Case No. D39/09

Profits tax – sale and purchase of properties – whether a mere nominee – whether purported arrangement artificial or fictitious – sections 2, 14(1), 16(1), 26(b), 61 and 68(4) of Inland Revenue Ordinance ('IRO').

Panel: Anthony So Chun Kung (chairman), D'ALMADA REMEDIOS Ng Lisa Wei Min and Vincent P C Kwan.

Dates of hearing: 4 and 5 September 2007.
Date of decision: 30 November 2009.

The Appellant returned only 10% of the net profit from the sale of Property II and Property III. The Appellant contended that it was a mere nominee for Company B in the subject properties transaction and its share of profit was only 10%.

Company B returned 90% of the profit from the subject properties transaction. The Appellant claimed that the same amount should not be included as its assessable profits. Alternatively, in the event that all the profit derived was regarded as the Appellant's profit, 90% of which should be regarded as its outgoing or expense incurred and deductible.

The Appellant further contended that the consultancy fee of $3,800,000 paid to Company N should be deductible.

Held:

1. The appellant took various active roles in the subject properties transaction and was more than a mere nominee. In contrast, the purported beneficiary Company B did nothing at all.

2. The fact that the Appellant did make a return incorrectly (deducting 90% of the profit in the subject properties transaction and returned that as chargeable profits of Company B) could not reduce its chargeability.

3. The purported arrangement of the Appellant as a nominee of Company B (a loss company) was artificial and fictitious under section 61 of the IRO and should be disregarded.

4. As the purported nominee arrangement is to be disregarded, there is no ground for the Appellant to make any payment, outgoing or expense to Company B.

5. The Appellant failed in its burden to prove the connection between the consultancy fee of $3,800,000 paid to Company N and its profit-earning process. The consultancy services for the development of the property site claimed to have been provided by Company N could only be provided to Company E as the Appellant was only involved in purchasing and sub-selling after-developed properties.

Appeal dismissed.

Cases referred to:

D47/02, IRBRD, vol 17, 737
D37/93, IRBRD, vol 8, 304
Commissioner of Inland Revenue v Douglas Henry Howe [HKTC 936]
Strong & Co v Woodifield [1906] AC 448
CIR v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161
CIR v Chu Fung Chee [2006] HKLRD 718
Seramco Ltd Superannuation Fund Trustees v Income Tax Commissioner [1997] AC 287
Cheung Wah Keung v CIR [2002] 3 HKLRD 773
D77/99, IRBRD, vol 14, 528
D66/89, IRBRD, vol 5, 42
D99/98, IRBRD, vol 13, 486
D99/02, IRBRD, vol 17, 1178
CIR v Tai Hing Cotton Mill (Development) Ltd [2006] 2 HKLRD 325

Taxpayer represented by its authorized representative and Lam Nga Lai, Alice of CCIF CPA Limited.
Chan Tak Hong, Yip Chi Yuen and Chan Shun Mei for the Commissioner of Inland Revenue.

Decision:

The appeal

1. Company A ('the Appellant') entered into a property transaction as a confirmor and made a profit (Fact (4) below). It returned only 10% of such profit saying that 90% thereof belonged to Company B. The Appellant claimed that it was a nominee for Company B in the said property transaction and its share of profit for acting as a nominee was 10%. The Assessor disregarded the nomination and assessed the Appellant on 100% of the profit. Such assessment was confirmed by the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') in his Determination dated 30 May 2007 ('the Determination').

Against such Determination, the Appellant appealed to this Board.

2. In its Statement of Grounds of Appeal dated 29 June 2007, the Appellant stated:

> ‘This appeal is made on the grounds that the quantum of the taxable profit derived by the Company from the sales of the properties (which were referred to as Property II and Property III in the Statement of Facts) for the year of assessment 1997/98 is excessive.’

The facts

3. The parties agreed the facts in the Statement of Facts and we find them as facts.

4. The salient facts are as follows:

(1) The Appellant was a private company incorporated in Hong Kong on 25 June 1991. At all relevant times, its shareholders were Mr C and his wife Mrs C and its directors were:

Mr C	
Mr D	(Resigned on 13 January 1997)
Mrs C	(Appointed on 13 January 1997)

Before Year of Assessment 1997/98

(2) For the period from 25 June 1991 (date of incorporation) to 31 March 1995, the Appellant did not commence to carry on any business activities during the period. The Appellant’s financial statements ending 31 March 1995 show that it did not have any income but it claimed for the year of assessment 1994/95 loss brought forward of $976,251.

(3) For the year of assessment 1995/96, the Appellant did not have any business income for the year, but it claimed loss brought forward of $970,664.

(4) For the year of assessment 1996/97, the Appellant declared that its principal activities were in general trading. Turnover for the year was $1,350,050 and loss was $908,360. The Appellant claimed loss brought forward from prior year of $1,946,915 ($970,664 (1995/96) + $976,251 (1994/95)).

(5) The Assessor did not accept that the Appellant had incurred any allowable loss under the Inland Revenue Ordinance (‘the Ordinance’) for the years of assessment 1994/95 and 1995/96 as the Appellant had not commenced trading [Facts (2) & (3)]. The Assessor notified the

Appellant that it had no profits chargeable to profits tax for the years of assessment 1994/95 and 1995/96 and the losses claimed for these two years (that is, 1994/95 and 1995/96) were not accepted.

(6) The Assessor issued to the Appellant a Statement of Loss for the year of assessment 1996/97 with details as follows:

	$	
Adjusted loss for the year	908,360	[Fact (4)]
Add: Loss brought forward	0	
Loss carried forward	908,360	

For Year of Assessment 1997/98

(7) By an agreement for sale and purchase dated 7 August 1997, Company E agreed to sell to the Appellant the following properties at a total consideration of $10,700,000:

(i) 15 carparking spaces of Housing Estate W, No AA Road F, Hong Kong plus the external wall from G/F to 2/F.
[Note: The carparking spaces of Housing Estate W comprised Carparking Space No. 1 to No. 15. All the Carparking Spaces excluding Carparking Space No. 8 and excluding the external wall from G/F to 2/F hereinafter are collectively referred to as 'Property II'.]

