeared in person, affirmed to give evidence before us and was subjected to cross-examination by Mr Chan, the representative for the Respondent. Having considered all documentary evidence sent to the Board before and the oral evidence given by the Appellant during the hearing, we find the following facts as facts relevant to this appeal:

(1) The Appellant had been the Deputy Chairman and Managing Director of Company F, which subsequently changed its name to Company G, until August 2002. His brother, Mr H, had been the Chairman of Company F until August 2002. Company F was a listed company in Hong Kong. Company F was an investment holding company; its subsidiaries were

principally engaged in the business of providing services I, J, K and other related services. According to Company F's annual report 2002, the Appellant had XX years' experience in business J, XX years' experience in international trading, industrial investment and property investment and had experience in securities, finance and property development.

(2) The Appellant's employment with Company F was terminated on 19 August 2002.

(3) Company F filed the following employer's returns in respect of the Appellant, which showed, among others, the following particulars:

(a) Year ended 31 March 2002

(i) Capacity in which employed:	Managing director
(ii) Period of employment:	1-4-2001 to 31-3-2002
(iii) Income: Salary/Wages:	$2,600,000

(b) Period from 1 April 2002 to 18 August 2002

(i) Capacity in which employed:	Managing director
(ii) Period of employment:	1-4-2002 to 18-8-2002
(iii) Reason for cessation:	Resignation
(iv) Total income:	$3,320,000

(4) During the year of assessment 2001/02, both Mr H and the Appellant were directors of Company L and Company M.

(5) The Appellant filed his individual tax returns for the years of assessment 2001/02 and 2002/03.

(a) The Appellant reported the same particulars of employment as in paragraph 3(a) and (b) above.

(b) For the year of assessment 2002/03, the Appellant declared that he had sustained a net loss of $2,589,192 from his sole-proprietorship business in the name of Company N. The Appellant elected for personal assessment for this year of assessment.

(6) The assessor raised on the Appellant the following salaries tax assessment and personal assessment for the years of assessment 2001/02 and 2002/03 respectively:

(a) Salaries tax assessment for 2001/02 (dated 4 September 2002)

	$
Income	2,600,000
Less: Contributions to approved retirement scheme	12,000
Net assessable income	2,588,000
Tax payable thereon (at standard rate)	388,200*

* The tax payable was subsequently reduced to $385,200 pursuant to the Tax Exemption (2001 Tax Year) Order

(b) Personal assessment for 2002/03 (dated 16 September 2003)

	$
Income	3,320,000
Less: Contributions to approved retirement scheme	4,000
Reduced total income	3,316,000
Tax payable thereon (at standard rate)	497,400

(7) The Appellant did not object to the salaries tax assessment for the year of assessment 2001/02 within the stipulated time period.

(8) The Appellant subsequently wrote to the assessor on several occasions, by letters dated 18 October 2003, 18 December 2003, 31 March 2004, 24 January 2007 and 14 February 2007 respectively, alleging that, contrary to both the employer's and his returns he had not received ten months' salaries amounting to $2,000,000, out of the 13 months' pay in a total amount of $2,600,000 as agreed with Company F.

(9) In response to the assessor's enquiries, Company F and its representative provided information and documents, including:

(a) a copy of the schedule of payments for the Appellant's salary, together with copies of cheques, withdrawal forms, customer's advices and autopay electronic payment reports;

(b) a form specified by the Companies Ordinance signed by the Appellant confirming his remuneration of $2,600,000 (plus employer's contribution in the sum of $360,000 to a recognized occupational retirement scheme) for the year of assessment;

(c) an acknowledgement dated 23 August 2002 signed by the

Appellant confirming that he had received the cheques thereunder from Company F being full and final payment pursuant to their agreement.

(10) After considering the information and documents furnished by Company F, the assessor notified the Appellant by letter dated 17 July 2007 that he was not satisfied that the salaries tax assessment for the year of assessment 2001/02 was excessive by reason of any error or omission as prescribed by section 70A of the IRO.

(11) By letter dated 13 September 2007, the Appellant objected to the assessor's notice of refusal to correct the salaries tax assessment for the year of assessment 2001/02, reiterating that he had not received the disputed $2,000,000 and disputing that he had never received or acknowledged receipt of the said sum.

