Case No. D53/08

Profits tax – whether the Appellant incurred such expenses – whether such expenses were incurred in the production of the Appellant's chargeable profits – whether an employment existed or not was not relevant.

Panel: Chow Wai Shun (chairman), Lee Hung Chak and Vincent Mak Yee Chuen.

Date of hearing: 26 November 2008.
Date of decision: 16 February 2009.

The Appellant is a private company and its principal activities are general trading and property investment. The Appellant objected to the profits tax assessment on the grounds that salaries and related expenses for Mr H should be deductible. The Appellant's case has been that Mr H was at all relevant times its only employee providing services to the Appellant. It was the Appellant's case that remuneration and such other related expenses paid by the Appellant in respect of Mr H were deductible on the Appellant's account. The Appellant also argued on the ground that the annual fee and related bank charges should be deductible.

The issue for the Board to decide is whether any of the following expenses should be deductible for computing the assessable profits of the Appellant: (1) The salary expenses, local traveling allowance and contribution to the mandatory provident fund in respect of Mr H; and (2) the annual fee and the related bank charges.

Specially, the Board has to determine whether the Appellant incurred such expenses, and if so, whether they were incurred in the production of the Appellant's chargeable profits.

Held:

1. Whether an employment existed or not was not relevant to the Appellant's case. Remuneration to an independent contractor for services performed to the Appellant could have been deducted to the extent that such was incurred in the production of the Appellant's chargeable profits and was not so excluded under section 17 of the IRO. The Board was not satisfied, on balance of probabilities, that the Appellant incurred such expenses (D53/94, IRBRD, vol 9, 313 considered).

2. Not all expense is deductible. To what extent were such expenses connected with in

the sense that they were incidental to the Appellant's trade? In other words, to what extent were such expenses made by the Appellant for the purpose of earning its chargeable profits?

3. On such limited evidence made available before the Board, it cannot satisfy itself that such expenses incurred by the Appellant for services, if any, rendered by Mr H were connected with the trade of the Appellant. The Board found therefore that such expenses were not incurred in the production of the chargeable profits of the Appellant (Strong v Woodifield [1906] AC 448 considered).

4. The maintenance of the membership has no direct relevance to the Appellant's chargeable profits in the relevant years of assessment. The Appellant failed to adduce any evidence to show that its development in Country U, if any, would be in any way connected to any profit chargeable to profits tax in Hong Kong.

5. Expenses incurred in the production of chargeable profits of Company K cannot be deducted in the account of the Appellant and vice versa.

Appeal dismissed.

Cases referred to:

D53/94, IRBRD, vol 9, 313
Strong v Woodifield [1906] AC 448
Copeman v William Flood & Sons, Ltd (1941) 24 TC 53
Johnson Brothers & Co v CIR [1919] 2 KB 717
CIR v Chu Fung Chee [2006] 2 HKLRD 718

Taxpayer represented by its representative.
Lau Wai Sum and Chan Wai Yee for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 18 April 2008 ('the Determination') whereby:

(1) Additional profits tax assessment for the year of assessment 2000/01 under charge number x-xxxxxxx-xx-x dated 15 September 2006, showing additional assessable profits of $180,365 with tax payable thereon of

$28,859 was reduced to additional assessable profits of $91,000 with tax payable thereon of $14,650.

(2) Additional profits tax assessment for the year of assessment 2001/02 under charge number x-xxxxxxx-xx-x dated 15 September 2006, showing additional assessable profits of $291,000 with tax payable thereon of $46,560 was confirmed.

(3) Additional profits tax assessment for the year of assessment 2002/03 under charge number x-xxxxxxx-xx-x dated 15 September 2006, showing additional assessable profits of $305,500 with tax payable thereon of $48,800 was confirmed.

(4) Additional profits tax assessment for the year of assessment 2003/04 under charge number x-xxxxxxx-xx-x dated 15 September 2006, showing additional assessable profits of $303,000 with tax payable thereon of $53,025 was confirmed.