(ii) Garage at No. AB and Garage at No. AC of Road F ('Property III').

(8) Recital C of the agreement stated that it superseded a preliminary agreement made between the same parties and on the same terms dated 18 July 1997.

(9) By a supplemental agreement dated 22 September 1997, Company E and the Appellant agreed, among other things, to cancel the sale and purchase of Carparking Space No. 8, Housing Estate W and the external wall from G/F to 2/F and to reduce the consideration stated in the agreement of 7 August 1997 from $10,7000,000 to $9,900,000.

(10) By 14 separate agreements for sub-sale and sub-purchase all of 21 August 1997, the Appellant in the capacity of confirmor sold to Company G Property II at a total consideration of $11,200,000, that is, at $800,000 for each carparking space in Property II. In the fourth schedule of each agreement, it was stated that estate agent's commission payable by the vendor and the purchaser was $8,000 respectively and the estate agent was Company H. The sale was completed on 22 September 1997.

(11) By an agreement for sub-sale and sub-purchase dated 9 October 1997, the Appellant in the capacity of confirmor sold to Company J Property III at a consideration of $12,000,000. In the fourth schedule of the agreement, it was stated that estate agent's commission payable by the vendor and the purchaser was nil respectively. The sale was completed on 17 November 1997.

(12) The Appellant has also on 14 May 1997 completed sale of another property at Address K ('Property I') at a profit of $680,311 which the parties did not dispute as capital in nature and not chargeable to tax.

(13) The Appellant in its Profits Tax Return for the year of assessment 1997/98 worked out its assessable profits on 10% of the sales of Property II and Property III at $285,679. At the same time, the Appellant claimed set-off of loss brought forward of $2,855,275 ($908,360 + $970,664 + $976,251)[Facts (2), (3) & (4)]:

Profit and loss account for the year ended 31 March 1998

	$
Sales ($11,200,000+$12,000,000) x 10%	2,320,000
Less: Cost of sales	(1,407,592)
	912,408
Add: Other income	18,704
	931,112
Less: Operating expenses	(643,478)
Profit before exceptional item	287,634
Add: Exceptional item	
Profit on disposal of Property I	680,311
Profit before taxation	967,945

Tax computation

	$
Profit before exceptional item	287,634
Less: Tax adjustments	(1,955)
Taxable profit	285,679
Less: Loss brought forward	(2,855,275)
Loss carried forward	(2,569,596)

(14) The Assessor requested the Appellant to provide further information on how the sales of Property II and Property III were reflected in its financial statements.

(15) The Appellant did not furnish the Assessor with the details requested. The Assessor raised the following profits tax assessment for the year of assessment 1997/98 on the Appellant:

	$	
Profit per return	285,679	[Fact (13)]
Add:		
Gain on disposal of fixed assets	680,310	
Gain on disposal of Property II and Property III	14,100,000	
Adjusted assessable profits	15,065,989	
Less: Loss set-off	(2,855,275)	
Net assessable profits	12,210,714	
Tax payable thereon	1,813,291	
Statement of loss		
Loss brought forward		
($908,360+$970,664 + $976,251)	2,855,275	
Less: Loss set-off	(2,855,275)	
Loss carried forward	0	

(16) The Assessor subsequently noted that the loss brought forward for set-off should be $908,360 [Fact (6)] instead of $2,855,275.

(17) The Appellant through CCIF CPA Limited (formerly known as Charles Chan, Ip & Fung CPA Ltd) ('the Representative') objected the assessment, inter alia, in the following terms:

(a) 'The assessment is excessive.'

(b) 'The amount of gain on disposal of (Property II and Property III) included in the assessable profits is incorrect.'

(18) In the course of correspondence with the Assessor, the Appellant was advised that a mistake was inadvertently made in the computation of the 1997/98 assessable profits [Fact (16)]. The loss brought forward for set-off should be $908,360 instead of $2,855,275. The Appellant disagreed and claimed that the loss available for set off should be $2,855,275.

(19) On the losses claimed for the years of assessment 1994/95 to 1996/97, the Appellant, through its representative, contended that:

(a) The Appellant was formed to take up the prospective business transferred from Company B … Mr C was the common shareholder and director of the Appellant and Company B.

(b) Since 1 April 1994, Mr C and Mr D had actively sought businesses for the Appellant. Full time staff was employed to perform daily administrative and accounting functions.

(c) The prospective businesses and projects included ice cream production technology, Brand Y computer systems, auto toll systems, real estate development consultancy and investment in fishery business.

(d) The Appellant cooperated with Company L on the businesses involving ice cream production technology, Brand Y computer systems. Company L was a Hong Kong subsidiary of a Country M company. The Appellant was unable to provide copies of correspondence exchanged with Company L on the prospective businesses.

(e) As the businesses had not been successfully developed, the Appellant thus declared in its Profits Tax Return for the year of assessment 1995/96 that it did not commence to carry on any business.

The Representative provided a summary and copies of two business proposals.

(20) With regard to Property II and Property III, the Representative advised that:

(a) The purchase and sale of Property II and Property III were accounted for in the profits and loss account for the year ended 31 March 1998 [Fact (13)] as follows:

		$
Sales proceeds		
Property II	$800,000 x 14 [Fact (10)] x 10%	1,120,000
Property III	$12,000,000 [Fact (11)] x 10%	1,200,000
Sales per profit and loss account		2,320,000
Cost of sales		
Property II and Property III	$9,900,000 [Fact (9)] x 10%	990,000
Consultancy fee to Company N	$3,800,000 x 10%	380,000
Commission paid	$232,000 x 10%	23,200
Legal fee	$143,923 x 10%	14,392

Cost of sales per profit and loss account	1,407,592
Profit on sale of properties	912,408

(b) When the Appellant acquired the property at Road F [Facts (7-11)] from Company E, the Appellant and Company E were unrelated. The Appellant and Mr C only became directors of Company E on 8 December 1997.