(12) By letter dated 11 October 2007, the Appellant once again alleged that he had just received the $600,000 as salaries for the year of assessment 2001/02 but, with reference to information and documents provided by Company F, he agreed to, though reluctantly as he said, take a further sum of $800,000 as part of his salary payments.

(13) The Appellant also objected to the personal assessment for the year of assessment 2002/03 on the ground that 'actual loss/expenses are incurred in operating the business' via Company N. The said loss/expenses in dispute comprised: (i) a trading loss of $1,390,000 arising from purchase from Company P and subsequent sale to Company Q; (ii) business trip expenses of $110,278.15; (iii) entertainment expenses of $776,587.66; (iv) management fee expenses of $240,000 to Company R pursuant to a service agreement made on 1 December 2002 (the Service Agreement); (v) salaries and wages of $68,277; and (vi) other sundry items of $4,049.50.

(14) According to the Business Registration record, Company N commenced its business on 23 August 2002 and ceased its business on 12 March 2004. The nature of its business was 'general trading and investment'.

(15) By letter dated 19 January 2004, the Appellant acknowledged that he had known Company P for many years, of which Ms S was a director. According to the annual return filed by Company R to the Companies Registry, Ms S was a director as well as the majority shareholder and secretary of Company R at the relevant times.

We shall deal with the evidence as necessary in the relevant parts of our decision below.

3. The Appellant stated in his notice and statement of grounds of appeal the following reason and grounds which are reproduced verbatim below:

> ' REASONS
>
> This Notice of Appeal raised one major issue –
>
> Why did the Inland Revenue levy tax on income which has never Accrued or Existed?
>
> GROUNDS
>
> The ground of this Notice based on facts –
>
> A) The fact that I have never received any of the amount that the Deputy Commissioner deemed I have been received … (clause 4(b), P.15). Does our government judged, and, make decision based on assumption only? Fact is fact, and facts will prove his assumption is wrong.
>
> B) It was clearly highlighted on clause (4) (c), P.15 that "cash cheque signed by the Taxpayer's brother…" It was the taxpayer's brother who had received the money, so why should the taxpayer be taxed on that?
>
> C) Being a Non Executive Director of the two companies, [Company L] and [Company M], mentioned in (clause (9)(b), P.4), my role was a silent partner with no actual duties, I was not involved in any daily operations and had never earned any salary from these two companies. It is the Inland Revenue Department who informed me that the claimed salaries were deposited to the A/C of these two companies. In this case, how could the commissioner assumed that the money was received by me?
>
> D) The assumption stated in clause ((6)(a), P.16) was once again not correct. I have been engaged in the garment industry for many years and am are [*sic*] well experienced in this trade.'

4. What has been said in D) above is just an assertion. Even if the Appellant had been engaged in the industry for so long and were experienced in the trade, the loss and the expenses claimed for would not have necessarily been deductible for profits tax purposes. We therefore conclude that on his notice and statement of grounds of appeal the Appellant has raised no reason or ground to challenge the Determination so far as the year of assessment 2002/03 is concerned.

5. Mr Chan for the Respondent reminded us that consent of this Board would have to be obtained pursuant to section 66(3) of the IRO for the Appellant to rely on an additional ground of appeal. Section 66(3) of the IRO provides:

> '*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…*'

6. Mr Chan submitted that he would object to the Appellant's application to rely on any additional ground of appeal on the basis that the Appellant could have and should have been able to raise and formulate a ground in his notice and statement of grounds of appeal in the very first place. It is so because from the previous correspondence with the Appellant, the markings on the Determination and the assertion in 3 D) above, the Appellant should have been aware of that being one of the subject matters of this dispute.

7. Having been directed to section 66(3) of the IRO, the Appellant appeared to intend to proceed his appeal, inter alia, against the assessment made in respect of the year of assessment 2002/03. Since the Appellant was not legally represented, we had not pushed for a formal application under section 66(3) but took that by his conduct he would have formally done so if required. On the same footing, we had not demanded a clear formulation of the additional ground but allowed the hearing to proceed on the assumption that our consent for an additional ground was granted. This issue will be further dealt with in our decision below.