(5) Profits tax assessment for the year of assessment 2004/05 under charge number x-xxxxxxx-xx-x dated 15 September 2006, showing assessable profits of $480,404 with tax payable thereon of $84,000 was confirmed.

(6) Profits tax assessment for the year of assessment 2005/06 under charge number x-xxxxxxx-xx-x dated 20 April 2007, showing assessable profits of $3,246 with tax payable thereon of $568 was confirmed.

2. The Appellant, via its representative, Mr A, raised no dispute as to the facts upon which the Determination was arrived at. We therefore find those as facts. The relevant facts leading to this hearing are set out as follow:

(1) The Appellant was incorporated as a private company in Hong Kong on 22 September 1978. At all relevant times, its authorized, issued and paid-up capital was $100,000 divided into 1,000 ordinary shares of $100 each. Its shareholders were (a) Company B holding 100 shares; (b) Mr C holding 500 shares; and (c) Ms D holding 400 shares.

(2) Mr A, representing the Appellant at this hearing, has been director of the Appellant until 1 August 2006. Other directors were (a) Ms E, wife of Mr A, until 1 October 2006; (b) Ms F, sister of Mr A; (c) Mr G; (d) Mr C; (e) Mr H, brother of Mr A, since 20 May 2006; and (f) Mr I, son of Mr A, since 20 May 2006.

(3) Company B, a private company incorporated in Hong Kong on 4 July 1978, was set up by Mr A. At all relevant times, the majority of the directors of Company B were in common with that of the Appellant. The directors of Company B were (a) Mr A; (b) Ms E; (c) Ms F; (d) Mr C and (e) Mr J.

(4) Effective from 17 April 2001, the Appellant held 38.5% of the shareholding (3,850,500 out of 10,000,000 shares) in Company K. Company K is a private company incorporated in Hong Kong on 20 May 1980. Other shareholders of Company K were: (a) Mr A, holding 1,330,775 shares; (b) Mr C, holding 4,813,125 shares and (c) Mr L, holding only 5,600 shares.

(5) The major directors of Company K were in common with those of the Appellant and they were: (a) Mr A; (b) Ms E; (c) Mr J; and three others who resigned on 17 April 2001.

(6) At all relevant times, the Appellant owned the following properties:

	Location of property	Date of acquisition	Purchase price
(a)	Address M [Property 1] (Note)	8 December 1984	$1,060,000
(b)	Address N [Property 2]	26 June 2001	$6,000,000

Note: A portion of Property 1 was sub-divided as Unit A [Property 1A].

(7) At all relevant time since the date of acquisition, the Appellant leased Property 1 to Company B as Company B's business premises and Property 2 to Company K as the director's quarters provided to Mr A. No tenancy agreement was signed. Property 1 was also used as the warehouse of Company K which engaged in the trading of product O.

(8) (a) In its Reports of Directors, the Appellant described its principal activities as follow:

Year of assessment	
2000/01 and 2001/02	General trading and property investment (Note)
	Property investment and investment holding
2002/03 to 2004/05	Property investment holding
2005/06	

Note: The Appellant ceased its trading business since May 2001.

(b) The Appellant closed its accounts on 31 March each year.

(9) On divers dates, the Appellant filed its 2000/01 to 2005/06 profits tax returns, together with audited financial statements and tax computations, which showed, among other things, the following particulars:

(a) From 2002/03 onwards, the Appellant received rental income, dividend income from Company K and bank interest income.

(b) In all relevant years of assessment, the Appellant claimed deduction for ' salaries / staff salaries' .

(c) In 2004/05, the Appellant incurred the corporate membership initial fee (the Initiation Fee) paid to Club P, a golf club in City Q (Country U) (the Golf Club), and capitalized in its accounts for the year ended 31 March 2006.