(21) In amplification of its grounds of objection in respect of the sale of Property II and Property III, the Representative put forth the following assertions:

The role of Company B

(a) Mr C was notified by the directors of Company E that they intended to sell the properties. Company E appointed Company P, a company in which Mr C had interest, to solicit buyers. Company B planned to purchase the properties at a relatively low price and resell them to third parties as confirmor.

(b) However, the shareholders and directors of Company E knew that Mr C was a shareholder and director of Company B. As Mr C did not want them to know he was involved in the transaction, Company B therefore entered into an agreement with the Appellant on 17 July 1997. According to the agreement, the Appellant acted as a nominee of Company B. It was agreed that the Appellant would purchase Property II and Property III and sell the properties immediately after the purchase and Company B would share 90% of the resultant profit from the sales of the properties while the Appellant would share 10% of the resultant profit.

(c) The agreement and supplemental agreements for purchase of the subject properties from Company E were signed by Company Q instead of by Mr C such that directors of Company E did not know that Mr C was involved in the Appellant.

(d) Company E paid commission of $107,000 to Company P for introducing the Appellant as the buyer. The commission was computed at 1% of the original purchase price of $10,700,000. The purchase price was subsequently reduced to $9,900,000.

Source of finance in the acquisition of Property II and Property III

(e) Out of the $550,000 deposit paid for the acquisition of Property II and Property III, $100,000 was borrowed from Company P. The balance was funded by the initial deposits received from the subsequent buyers.

Payment to Company N

(f) Company N was not related to the Appellant or Company B.

(g) Company N was a property surveyor at that time. It acted as a consultant of Company B and the Appellant and advised on the marketing strategies for developing and selling the 14 carparking spaces and 2 garages at Nos. AA, AB-AC Road F.

(h) When Company E acquired the property at No. AA Road F, it was a bare site with no erection of any structures or buildings thereon. For development of the site, Company E was required to pay the land premiums and resolve the issue of plot ratio. Company N had provided valuable advice and assistance in obtaining legal and professional opinions for Mr C. After long negotiation with the Government, the Government ultimately agreed to amend the deed made in 1938 such that no land premiums were required to be paid on the development of the site at No. AA Road F. Company N also advised on developing and selling the carparking spaces and the garages in one lot to a single buyer. As a result of the advice given, in developing the multi-storey carparking spaces at No. AA Road F, spaces were reserved for passages linking the carparking spaces and the garages at Nos. AB-AC Road F and a temporary wall was built to cover the passage. This development plan gave rise to appreciation of the market value of the properties.

(i) Although the plan for selling the garages and carparking spaces as a whole to a single buyer was subsequently abandoned and the garages and carparking spaces were sold to two different buyers, namely, Company J and Company G, the Representative considered that the consultancy fee was incurred in the production of assessable profits and should be deductible pursuant to section 16(1) of the Ordinance.

(j) The services were rendered by Mr R on behalf of Company N. The consultancy fee was determined by reference to the time spent by Mr R and on mutual agreement.

(k) Written consultancy agreement had not been made with Company N and copies of correspondence with Company N regarding the appointment and waiver of land premium were not available.

Commission paid

(l) The purchaser of Property II was solicited by Company H whereas the purchaser of Property III was introduced by Mr S.

(m) The commission paid of $232,000 included the commission of $112,000 in total paid to Company H and commission of $120,000 paid to Mr S.

(22) On the contention that the Appellant was not the beneficial owner of Property II and Property III and that only 10% of the profit on the disposal of the properties should be assessed on the Company, the Representative cited Board of Review Decisions, D47/02, IRBRD, vol 17, 737 and D37/93, IRBRD, vol 8, 304, in support. Further, the Representative argued that the following should be taken into account:

(a) Company B and the Appellant entered into an agreement on 17 July 1997 whereby it was agreed that the Appellant would act as a nominee to buy and sell the properties and that 90% of the profit belonged to Company B and 10% of the profit belonged to the Appellant.

(b) Mr C was the person who was actively involved in the subject transactions including soliciting real estate agents and liaison with the vendor and ultimate buyers. During the year ended 31 March 1998, the Appellant did not pay any remuneration to Mr C whereas Company B paid director's fee of $244,500 to Mr C and provided rent free accommodation to him. This evidenced that Mr C acted on behalf of Company B instead of the Appellant in the subject transactions.

(c) 90% of the profit derived from the subject transactions had been reflected in Company B's audited financial statements for the year ended 31 March 1998.

(d) Other than the execution of the agreements relating to the purchase and the sale of the properties, the participation of the Appellant was limited.

(e) The expenses such as the deposits, commission and consultancy fee were paid by the Appellant only because the proceeds from the sales of the properties were received by the Appellant. However, only 10% of these expenses were charged in the accounts of the Appellant and the remaining balance was paid on behalf of Company B.

(f) The 10% profit shared by the Appellant represented a reasonable remuneration for acting as a nominee.

(g) The shareholders of the Appellant and Company B were different at the time.

(23) At all relevant time, Mr C was a shareholder and director common to the Appellant, Company B and Company P:

(i) the other director and shareholder of the Appellant was his wife Mrs C;

(ii) in respect of Company B, the other directors were his wife Mrs C and Company Q, the other shareholder was his brother Mr T;

(iii) the other director and shareholder of Company P was Mr U.

(24) The Assessor requested the Appellant to provide a copy of the consultancy report compiled by Company N to illustrate the services provided by Company N to the Appellant. The Appellant failed to provide the report requested.

(25) In a subsequent letter, the Appellant, through the Representative, reiterated that the loss of $976,251 for the year of assessment 1994/95 should be allowed and asserted that the expenses incurred in that year were for the production of revenue of $1,350,050 from the sales of ceramic rollers in the year of assessment 1996/97.

(26) The Assessor had ascertained that:

Company B

(a) For the years of assessment 1994/95 to 1995/96, Company B stated in its audited financial statements that its principal activity was investment holding.