Our decision

Year of Assessment 2001/02

8. We set out the relevant provisions of the Inland Revenue Ordinance below:

(a) Section 70 provides:

> '*Where no valid objection or appeal has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable income or profits or net assessable value assessed thereby, … the assessment as made … shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income or profits or net assessable value…*'

(b) Section 70A(1) provides:

> '*Notwithstanding the provisions of section 70, if, upon application made within 6 years after the end of a year of assessment or within 6 months after the date on which the relative notice of assessment was served, whichever is the later, it is established to the satisfaction of an assessor that the tax charged for that year of assessment is excessive by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the amount of the net assessable value (within the meaning*

of section 5(1A)), assessable income or profits assessed or in the amount of the tax charged, the assessor shall correct such assessment…'

(c) Section 8(1) provides:

'*Salaries tax shall… be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from…*

(a) any office or employment…'

(d) Section 9(1) provides:

'*Income from any office or employment includes –*

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others…'

(e) Section 11B provides:

'*The assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment.'*

(f) Section 11D provides:

'*For the purpose of section 11B –*

(a) income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income… Provided that for the purpose of this paragraph income which has been either made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person…'

(g) Section 68(4) provides:

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

9. Since the Appellant did not object to the assessment in time (paragraph 2(7) above), the assessment is final and conclusive (section 70) unless it can be established that

the tax charged for that year of assessment is excessive by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the assessable income or in the amount of the tax charged (section 70A).

10. There is no dispute that the Appellant's income from Company F is chargeable for salaries tax in Hong Kong. The Appellant's case is that, contrary to what he put down in his tax return (and what Company F put down in its employer's return), he has not received part of the income which has been assessed tax in the year of assessment. If that is established, that part of his income should not have been assessed tax and there would have been an error in both returns for which the assessor should have corrected the assessment pursuant to section 70A. The onus of proof is on the Appellant: section 68(4), which means no more than that the Appellant must substantiate his case: D31/87, IRBRD, vol 2, 409 at 410 and Mok Tsze-fung v CIR (1962) 1 HKTC 166 at 182. However, the Appellant cannot expect us to act on bare allegations: D78/02, IRBRD, vol 17, 978 followed in D57/06, (2006-07) IRBRD, vol 21, 1061.

The evidence

11. Apart from the two returns, Mr Chan of the Respondent referred us to the following evidence, all of which have been annexed to and considered in the Determination:

(a) documents referred to in paragraph 2(9) above;

(b) Company F's annual report for the year of assessment.

12. Among the documents referred to in paragraph 2(9), the form specified by the Companies Ordinance by itself confirms *only* to the effect that the remuneration *receivable* by the Appellant from or in respect of Company F was $2,600,000 (plus employer's contribution in the sum of $360,000 to a recognized occupational retirement scheme) for the year of assessment.

13. Among the documents referred to in paragraph 2(9), the acknowledgement dated 23 August 2002 shows that the Appellant acknowledged receipt two cheques being 'full and final payment' from Company F to him pursuant to their agreement dated 22 September 1997 and to the Employment Ordinance, one of the cheques in the sum of $120,000 being wages from 1 August to 18 August 2002 while the other cheque in the sum of $2,600,000 comprising, as subsequently advised by Company F by letter dated 11 February 2004, (i) $2,000,000 being leave entitlement; (ii) $400,000 being gratuity; and (iii) $200,000 being payment in lieu of notice. The Appellant told us that he signed the acknowledgement in anger and in a hurry. Documentary evidence shows, however and as put forward by Mr Chan for the Respondent, that his contract was terminated with effect from 18 August 2002 while he acknowledged receipt of those cheques as full and final settlement on 23 August 2002. In response, the Appellant said that it took a few days for Company F to issue the cheques. No matter how much, if any, was the disputed amount at that time between the Appellant and Company F, the Appellant was bound by his

presentation and clearance of the cheques without informing Company F duly that the cheques had not been accepted for full and final settlement. Although we do not find it necessary in light of our analysis of the evidence as a whole as seen below, we opine that the Appellant's acceptance of the cheques falls within the deeming provision of section 11D(a), despite the fact that we were not specifically asked to make a ruling, nor had we been provided with any direct authority, on this point.