(10) On divers dates, the assessor issued to the Appellant profits tax assessments for the years of assessment 2000/01 to 2003/04 according to the profits returned. No objection was lodged by the Appellant.

(11) Subsequently, the assessor raised on the Appellant the additional profits tax assessments for the years of assessment 2001/02 to 2003/04 and statement of loss for the year of assessment 2004/05, disallowing entirely the depreciation allowance claimed for the Initiation Fee.

(12) The assessor then agreed with the Appellant the amount of depreciation allowance to which it was entitled. The additional assessments and the statement of loss were revised accordingly.

(13) In early 2006, the assessor commenced an investigation into the tax affairs of the Appellant and its related companies.

(14) On 2 May 2006, Mr A attended an interview with the assessor, confirming the usage of Property 1 and Property 2 as that stated in sub-paragraph (8) above and explaining the reasons for the purchase of a membership in the Golf Club.

(15) Between 29 May 2006 and October 2006, the Appellant appointed Company R as its tax representative (the Tax Representative).

(16) In relation to the rental income reported in its account, the Appellant provided information and supplied documents to the effect that:

(a) Until 2005/06, the major tenants were Company B and Company K although there had also been rental income, albeit in less amount, in respect of the Property 1 (including Property 1A) from other (non-related) tenants.

(b) Not all tenancies had written tenancy agreements. There were no written tenancies between the Appellant and its two related companies. The Appellant did not furnish any tenancy agreement with one of its other tenants.

(c) All tenancy agreements, if signed, were signed by Ms F on behalf of the Appellant.

(17) In the course of the tax audit, the assessor queried the following expenses claimed by the Appellant:

(a) Salary for Mr H, for all relevant years of assessment.

(b) Local traveling expenses to Mr H, for all relevant years of assessment except 2005/06

(c) Contribution to MPF, for all relevant years of assessment since 2002/03.

(d) Initiation Fee for 2004/05.

(e) Entertainment – Annual membership fee paid to the Golf Club (the Annual Fee) for 2004/05 and 2005/06.

(f) Bank charges – Remittance expenses charged by the bank for the payment of the Annual Fee for 2004/05 and 2005/06.

(18) The assessor ascertained that:

(a) In his Tax Return – Individuals filed for the years of assessment 2000/01 to 2005/06, Mr H declared, among other things, that he received employment income from (i) Company K as Deputy General Manager for 2000/01; and (ii) the Appellant as Manager for all relevant years of assessment.

(b) Salaries tax assessments were raised on Mr H accordingly.

(c) According to the records obtained from the Immigration Department, Mr H was present in Hong Kong for only 6 days during the period from 1 April 2000 to 31 March 2006. Specifically, he arrived at 17:54:00 on 6 July 2001 and departed at 11:44:00 on 11 July 2001.

(19) By letter dated 25 July 2006, the Tax Representative put forth, among other things, contentions in support of the claims for deduction of salaries expenses for the years of assessment 2000/01 to 2004/05. In summary, the Tax Representative attempted to set out the services provided by Mr H to the Appellant and the mode of operation.

(20) Having reviewed the information and documents available, the assessor considered that the claimed expenses per sub-paragraph (17) above were either capital in nature, namely the Initiation Fee, or not incurred by the Appellant in the production of its chargeable profits and therefore not deductible. Accordingly the assessor prepared draft computation of discrepancies (the Draft Computation) in respect of the Appellant for the years of assessment 2000/01 to 2004/05.

(21) On 1 August 2006, Mr A, accompanied by the Tax Representative, attended an interview with the assessor. During the interview, the assessor presented and discussed the Draft Computation with Mr A. Mr A signed a settlement agreement (the Settlement Agreement) on behalf of the Appellant indicating its acceptance of the discrepancies as shown in the Draft Computation.

(22) On 31 August 2006, the assessor received an undated letter by which Mr H expressed his grievances on disallowing the Appellant' s claim for deduction of his salaries under profits tax.