(b) For the year of assessment 1996/97, Company B stated in its audited financial statements that its principal activity was property dealing and investment holding. There was no turnover for the year and the company did not hold any land properties during the year.

(c) For the year of assessment 1997/98, Company B stated in its audited financial statements that it was engaged in property dealing and investment holding. The only property transaction

was that of Property II and Property III. According to Company B, its assessable profits for the year was $7,779,652 (before set-off of loss brought forward of $12,057,975).

Company E

(d) Company E acquired the property at No. AA Road F and garages at Nos. AB and AC Road F on XX-XX-1992. No. AA Road F was redeveloped into a residential building with two floors of carparking spaces. Occupation permit of the building was issued on XX-XX-1995.

(e) All the residential units in the building were sold soon after the issue of occupation permit.

(27) The Assessor did not accept that:

(i) the losses claimed by the Appellant for the years of assessment 1994/95 to 1995/96 were allowable.

(ii) the Appellant was a nominee in the purchase and sale of Property II and Property III.

(iii) payments made to Company B and Company N in the purchase and sale of Property II and Property III were allowable.

(28) The Assessor computed the gain derived by the Appellant on the disposal of Property II and Property III as follows:

			$
Sales $11,200,000 + 12,000,000 [Facts (10) & (11)]			23,200,000
Less:			
Purchase price	[Fact (9)]	9,900,000	
Commission paid	[Fact (20)(a)]	232,000	
Legal fee	[Fact (20)(a)]	149,923	10,281,923
Profit			12,918,077

(29) The Assessor proposed to revise the profits tax assessment for the year of assessment 1997/98 as follows:

	$
Profit per return	285,679
Add: Profit on the disposal of Property II and Property III understated $12,918,077 [Fact (28)] –	

	$
$912,408 [Fact (20)(a)]	12,005,669
Assessable profits	12,291,348
Less: Loss brought forward and set-off [Fact (6)]	908,360
Net assessable profits	11,382,988
Tax payable thereon	1,690,373

Statement of Loss

	$
Loss brought forward	908,360
Less: Loss set-off	908,360
Loss carried forward	0

(30) The Assessor informed the Appellant of the proposed computation at Fact (29) and invited for further representations, if any. In reply, the Representative, on behalf of the Appellant, contended as follows:

(a) According to the co-operative agreement, the Appellant purchased the properties at Road F as a nominee and shared 10% of the profit from the disposal of the properties. Company B shared 90% of the profit. At the time the written agreement was made, the Appellant had not yet entered into any agreement for the purchase of the properties. The written agreement was made in good faith and should be regarded as a valid contract between the Appellant and Company B.

(b) Pursuant to section 26(b) of the Ordinance, no part of the profits of a trade, profession or business carried on by a person who was chargeable to profits tax should be included in ascertaining the profits in respect of which any other person was chargeable to profits tax. As the profit in the amount of $8,211,670, that is, 90% of the profit from the sales of Property II and Property III [Fact (20)(a)], had been included as the assessable profits of Company B for the year of assessment 1997/98, the same amount should not be included as the assessable profits of the Appellant.

(c) Alternatively, in the event that the profit derived from the disposal of Property II and Property III was regarded as the Appellant's profit, the sum of $8,211,670 should be regarded as outgoing or expense incurred by the Appellant and deductible under section 16(1) of the Ordinance.

Authorities cited

5. The parties have cited to the Board the following authorities:

By the Appellant

(i) D37/93, IRBRD, vol 8, 304;
(ii) D47/02, IRBRD, vol 17, 737;
(iii) Commissioner of Inland Revenue v Douglas Henry Howe [HKTC 936]

By the Revenue

(i) Strong and Co v Woodifield [1906] AC 448;
(ii) CIR v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161;
(iii) CIR v Chu Fung Chee [2006] HKLRD 718;
(iv) Seramco Ltd Superannuation Fund Trustees v Income Tax Commissioner [1997] AC 287;
(v) Cheung Wah Keung v CIR [2002] 3 HKLRD 773;
(vi) D77/99, IRBRD, vol 14, 528;
(vii) D66/89, IRBRD, vol 5, 42;
(viii) D99/98, IRBRD, vol 13, 486;
(ix) D99/02, IRBRD, vol 17, 1178.

The appeal hearing

6. Mr V, the Appellant's authorized representative, represented the Appellant in the hearing. He called no witness. He repeated the Appellant's Statement of Grounds of Appeal claiming that 'the quantum of the taxable profit derived by the Company from the sales of …Property II and Property III …for the year of assessment 1997/98 is excessive.' He maintained that the Appellant's computation of profit in the transaction of Property II and Property III was the same as those set out in Fact (20)(a).

7. Mr V made no submission and adduced no evidence over the Appellant's alternative claim to deduct the sum of $8,211,670 (that is, the 90% profit paid to Company B) as the Appellant's outgoing and expense under section 16(1) of the Ordinance [the Representative's letter dated 16 May 2007, Fact 30(c)].

8. As regards the Appellant's claim for setting-off the losses for years of assessment 1994/95 and 1995/96 [the Representative's letter dated 13 October 2006], Mr V also made no submission and adduced no evidence.

Transaction of Property II and Property III

9. In respect of the computation of profit in the transaction of Property II and Property III, Mr V made two assertions:

(I) That the Appellant was a nominee of Company B and only 10% of the net profit from the sale of Property II and Property III should be regarded

as its taxable profits; and

(II) That the consultancy fee of $3,800,000 paid to Company N should be deducted in the computation of the net profit of the sale of Property II and Property III.

(I) Was the Appellant a nominee of Company B?

The Appellant's contention

10. Mr V cited D37/93, IRBRD, vol 8, 304 and D47/02, IRBRD, vol 17, 737, claiming that it is a principle of law that a taxpayer serving no more than as a mere nominee for a third party in a property transaction is not a person or a trustee within the meaning of sections 2 and 14(1) of the Ordinance and is not chargeable to profit tax.

11. Mr V claimed that in the subject properties transactions the Appellant was a mere nominee for Company B and accordingly did not fall inside the definition of trustee or person of the Ordinance.