14. Among the documents referred to in paragraph 2(9), the payment schedule and supporting documents, including copies of cash cheques, customer advices, withdrawal forms, show:

Month/Double Pay	Sum A $	Sum B $	Sum C $	Sum D $
April 2001				200,000
May 2001			200,000	
June 2001			200,000	
July 2001		200,000		
August 2001		200,000		
September 2001				200,000
October 2001				200,000
November 2001		200,000		
December 2001				200,000
January 2002		200,000		
February 2002	200,000			
Double Pay	200,000			
March 2002	200,000			
Total	600,000	800,000	400,000	800,000

where: (a) Sum A comprised sums deposited into the Appellant's bank account by cash cheques or by auto-pay; (b) Sum B comprised sums issued by cash cheques that were signed by the Appellant; (c) Sum C comprised sums transferred into Company L and Company M; and (d) Sum D comprised sums issued by cash cheques that were signed by the Taxpayer's brother.

15. The Appellant accepted receipt of Sums A and B (see paragraph 2(12) above) but disputed Sums C and D where the relevant cheques were all signed by the Appellant's brother.

16. Regarding its procedures and controls on issuance of cheques, Company F, by way of letter dated 19 February 2008 via its auditor, explained that since the Appellant and his brother were executive directors during the relevant year of assessment and were in charge of its management and daily operations, they had sole decision and control on how the director fees of the Appellant could be paid off. Further, some of the application forms for the issuance of cash cheques indicated that such cheques were for salary payments to the Appellant, such forms and cheques being all approved by either the Appellant or his brother.

Moreover, no receipt from the Appellant on such payments was required because of the status of the Appellant in Company F at that time. The Appellant did not dispute these. He further confirmed that during the relevant time either he himself or his brother alone could approve and sign cheques for and on behalf of Company F.

17. Sum C comprised sums transferred into the bank accounts of Company L and Company M. Apart from being one of the directors (see paragraph 2(4)), the Appellant was the secretary and a shareholder of the two companies (the other shareholder being his brother). The Appellant said in cross examination that the two companies were indeed set up by his brother and that he was just a 'silent' shareholder with no involvement in the operation of the companies. The Appellant also said that in his best knowledge the two companies were dormant. From the evidence, we cannot find any business relationship between Company F and Company L or Company M. We note from the copy withdrawal forms and the typed remarks on the pages that the total amount transferred on those two occasions was said to have included, inter alia, salaries for his brother for those two months.

18. Sum D represented cash cheques, according to Company F, issued to pay the Appellant for his income for April, September, October and December 2001. The Appellant repeatedly said that he did not receive any of the money. We note from the copy cheques dated 23 May 2001 and the typed remark on the page that the two cheques were said to have been for salaries payment for the Appellant and his brother respectively. We also note from the copy cheque in the sum of $380,000 dated 21 November 2001 and the typed remark on the page that it was said to represent two months' salary for the Appellant. We further note from the copy cheque dated 7 January 2002 and the typed remark on the page that it was said to have included, inter alia, salaries for his brother for December 2001. For comparison, we note from the copy cheque signed *by the Appellant* dated 10 December 2001 in the sum of $380,000 and the typed remark on the page that it was said to have included, inter alia, salaries for his brother for November 2001.

19. Company F's annual report for the year of assessment does not reflect any outstanding balances owed and due to the Appellant as its director. Nothing to that effect can be found either from the director's report signed by the Appellant on behalf of the Board of directors or from the financial statements signed by the Appellant and his brother and certified by the auditor.

20. In his initial application for correction under IRO section 70A dated 31 March 2004 after being notified that his late objection was not considered, the Appellant explained that during the relevant year of assessment Company F *might* have difficulties in its cash flow and so as a director of Company F, he did not receive part of his salaries on the understanding the same would be received at a later date when Company F's financial situation allowed. The Appellant provided no further evidence on this matter. Although we note from Company F's annual report of that year that it suffered a loss, there was no indication of such a cash flow problem as alleged by the Appellant. After all, the financial report of Company F did not show any arrears of salaries towards any of its directors or employees. While we also note from some of the requests for issuance of cheques were made later than the month for which the salaries were paid, that supports possibly late

payment rather than non-payment.