(23) By letter dated 4 September 2006, Mr G, another director of the Appellant, put forth certain contentions and asked on behalf of the Appellant to have the deductions of the salaries for Mr H allowed for the years of assessment 2000/01 to 2004/05.

(24) On 15 September 2006, the assessor raised on the Appellant additional profits tax assessments or profits tax assessment on the basis of the Settlement Agreement.

(25) The Appellant objected to the assessments per sub-paragraph (24) above on

the ground that salaries and related expenses for Mr H should be deductible.

(26) On 13 November 2006, the assessor issued to the Appellant a statement of loss for the year of assessment 2005/06 with adjusted loss which was in accordance with the return filed by the Appellant. The Appellant did not indicate any disagreement to that statement of loss.

(27) On 20 April 2007, the assessor raised on the Appellant profits tax assessment denying deduction of those relevant items claimed in sub-paragraph (17) above.

(28) The Appellant objected to the 2005/06 assessment on the grounds that those expenses should be deductible.

(29) In support of the claim for deduction of salaries expenses for the year of assessment and the services claimed to have been provided by Mr H as its employee, the Appellant furnished copies of following documents:

Date of document	Nature of document
12 September 1984	A document under the Appellant' s letterhead and bearing a signature addressed to a 'Mr S' regarding the purchase of Property 1
25 October 2004	An advice of time deposit held in the joint name of Mr A and Ms E with Bank T at a principal of AUD27,027,876.08 to be matured at 25 April 2005 at principal plus interest of AUD27,763,004.28
15 November 2004	An Investment Proposal from Mr H to the Appellant (the Investment Proposal)
1 March 2005	Minutes of meeting of the Board of Directors of the Appellant (the March Minutes) resolving the acceptance of the Investment Proposal and a loan of AUD28,566,026 from Mr A and Ms E to be transferred from their joint name bank account to the Appellant by 25 April 2005 to finance the proposed investments.
25 April 2005	An advice of time deposit held in the name of the Appellant with Bank T at a principal of AUD27,763,004.28 to be matured on 25 October 2005 at principal plus interest of

AUD28,566,026.04

25 October 2005	An advice of time deposit held in name of the Appellant with Bank T at a principal of AUD28,566,026.04 to be matured on 25 October 2006 at principal plus interest of AUD30,221,248.71, with a note of early redemption on 17 August 2006 at principal of AUD29,908,343.60
17 August 2006	Minutes of meeting of the Board of Directors of the Appellant resolving for the liquidation of the Company and the transfer of its time deposit of AUD29,908,343.60 to the joint name bank account of Mr A and Ms E on 17 August 2006 as a repayment of their loan to the Appellant.
17 August 2006	An advice of time deposit held in the joint name of Mr A and Ms E with Bank T at a principal of AUD29,908,343.60 to be matured at 25 October 2006 with a principal plus interest of AUD30,221,249.00

(30) The assessor identified from the Appellant' s accounting records entries in the general ledger, transfer vouchers and copies of cheques which purportedly supported payment of salaries and other related expenses claimed.

(31) The Appellant also made contentions with regard to its claim for the deduction of the Annual Fee and the related bank charges. In short, the Appellant claimed that the membership with the Golf Club was essential to its expansion of business into and in Country U.

(32) On 16 July 2007, Ms F attended an interview with the assessor. During the interview, Ms F provided, among other things, information about herself, her service to the Appellant, her knowledge about Mr H and the operation of the Appellant. She was given a copy of the note of interview and she did amend and confirm such notes.

(33) The assessor considered that the 2000/01 additional profits tax assessment should be revised and reduced, which, together with other confirmed assessments, all of which are set out in paragraph 1 above, form the subject of this appeal.

3. When asked if he would be giving any oral evidence, Mr A replied that he just appeared for and on behalf of the Appellant to present its case. He was neither authorized nor prepared to give any evidence.