12. As evidence, Mr V referred the Board to a co-operative agreement dated 17 July 1997 ('the Co-operative Agreement') entered between the Appellant and Company B [Facts 22(a) & 30]. He argued that the Co-operative Agreement was the evidence showing that the Appellant was Company B's nominee in the transaction of Property II and Property III.

13. Mr V claimed that the transaction began with Company E asking Company P to introduce buyers for Property II and Property III and Mr C was known to Company E as related to Company P and Company B. Company E however did not know that Mr C was related to the Appellant. As a consequence, Company P introduced the Appellant as the buyer. He pointed out that Company B was separate and different from the Appellant in that Company B was owned by Mr C and his brother whereas the Appellant was owned by Mr C and his wife.

14. Mr V also cited CIR v Douglas Henry Howe (HKTC 936) where a writer used to write books and earned royalties for himself. The writer subsequently formed a company to employ himself to write books whereby royalties were earned for the company instead of for himself. The writer assigned to the company for $1 the benefit of all royalties to which he was entitled when he entered the employment with the company. Con J of the Supreme Court decided that both the contract of employment and the assignment of royalties were not artificial or fictitious within the meaning of section 61. Mr V argued that the Howe case is authority that allows a taxpayer to arrange his affairs so that the tax attaching under the law is less than it otherwise would be.

15. Mr V argued that the manner how Company B engaged the Appellant as its nominee by a co-operative agreement in a property transaction for 10% of the profit was similar to Howe case. In Howe instead of earning royalties direct, a writer formed a

company to employ himself to write books and to take up all royalties he was entitled. In this case, Mr C was the key figure to whom Company E confided with the sale of Property II and Property III without whom there could not have any property transaction. The arranging of the Appellant to take up the property transaction of Mr C is similar to the arranging of a company to take up the employment and royalties by the writer in Howe.

16. The Board questioned Mr V whether he was arguing that the property transaction belonged to Mr C and that he was entitled to order such transaction to be completed by the Appellant as the nominee for Company B. Mr V did not answer.

17. Instead, Mr V argued that the said transaction of Property II and Property III was originally intended for Company B, not the Appellant. He argued that according to the respective accounts of the Appellant and Company B, and the respective employer's return filed by Company B and the Appellant, Mr C was paid only by Company B and not by the Appellant. It was Company B which incurred costs on Mr C, not the Appellant. This indicated that the said transaction of Property II and Property III was conducted by Mr C for Company B. The Appellant which did not incur costs on Mr C must have been the nominee for Company B.

18. Mr V further argued that the entire 100% of the profit in the said transaction of Property II and Property III has been booked and accounted, 10% thereof in the sum of $912,408 in the accounts of the Appellant with the balance 90% thereof in the sum of $8,211,670 in the accounts of Company B. Mr V submitted that pursuant to section 26(b) of the Ordinance, the same 90% profit which has already been returned in Company B's accounts should not be included as the assessable profits of the Appellant.

19. Mr V referred the Board to the Agreement for Sale and Purchase dated 7 August 1997 and the Supplemental Agreement dated 22 September 1997 (collectively 'the Purchase Agreements') showing that the Appellant as purchaser acquired Property II and Property III from Company E.

20. Mr V also referred the Board to an undated letter of Appointment of Exclusive Agent (「獨家代理委託書」) appointing Company H as the exclusive realty agent to sell 14 carparks of Property II. The appointer shown on such appointment letter was '[Company E] c/o Mr [C]' and '[Company A]', the Appellant herein. Such an agency appointment was agreed for 3 months commencing from 10 July 1997 to 10 October 1997. Company H introduced the buyer Company G who bought Property II from the Appellant on 23 July 1997. Mr V produced 14 official receipts all dated 24 July 1997 separately issued by Company H charging the Appellant for the 1% realty agency commission for each and every of the 14 carparks of Property II. Mr V also produced 14 separate sub-sale agreements dated 21 August 1997 wherein the Appellant as the Confirmor sold the 14 carparks of Property II to Company G.

21. Mr V also produced to the Board a sub-sale agreement dated 9 October 1997 wherein the Appellant as the Confirmor sold Property III to the buyer Company J. He also produced an official receipt dated 19 November 1997 issued by Mr S charging the

Appellant for the 1% realty agency commission for introducing Company J.

22. Mr V claimed that by entering into the Purchase Agreements with Company E, the Appointment of Exclusive Agent with Company H, and sub-sale agreements respectively with Company G and Company J, the Appellant did complete the transaction of Property II and Property III as the nominee of Company B in manner as agreed under the Co-operative Agreement.

Analysis

23. To begin, we must say that Mr V for the Appellant has made a correct statement of law in that a taxpayer serving as a mere nominee for a third party is not a person or a trustee within the meaning of section 2 and therefore not chargeable to profit tax under 14(1) of the Ordinance.

24. Section 14(1) of the Ordinance provides,

> '*Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.*'

25. Section 2 of the Ordinance provides,

> '*"Person"(人、人士) includes a corporation, partnership, trustee, whether incorporated or unincorporated, or body of persons;*'

> '*"Trustee"(受託人) includes any trustee, guardian, curator, manager, or other person having the direction, control, or management of any property on behalf of any person, but does not include an executor.*'

26. By operation of sections 2 and 14(1), therefore, a trustee having the direction, control, or management of any property on behalf of another person is a person chargeable to profit tax.