21. From the evidence, the Appellant first alerted Company F of his non-receipt of salaries (originally totaling $2,000,000 – see paragraph 2(8)) on 16 October 2003, which appeared to have been prompted by the assessment. On receipt of a reply of denial from Company F and a subsequent letter requesting all future correspondence be in writing to its legal counsel, the Appellant made no further attempt to pursue his claim. He provided an explanation at the hearing that at that time there were claims pursued against him and soon afterwards he was put under bankruptcy proceedings. As such he saw no real meaning of pursuing his own claim against Company F.

22. Having been provided with documents referred to in paragraph 2(9), in particular, the payment schedule and supporting documents, including copies of cash cheques, customer advices and withdrawal forms, the Appellant cut down the amount in dispute with the Inland Revenue. The Appellant had explained, in his correspondence with the Inland Revenue dated 11 October 2007, that he could not recall exactly the reasons for issuing cheques in those occasions and so he *reluctantly* accepts receipts of those monies.

Conclusion of this part

23. During the relevant period, there might have been something bitter and sour going on between the Appellant and his brother, particularly over their finances and hence relationship or vice versa. However, this is not something we are concerned with. We must say that from what we have seen and heard, we find the Appellant overly casual with his financial and tax affairs. He backed down in the amount in dispute upon being confronted by documentary evidence from Company F. According to his evidence, he even could not recall exactly the circumstances and reasons for signing some of the cheques which were, according to Company F's record, for his salary payment. In addition, as suggested by Mr Chan of the Respondent, which we very much agree, the Appellant could have stated in his return the circumstances he was facing at that time if he was owed a substantial part of his salary in the relevant year of assessment. He could have received the two cheques which represented his entitlement without accepting the same as full and final settlement. He could have pursued his claim against Company F despite the reasons he gave. All these put together, in our view, weaken the Appellant's case. On the other hand, the Appellant has hardly been able to substantiate his case over and above mere assertions as required by section 68(4).

24. In totality of the evidence and on balance, we therefore hold that the Appellant has failed to satisfy the burden of proof imposed on him by virtue of section 68(4) that there has been error in his return for the purposes of invoking section 70A.

Year of Assessment 2002/03

Additional ground of appeal

25. We agree with Mr Chan's submission on this point. For whatever reasons, the

Appellant had chosen to deal with the issue of deductibility of certain items of alleged expenditure in such a loose and casual manner in his notice and statement of grounds of appeal. Even with the full benefits given to the Appellant on the technical and procedural matters of the application under section 66(3), we still cannot find in ourselves much, if any, sympathy to him. For the avoidance of any doubt, even if the Appellant did comply with such formalities under the provision, we would still reject the application.

26. Having decided so, it is sufficient for us to dismiss the appeal so far as this year of assessment is concerned. However, we proceed below to deal with the substantive issues in case we have jumped the gun too quickly in having not allowed to be added any additional ground of appeal under section 66(3).

Relevant statutory provisions and legal principles for deductions

27. (a) Section 16(1) of the IRO provides:

> '*In ascertaining the profits in respect of which a person is chargeable to tax under this Part [IV] 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…*'

(b) Section 17(1) provides:

> '*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;*
>
> *(c) any expenditure of a capital nature…*'

28. To be deductible, the expenditure in question must have been incurred. In addition, it must fall on the taxpayer as trader, and must be for the purpose of earning chargeable profits. It is not enough for the expense to simply arise out of the trade or otherwise be connected with the trade. The following extracts from Strong & Co v Woodifield [1906] AC 448 were adopted and approved in CIR v Chu Fung Chee [2006] 2 HKLRD 718:

> '*In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade, or it may be connected with*

something else quite as much as or even more than with the trade. I think that only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation or fall on the trader in some character other than that of trade. The nature of the trade is to be considered' (per Lord Loreburn at page 452)

'I think that the payment of these damages was not money expended "for the purpose of the trade." These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits.' (per Lord Davey at page 453)

29. In So Kai Tong v CIR [2004] HKLRD 416, the court agreed with this Board and accepted the 'objective approach' in D94/99, IRBRD, vol 14, 603 be adopted to consider to what extent, if any, an item of expenses is incurred in the production of chargeable profits. All circumstances will have to be looked at.