4. In the notice of appeal, the Appellant indicated that Ms F, its director, was authorized and appointed to attend the hearing. On the date of hearing, we were informed by the Clerk to this Board that Ms F would not attend.

5. In the notice of appeal, the Appellant also raised that given Mr H was residing in another country, where is a 14-hour flight from Hong Kong, he would wish to excuse himself from the hearing even though he was the only person familiar with the operations of the Appellant. As such, Mr H did not attend the hearing to give any oral evidence. Nor was there any written statement from him to explain how he operated the Appellant' s business in distance. This is entirely a choice of the Appellant and Mr H. Perhaps it is just sufficient for us to point out at this juncture that the statutory burden is on the Appellant to show that the assessments are excessive or incorrect.

6. The notice and statement of grounds of appeal is rather in detail. The document was actually signed by Mr H and on such basis we believe that he actually prepared or at least perused the document. However, all parties, including this Board, were deprived of the opportunities to hear directly oral testimonies from the three people who had been much involved in the operation of the Appellant during the relevant times. We can only arrive at our decision on the basis of the documentary evidence made available before us and the submissions made by both sides during the hearing.

The relevant statutory provisions

7. 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…'*

8. Section 17 of the IRO provides:

> *'(1) 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) …*
> *(b) … any disbursements or expenses not being money expended for the purpose of producing such profits;*

(c) any expenditure of a capital nature…'

9. Section 68(4) of the IRO provides:

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

The issue

10. The issue for us to decide is whether any of the following expenses should be deductible for computing the assessable profits of the Appellant:

(1) The salary expenses, local traveling allowance and contribution to the mandatory provident fund in respect of Mr H; and

(2) The Annual Fee and the related bank charges.

11. Specifically, we have to determine whether the Appellant incurred such expenses, and if so, whether they were incurred in the production of the Appellant's chargeable profits.

Salary expenses, local traveling allowance and MPF contributions in respect of Mr H

12. In this regard, the Appellant's case has been that Mr H was at all relevant times its only employee providing services to the Appellant, including property leasing, formulating business strategies, looking for business opportunities, supervising investments, advising the Board of Directors and arranging finance for investments, looking after the annual general meeting, annual audit, as well as tax-related and secretarial matters, albeit at his home outside Hong Kong. As a result, it is the Appellant's case that remuneration and such other related expenses paid by the Appellant in respect of Mr H are deductible on the Appellant's account. The Appellant also emphasizes that payment of Hong Kong salaries tax by Mr H and their MPF contributions indicate an employment relationship between the Appellant and Mr H.

Whether the Appellant incurred such expenses

13. Miss Lau referred us, in her written submission, to D53/94, IRBRD, vol 9, 313.

14. In D53/94, the taxpayer carried on business and claimed as deductible expenses sums of money stated to have been paid to the mother and father of the taxpayer by way of salary or commission. Receipts signed by the parents were produced to the assessors. On cross-examination by the representative for the Commissioner, the taxpayer said that the receipts were all typed 'in one go'. The taxpayer also claimed that the payments were made in cash. No other records were produced by the taxpayer. The Board considered that 'the taxpayer never in

fact paid any of his parents but claimed the amount as salary / commission to each of his parents in order to get away with the maximum allowance' both for himself and for his parents who would not have to pay salaries tax as the married person's personal allowance for that year was precisely the total of the two sums and found, on a balance of probabilities that the taxpayer did not pay or incur the sum or any other sum, whether to the father or the mother.

15. Is the Appellant's case any better than that of the taxpayer in D53/94?

16. The Appellant admitted that no employment contract had been entered into but emphasized, inter alia, that their MPF contributions indicated the existence of an employment relationship. In our view, whether an employment exists or not is not relevant to the Appellant's case. Remuneration to an independent contractor for services performed to the Appellant could have been deducted to the extent that such was incurred in the production of the Appellant's chargeable profits and was not so excluded under section 17 of the IRO. We expect, however, some cogent evidence supporting a mutual intention on both sides to enter into some form of legal relationship, one way or another, as distinguished from an informal and, more often than not, oral arrangement under which one might just be consulted by his close family members occasionally from time to time. Have we been provided with such evidence?