27. In D37/93, IRBRD, vol 8, 304, a company purchased and sold a property for its own account using the name of a taxpayer. The taxpayer has not performed any function other than holding the legal title. The Board held that the taxpayer had done nothing and he was nothing more than a nominee and that the profit did not belong to him. The Board stated:

> '*…There is no way on the facts before us that we can find that this particular profit belonged for taxation purposes to the Taxpayer. The Taxpayer did nothing. The Taxpayer made no decisions, did not provide the capital to*

> *purchase the property, did not receive the proceeds of sale nor perform any function other than holding the legal title to the property. We find as a fact that for the purposes of the Ordinance that the profit in question was not 'his'. It was the profit of company X.'*

28. In D47/02, the property was not bought with the taxpayer's money and the taxpayer did not receive the price or the profit from its sale. The Board pointed out there could be two extremes in the meaning of the term 'trustee', one being 'trading trustee' who takes active role in carrying out trading activities, the other is 'nominee' who only lends out its name. The Board went on to find that the taxpayer had not actively involved in carrying out the relevant property transaction and therefore was only a nominee, not liable to profits tax. The Board stated:

> *'《稅務條例》對「人」(person)的定義包括「受託人」(trustee)。稅務上訴委員會案件編號D66/89,IRBRD, vol.15, 42中曾分析「受託人」的定義，分別界定兩個極端：一方為積極參與進行營業活動的「營業受託人」(trading trustee)，而另一方為只是借出名義的「代名人」(nominee)。若納稅人只是一名代名人(nominee)，並非物業的實益擁有人(beneficial owner)，沒有積極參與進行有關的物業買賣，而有關的物業買賣所得的利潤並不屬於他本人(his profit)，則他不需要就有關物業繳付利得稅。'*

29. We agree with the decisions of the respective Boards in D37/93, and D47/02. However, a taxpayer who took active roles in a transaction could not be dealing as a nominee for a third party.

30. To find out whether a taxpayer has taken active roles, we have to examine the activities he has taken in the transaction.

31. In this case, by its own admission and according to the documents it produced, the Appellant not only used its name, it took active roles in carrying out the subject properties transaction:

(i) To appoint Company H as realty agent;

(ii) To enter into a preliminary agreement to purchase the relevant properties from Company E, paying initial deposit to Company E;

(iii) After sales having been arranged by Company H, to enter into an unwritten agreement to sub-sell Property II to Company G, receiving payment of deposits from Company G;

(iv) To pay commission in respect of the sale of Property II to Company H;

(v) To enter into a formal agreement to purchase the relevant properties from Company E, paying further deposit;

(vi) To enter into 14 formal agreements to sub-sell Property II to Company G, receiving further deposits from Company G;

(vii) To enter into a Supplemental Agreement with Company E;

(viii) To complete the purchase of Property II from Company E and the sub-sale of the same to Company G;

(ix) To enter into a formal agreement to sub-sell Property III to Company J;

(x) To complete the purchase of Property III from Company E and the sub-sale of the same to Company J; and

(xi) To paid commission in respect of the sale of Property III to Mr S.

32. In contrast, the purported beneficiary Company B did nothing. It did not even negotiate the purchase of the subject properties from Company E.

33. In light of the extent of activities performed, we could have no doubt that the Appellant was more than a mere nominee in the subject properties transaction. The Appellant's contention that it was a mere nominee for Company B must fail. The entire profit in the subject properties transaction was chargeable to the Appellant.

34. To complete our analysis, we would say a few words on the Co-operative Agreement.

35. There are only two clauses in the Co-operative Agreement. One clause states, '…In the name of [Company A] (the Appellant) to purchase from [Company E] 14 carparking spaces of [Housing Estate W, No. AA Road F] and the Basement at [Nos. AB, AC], and to sub-sell immediately.' The other clause states, '…Net profit to be shared at 9:1, i.e. 9/10th to [Company B], 1/10th to [Company A] (the Appellant)'.

The original text is in Chinese:

合作內容：以A公司名義向E公司購入[F道AA號W屋苑]其中14個車位及AB, AC號的地庫，並即時轉售。

利潤分配：按純利9:1分配，即甲方(Company B)九成，乙方(Company A, the Appellant)一成。

36. It was dated 17 July 1997. It covered 14 carparks.

37. The purchase from Company E however covered 15 carparks plus external walls. It was so stated in the sale and purchase agreement between the Appellant and

Company E dated 7 August 1997. Carparks were reduced from 15 to 14 with external walls deleted only by amendment on 22 September 1997. How could the Appellant and Company B enter into co-operation on 17 July 1997 over 14 car-parks even before such amendment was known?

38. The Appellant offered no explanation.

39. Similar question exists in the letter of Appointment of Company H produced by the Appellant.

40. It stated that Company H was appointed as realty agent jointly by Company E and the Appellant. It was stated to commence on 10 July 1997. It also covers only 14 carparks. How could the Appellant appoint Company H as realty agent to commence on 10 July 1997 even before its nomination under the Co-operative Agreement by Company B on 17 July 1997? Likewise, in what capacity could the Appellant appoint Company H to commence on 10 July 1997 when it entered preliminary agreement to purchase the subject properties from Company E only on 18 July 1997? How could the Appointment which commenced on 10 July 1997 cover only 14 carparks instead of 15 carparks, a fact which could only be known after the amendment on 22 September 1997?

41. The other appointer as typewritten on the said letter of Appointment was Company E. Why would Company E involve the Appellant if it had appointed Company H to sell the properties, bearing in mind the agency was stated to commence on 10 July 1997, and sale was arranged by Company H with deposit cheques originally made to Company E issued by purchaser on 20 July 1997?

42. Again, the Appellant offered no explanation.

43. The Co-operation Agreement made no mention of what Company B had to do to earn 9/10th of the net profits. It was silent on who was responsible for paying the purchase price, how financing was arranged, who was responsible for soliciting buyers and how sale was to be achieved etc.

44. The Appellant claimed that Company B entered into the Co-operative Agreement so as to nominate the Appellant to buy from Company E. Appellant argued that Company B was entitled to nominate the Appellant to take up the property transaction similar to the writer in Howe who formed a company to employ himself to write books and to take up all royalties he was entitled.

45. Mr V for the Appellant in the hearing talked about Mr C being the key figure similar in capacity to the writer in Howe. Mr V however could not say that the subject properties transaction in this case belonged to Mr C, or to Company B, in manner same as the copyright and royalties which belonged to the writer in Howe. The writer in Howe was transferring copyright in his own writing and he was generating income by writing as an employee of his own company. In this case, Company B had done nothing and it had no transferable interest or right to transfer to the Appellant. The facts in this case are markedly

different and accordingly Howe is not applicable to this case.