30. In addition to the facts and the decision of D94/99, Mr Chan of the Respondent referred us further to both section 61 of the IRO and Cheung Wah Keung v CIR [2002] 3 HKLRD 773.

(a) In relation to D94/99, Mr Chan drew our attention to the following extracts:

'24. … 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 [his service company] 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 relationship between the payer and the payee is a relevant circumstances. 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.'

(b) Section 61 provides:

'*Where an assessor is of an 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 assessed accordingly.*'

(c) In Cheung Wah Keung v CIR, the Court of Appeal referred to a Privy Council decision in relation to the meaning of 'artificial or fictitious':

'*40. The meaning of "artificial or fictitious" has been dealt with in Seramco 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 … 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.

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, however, that commercial realism or otherwise can be one of the considerations for deciding artificiality.'

31. The Appellant bears the same onus of proof of the assessment being excessive or incorrect as prescribed by section 68(4).

Trading loss

32. The Appellant had forwarded to the assessor copies of documents which are also attached to the Determination and contended:

(a) in his letter dated 19 September 2003, that:

'[Company N] took its position to purchase the goods in August of 2002 as there were prospective buyers from China. Prior to acknowledging receipt of the goods, samples were taken from the lot and the quality was found to be satisfactory. [Company N] had to settle the purchase value of goods in cash because it's [sic] bank account had not been opened at the time. Most unfortunately, through an inspection taken by a prospective buyer, the products were found to have water stains and spots that the sales could not be finalized. The supplier was not in the position to entertain any claims as the goods had been acknowledged receipt in good order and conditions. [Company N] then tried its greatest effort in finding buyers to dispose of the defective goods. To avoid additional expenses and escalating loss in keeping the goods, [Company N] had made the decision to cut its loss to sell the lot at HK$30,000, making a trading loss of $1,390,000. The operating expenses were incurred as the business continued to be carried on';

(b) in his letter dated 19 January 2004, in respect of the purchase, that:

(i) 'I had known [Company P] for many years. [Ms S], a director of [Company P] approached me regarding a stock lot of clothes which the company would be able to offer at a very special price. She left the stock lists, samples, photos and a price indication of $1.5 million for my perusal. I had in mind that some business friends in China might be interested in purchasing the stock lot to utilize their purchase budget. [Mr T] (Chairman of [Company U]) who used to make businesses with me some years ago confirmed that he could take the stock lot for his clients. [Mr T] collected the samples, photos and stock lists for order processing. I gave an offer at $1.75 million. At the same time, I asked [Ms S] to hold the stock lot. [Ms S] subsequently asked me to sign a contract or she would be free to sell the lot to other customers. I further confirmed with [Mr T] that his clients would take the lot at $1.65 million by early September as they needed time to arrange the funds. I then signed the contract with [Ms S] after negotiating the price to $1.42 million, and prepared a contract for [Mr T's] signature in Hong Kong.'

(ii) 'On 31 August, 02, inspection was taken at [Address V]. [Ms W], my secretary at that time, was instructed to conduct the matter. She reported to me that the goods were in 306 packages and that each

package was labeled with the relevant quantities and items. Three packages of the goods were inspected. I then acknowledged receipt of the goods by signing on the invoice of [Company P]. A delivery order was received when the payment for purchase was made.'

(iii) 'On 7 Sept, 02, [Mr T] sent his men to take inspection of the stock lot. I was shocked when [Mr T] informed me that he could not accept the goods as water stains/spots were found on most of the goods. [Ms W] was unable to explain the reasons for the defects – she was not aware of the defects when she checked the goods. In this awkward circumstances, I contacted [Ms S] to complain about the defects. She was not in a position to entertain my claims as the goods had been acknowledged receipt in good order and condition. I tried to convince [Mr T] to take the lot at a discounted price but not successful. The sales contract was finally cancelled at [Mr T's] request.'