46. The Appellant claimed that originally it was Company B who intended to purchase. However Company E knew that Mr C was a shareholder and director of Company B. As Mr C did not want Company E to know that he was involved in the transaction, Company B therefore entered into the Co-operative Agreement so that the Appellant was nominated to buy from Company E.

47. We must stress that a taxpayer is assessed only in respect of profits from the business he carried out and not from the business he originally intended but did not carry out.

48. Irrespective of what was originally intended, evidence shows that Company B has done nothing. Company B did not negotiate with Company E. Company B did not finance the acquisition. The preliminary deposit was borrowed from Company P and the further deposit was funded by the deposits for sale of the properties received from buyers. Company B did not arrange for the sales. The sales were arranged by realty agent Company H which the Appellant claimed to have been appointed by it. It was the Appellant who paid the purchase monies and all incidental expenses. It was the Appellant who received the sales consideration. Payments and receipts of money were made through the Appellant's bank account. The subject properties transaction was carried out by the Appellant.

49. Profits arose because of what the Appellant had done. They could only be ascertained as profits of the Appellant. Accordingly only the Appellant was chargeable in respect of the profits of the subject properties transaction, not Company B. It is therefore incorrect for the Appellant to deduct 90% of the profit in the subject properties transaction ($8,211,670) and returned that as profits chargeable to the accounts of Company B. The fact that the Appellant did make such a return incorrectly could not reduce its chargeability. Mr V's argument on section 26(b) of the Ordinance (paragraph 18 above) must fail.

50. The Appellant argued that Mr C was the key figure and he was paid by Company B, therefore the said transaction must have been Company B's transaction. We reject such an argument. No evidence shows that the subject properties transaction belongs to Mr C or Company B. Mr C was a director common to the Appellant and Company B. The fact that he was paid by Company B would not necessarily exclude him from providing services in negotiating and concluding the said transaction as a director for the Appellant. There is no connection between Company B's payment of directors' remuneration to the carrying out of the said transaction. Similar amount of directors' remuneration was paid even when Company B did not have any business. In year 1996/97, Company B paid out $439,400 of directors' remuneration even though its total income was $639.

Year	Director's remuneration
1994/95	$397,800
1995/96	$439,400
1996/97	$439,400

1997/98	$468,000

51. The Revenue pointed out that Company B was a loss company with an accumulated loss of $12,000,000 as at 31 March 1997. The Revenue submitted that the Co-operative Agreement was entered to siphon substantial amount of profit in the subject properties transaction to Company B for set-off such that the tax payable by the Appellant would be reduced. The Revenue submitted that the purported arrangement of the Appellant as a nominee in the transactions was artificial and fictitious under section 61 of the Ordinance and should be disregarded.

52. We agree with the Revenue.

53. Section 61 of the Ordinance provides:

> '*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 and the person concerned shall be assessable accordingly.*'

54. Which transaction could be described as 'artificial' or 'fictitious'? The Privy Council in Seramco Trustees v Income Tax Commissioner [1977] AC 287, while considering similar terms in section 10(1) of the Jamaican Income Tax Law 1954, said:

> '*It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10(1). Whether it can properly be so described depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.*
>
> *"Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of subsection is pleonastic, that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.*'

55. In CIR v Douglas Henry Howe 1 HKTC 936, Cons, J used the term 'commercially unrealistic':

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

56. In Cheung Wah Keung v CIR [2002] 3 HKRLD 773, Woo JA ruled that commercial realism can be one of the considerations for deciding artificiality:

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

57. In D77/99, IRBRD, vol 14, 528, the Board reviewed relevant authorities regarding section 61 of the Ordinance and drew up the following principles:

(i) The words 'artificial' and 'fictitious' are to be given the ordinary meaning.

(ii) 'Artificial' is wider than 'fictitious'. According to the Shorter Oxford Dictionary, 'artificial' means not natural, a substitute for what is natural or real, feigned, fictitious. 'Fictitious' means artificial, counterfeit, sham, not genuine, feigned, assumed, not real, imaginary, of the nature of fiction.

(iii) All the circumstances of the particular transaction have to be examined in order to see if it is artificial or fictitious.

(iv) A transaction is not artificial by reason of the fact that it is between related parties.

(v) A transaction is not artificial by reason of the fact that it is intended for tax planning purpose.

(vi) However, if there is no commercial sense for the transaction and no purpose for the transaction other than for tax benefit, it may well fit the expression 'artificial'.

58. Having examined the circumstances of this case as outlined in paragraphs 31 - 51 above, we are satisfied that there is no commercial sense for the arrangement whereby Company B could share 90% of profit in the properties transaction by being nothing and doing nothing in the subject properties transaction. We are also satisfied that the purported nomination and indeed the Co-operative Agreement served no purpose other than to reduce tax by setting-off the profit from the subject properties transaction against the loss accumulated by Company B. We find that the purported nomination and Co-operative Agreement were artificial and fictitious under section 61 of the Ordinance and should be disregarded.

(II) Is the consultancy fee paid to Company N deductible?

59. The Appellant claimed deduction of a sum of $3,800,000 of consultancy fee paid to Company N. Such consultancy fee was paid on 3 December 1997.

60. Section 16(1) of the Ordinance provides:

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

61. Under section 16(1), expenses are deductible not because they are incurred, they are deductible because they are incurred 'in the production of profits'.

62. In Strong & Co v Woodifield [1906] AC 448, a company paid damages and costs due to negligence of its servants. On the question of deduction of such damages and costs, the House of Lords said:

> '*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 or even more than with the trade. I think only such losses can be deducted as are connected with 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 trader. The nature of the trade is to be considered.'* (per Lord Loreburn at page 452, italics added)

> *'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, &c. 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, italics added)

63. The wordings in the English tax statutes were 'for the purposes of the trade' whereas in our section 16(1) they were 'in the production of profits'. In CIR v Cosmotron Manufacturing Co Ltd [1997] HKLRD 1161 however the two phrases were considered to have the same meaning. The Privy Council said:

> *'… [Liu JA] regarded the words "in the production of profits" as having a much narrower ambit than the words "for the purposes of the trade" which appear in the Income and Corporation Taxes Act 1988.*
>
> *The difference in language is undeniable, but the phrase used in the United Kingdom legislation has generally been interpreted by the courts in a manner, consistent with that of the Inland Revenue Ordinance. Thus in [Woodifield], Lord Davey said: [the above passage was quoted].'*

64. In CIR v Chu Fung Chee [2006] HKLRD 718 Hon Chung J, citing Woodifield said: [paragraph 19]

> *'…the degree of connection between the expenses and the profit-earning process of trade, profession or business is important … and must satisfy the tests of being "really incidental to the trade itself" or having been incurred "for the purpose of earning the profits"'.*

65. In CIR v Tai Hing Cotton Mill (Development) Ltd [2006] 2 HKLRD 325, Deputy Judge Poon adopted the following test: [paragraph 94]

> *'It is the nature of the payment that matters. "It is necessary to … attend to the true nature of the expenditure, and to ask oneself the question... Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning?": Tata Hydro-Electric Agencies Ltd Bombay v. CIT, Bombay Presidency and Aden [1937] AC 685, at p.696.'*

66. To be deductible, therefore, an expense must be connected with the profit-earning process of the taxpayer. It is necessary to examine the true nature of the payment to find out if the expense is connected in the sense that it is really incidental to the trade of the taxpayer.

67. The Appellant was asked to provide details of the consultancy services rendered by Company N.

68. The Appellant replied stating that the property at No. AA Road F was a bare site when Company E acquired it. Company N was engaged for the development of such a bare site. Company N gave advice and assistance, resolving the issue of plot ratio, negotiating with the Government on land premium, designing the development like reserving for passages linking carparking spaces at No. AA Road F and the garages at Nos. AB-AC Road F [Fact 21(h)].

69. Asides from the description given by the Appellant, there was no other evidence demonstrating the kind of consultancy services which cost the Appellant $3,800,000. The Appellant said that no written agreement was made and no correspondence was available.

70. According to the description given by the Appellant, the consultancy services claimed to have been provided by Company N were provided for the development of the property site. Such services for development could only be provided to Company E and not to the Appellant. It is because the Appellant was only involved in purchasing and sub-selling after-developed properties.

71. Further, the site was acquired by Company E on XX-XX-1992 [Fact (26)(d)] and the occupation permit was issued on XX-XX-1995. Company N services for development could happen only before XX-XX-1995. The Appellant was involved only two and half years later in July 1997 (see paragraph 31 above). Even if Company N did provide consultancy services as claimed by the Appellant, such services could have no connection with the profit earning process of the Appellant.

72. The Revenue reminded us that it is the Appellant's burden to prove the connection between the expense and its profit-earning process and that the expense had been incurred for the purpose of earning such profits.

73. According to our above reasoning, we are of the view that the Appellant has failed in its burden. The Appellant failed to prove that the consultancy fee it paid to Company N were expenses incurred in the production of its profits. Accordingly, the consultancy fee of $3,800,000 was not deductible under section 16(1) of the Ordinance.

Conclusion

74. Section 68(4) of the IRO provides that:

> '*The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.*'
>
> For reasons stated above, we find that the Appellant has failed to discharge its onus.

75. In the result, we dismiss the Appellant's appeal and confirm the assessment as determined in the Determination.

Other matter

76. Before leaving, we would also say a few words over the Appellant's claims which were made in its Representative's letters but not argued in the appeal hearing (see paragraphs 7-8 above).

Alternative argument under section 16(1) [Fact (30)(c)]

77. The Appellant made an alternative claim in its Representative's letter dated 15 May 1997. The Appellant claimed that it had an established liability to pay to Company B, purportedly under the Co-operative Agreement, 90% of the profits derived from the disposal of subject properties in the amount of $8,211,670. In the event the Appellant was chargeable to the entire profits derived from the subject properties transaction, such an amount of $8,211,670 which it was liable to pay to Company B should then be deductible under section 16(1) as an outgoing or expense incurred by it for the acquisition and disposal of the subject properties.

78. For reasons as analyzed above, we have decided that the Co-operative Agreement should be disregarded pursuant to section 61 of the Ordinance. In the result, there is no ground for the Appellant to make any payment to Company B more to say to claim deduction of any payment made to Company B as deductible outgoing and expense.

79. After all, Company B had done nothing in the subject properties transaction. There could not be any connection between a payment for doing nothing and the profit-earning process of the subject properties transaction.

80. We reject such an alternative argument of the Appellant.

Set-off of losses for years of assessment 1994/95 and 1995/96 [Fact (25)]

81. The Appellant did not derive taxable income in the years of assessment 1994/95 and 1995/96. It claimed loss for the year of assessment 1994/95 in the sum of $976,251 and for the year of assessment 1995/96 in the sum of $970,664 [Fact (2) and (4)].

82. The Appellant argued that during the relevant years of assessment 1994/95 and 1995/96 it did incur revenue expenses like salaries, rent etc in developing business with a

view to generating taxable income. The Appellant claimed that these were deductible expenses and that losses resulted after their deduction should be allowed. In another words, by claiming losses, the Appellant in fact was claiming that the expenses it incurred in developing prospective businesses were fully deductible under section 16(1) of the Ordinance.

83. Under section 16(1), however, an expense was deductible not because it was incurred with a view to generating taxable income. It was deductible only if it was incurred in the production of chargeable profits.

84. The Appellant named a few undertakings it was developing in the relevant years of assessment 1994/95 and 1995/96. None of such undertakings was successful and none produced any chargeable profits in the relevant years [see Fact (19)]. Even if the Appellant did incur expenses in the relevant years, no chargeable profits were generated, accordingly such expenses were not deductible under section 16(1). In the result, losses calculated by deducting such non-deductible expenses should not be allowed and the Appellant's claim thereof must fail.