(iv) 'The goods were not insured as the buyer was expected to take delivery of the goods shortly.'

(v) 'Payment of the purchase was made by cash withdrawn from my account no. XXX-XXXXXX-XX with [Bank Y]. A copy of the relevant bank statement is enclosed.'

(vi) 'Details of the bank account that have been used for business purpose are as follows:

Name of account holder:	[Company N]
Bank no. and account no.:	XXX-XXX-XXXXXX-XXX'

(c) in the same letter dated 19 January 2004, in respect of the goods alleged to have sold to Company Q, that:

(vii) 'I tried finding new buyers from China for the defective lot but no firm order could be finalized. Through some business friends, I knew [Mr Z] who is a director of [Company Q]. He was only willing to take the lot at $30,000. He made cash payment when he took delivery of the goods by his truck. No sales contract had been made as I did hope that I could find better buyers before [Company Q] took the goods.'

33. No witness was called and no further evidence, documentary or oral, has been submitted by the Appellant in this regard.

34. On the other hand, Mr Chan of the Respondent raised the following enquiries and concerns over the alleged transaction, which we very much share.

(a) Given the long-term relationship as alleged by the Appellant with Company P and Ms S, it is difficult to imagine that Ms S would have deliberately sold in such quantity of defective goods to Company N. According to the Appellant, Company N paid Company P by cash because Company N had not yet been able to open a bank account. It is at least equally difficult to understand, given the long-term relationship as alledged, why Company P did not allow Company N to settle the payment by any other means or even on credit terms which is rather common in the trade. It is also difficult to figure out why Ms S, as a director of Company P, was not in a position to entertain the Appellant's complaint or to share part of the loss. The Appellant's explanation that he was not sure if Ms S (we would have thought he meant Company P) might have also suffered any loss and his suggestion that perhaps both of them were victims did not advance his case very much further, if any. In our view, at the very best, these are no more than speculative self-serving statements.

(b) It is equally, if not more, surprising that shortly after the alleged transaction, Company N entered into the said Service Agreement with Company R, of which Ms S was a shareholder, a director and the secretary. The Appellant denied any prior knowledge of Ms S being in such capacities at Company R. However, such information forms part of the public record. As an experienced entrepreneur as he claimed, it is expected that the Appellant would have at least attempted to ascertain with whom he entered into such an agreement unless he had already known the other party, like what he explained in respect of the alleged transaction. Moreover, we do not accept that a mere denial can be considered sufficient for satisfying the burden of proof on the Appellant.

(c) Regardless of the quantity of the goods and their significant value, the Appellant did not inspect the goods himself. Instead he sent his secretary, whose expertise and experience in the relevant trade had never been proven, to do the job. On the basis that his secretary was lack of the necessary expertise or experience, one would have imagined that the Appellant should have advised her on how to carry out the task diligently. Surprisingly, his secretary inspected only 3, out of 360 in total, boxes of goods and failed to detect the water stains and spots among the goods allegedly to have been discovered by the subsequent purchaser.

(d) The inspection of the goods by the Appellant's secretary was allegedly carried out on 31 August 2002. We were also told by the Appellant that the purchaser inspected the goods 7 days later. The Appellant did not insure against any possible risk for the gap period. Alternatively, one would have thought that the Appellant could have arranged the inspections to be carried out simultaneously or one immediately after the

other.

35. We also note that Company N commenced its business on 23 August 2002, the same day he acknowledged receipt of the last payment from Company F as full and final settlement of his employment. According to the Appellant the alleged transaction is the one and only one business transaction that Company N entered into up to its cessation on 12 March 2004. The alleged loss, if allowed, could have set off a significant portion of the payment received from Company F.

36. Taking into account all the evidence made available to us, orally and in writing, we accept the proposition put forward by Mr Chan of the Respondent that the alleged transaction is suspicious and artificial. The claimed loss would therefore be denied if needed be.

Other expenses claimed

37. The Appellant had forwarded to the assessor copies of documents which are also attached to the Determination and contended:

(a) In his letter dated 19 January 2004

i. in respect of entertainment expenses, that '[s]everal investment projects were discussed/negotiated – including possibilities of investing in a project in Europe, possibilities of setting up a joint venture, investment regarding a Guangzhou land development project of [Group AD].'

ii. in respect of management fee expenses to Company R that,

- '[Ms AA], the General Manager of [Company R] negotiated the contract with me.'
- 'The agreement was first completed by each party affixing its company chop to confirm the terms and conditions of the agreement.'
- 'Until 6 December, 02, when the initial payment of $200,000 had been effected, I was alert that it would be more proper the agreement be signed by each party concerned. I had therefore signed on the agreement and was prepared to urge [Ms AA] to sign the same. In any case, I neglected to follow up the matter.'
- '[Company N] shared the use of [Company R's] office space at [Address AB], the telephone lines, fax machines, computers, printers, typewriters, internet broadband, copying

machine, desks, chairs, cabinets, and a motor car of [Company R]. The equipment and assets were placed at the address mentioned above. [Ms AA] was responsible for performing the logistic services to [Company N] at this office.'

- 'Payment of the management fee was made as follows:

$143,472.00	-	The sum was advanced by a relative in the Philippines and credited to [Company R's] account on 6 Dec, 02.
$56,528.00	-	made by cash out of my pocket.
$20,000.00	-	made by cheque through [Company N's] account with [Bank AC] on 25 Feb, 03.'

(b) In his letter dated 3 October 2006

(i) 'The business was operated on a continuous basis though no transaction had been successfully made after 5 Oct 2002.'

(ii) 'Trying its best to pursue business revenues, the expenses were incurred aiming at the production of profits.'

(iii) 'For clarification, the expenses were not related to [Company N's] own investments but incurred in entertaining potential clients who could participate in investment projects so [Company N] might be able to receive commission income or introduction fee.'

38. Again, no witness was called and no further evidence, documentary or oral, has been submitted by the Appellant in this regard.

39. Section 16(1) does not require a taxpayer to show that an expense actually produced profits in the same year of assessment, or that the expense was intended to produce profits in that same year. However, the expense must have been, inter alia, incurred for the production of chargeable profits. It is sufficient, as indicated in CIR v Swire Pacific Ltd (1979) 1 HKTC 1162, if an expense was incurred for the purposes of an ongoing business which produces chargeable profits.

40. Given the circumstances of this case as described and in light of the evidence made available to us, we would agree, if needed be, with Mr Chan of the Respondent that whether there had been such an ongoing business was in serious doubt, particularly when the one or only one transaction as alleged by the Appellant was considered artificial despite all the assertions the Appellant had made before and during the hearing that he had been looking for various profitable opportunities, which in our view, again, are just self-serving

statements at their very best.

41. Our observation in paragraph 35 above also applies to these expenses. If deduction would be allowed, the payment received from Company F would have been further reduced.

42. Further or alternatively, those profitable opportunities mentioned by the Appellant were mentioned as investment opportunities outside Hong Kong at first instance. If that was the case, any such profits from overseas investments would not be chargeable to Hong Kong profits tax. As such, expenses would not have been incurred for the production of chargeable profits. Subsequently, the Appellant in response to enquiry from the assessor by way of his letter dated 3 October 2006, he claimed that 'the expenses were… incurred… so [that] the company might be able to receive commission income or introduction fee'. This assertion is not consistent with his initial response. It is also contradictory to the nature of the business Company N was registered.

43. Giving the Appellant the benefit of any doubt to the greatest extent, we would not agree that the Appellant had satisfied the burden of proof with such sketchy and scanty evidence. To name two as examples:

(a) In relation to the management fees, no authorized signatories from Company R signed the Service Agreement and the receipts of payment.

(b) In relation to salaries, the Appellant stated that 'the company had missed to make employee's compensation coverage and that no copy of any employment contract or any employer's return was given to further substantiate those employments'.

Conclusion of this part

44. As explained above, we find no justifiable reason to disturb the original assessment for the year of assessment 2002/03.

Our decision

45. From the above analysis, we conclude that this appeal must be dismissed and the two assessments stated in paragraph 1 are confirmed.