17. The Appellant charged those expenses to the Appellant's account by way of a year-end entry. Instead of having paid Mr H, the Appellant credited those amounts to the director's current account with Mr A for the years of assessment 2000/01 to 2004/05 and sundry creditor for 2005/06 except on one occasion when the Appellant paid Mr H $267,000 on 2 August 2006 which was alleged to be Mr H's salary for the year ended 31 March 2005.

18. The Appellant explained that it was so done to simplify the operation of the Appellant and pursuant to Mr H's preference to keep some money in Hong Kong to provide financial assistance to some of his old friends and relatives in Hong Kong and China whenever necessary. While it might be so put forward as a justifiable reason, we were not provided with any evidence showing matters such as how much had been drawn from those accounts for such purposes from time to time and when, as well as the balance which Mr H was entitled to at any given time. We also note that the exceptional payment on 2 August 2006 was a belated one and was made after tax audit had commenced and the Settlement Agreement had been signed.

19. The Appellant claimed that the remuneration was fixed according to the market conditions and that the parties found it fair and acceptable. However, it did not even explain what those market conditions were and on what basis they found it fair and acceptable.

20. If we discard the dividend income from Company K and the bank interest income in those relevant years of assessment since they were not chargeable to tax anyway, the remuneration for Mr H represented approximately 35.5%, 59.3%, 56.8%, 55.7%, 54.2% and 460% of the gross income of the Appellant in each of those relevant years of assessments respectively,

commensurable to those figures in D53/94.

21. Perhaps Mr H should be commended for his voluntary payment of salaries tax. However, such payment was absolutely unnecessary. In the hands of Mr H, none of those receipts was chargeable to Hong Kong salaries tax because his absence (or nominal presence) from Hong Kong during the relevant years of assessments exempted him from the salaries tax charge. Even if Mr H had been in Hong Kong for such time that would have made any of his receipts subject to salaries tax, his tax liability would just be minimal, as evidenced from the relevant tax assessments. More than half of his remuneration would have been taken away by the married person allowance during the relevant years of assessment in computing his assessable income.

22. His voluntary payment (and subsequent refusal for refund), in our view, bears no relevance to the Appellant' s case. The statutory provisions for deduction of expenses incurred by a profits tax payer indicate no such symmetry of taxation with the taxability of (or even payment of any tax on) such amount in the hands of the recipient and vice versa.

23. We conclude, on this issue, that the Appellant' s case is no better than that of the taxpayer in D53/94. We are not satisfied, on balance of probabilities, that the Appellant incurred such expenses.

To what extent such expenses were incurred in the production of chargeable profits of the Appellent

24. If we were wrong in relation to the issue above, the Appellant would still have to show that such expenses were incurred in the production of its chargeable profits.

25. Miss Lau cited the following cases: Strong v Woodifield [1906] AC 448, Copeman v William Flood & Sons, Ltd (1941) 24 TC 53 and Johnson Brothers & Co v CIR [1919] 2 KB 717. With full respect to Miss Lau, we do not find that the latter two cases can add much, if any, to the Commissioner' s case in this appeal and we shall just focus on Strong v Woodifield below.

26. Strong v Woodifield was applied in CIR v Chu Fung Chee [2006] 2 HKLRD 718, (2006) 6 HKTC 743. Chung J in the latter case quoted the passages below from Strong v Woodifield:

> *'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, … 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' (emphasis supplied) (per Lord Loreburn, page 452);

'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' (emphasis supplied) (per Lord Savey, page 453).

27. Not all expense is deductible. To what extent were such expenses connected with in the sense that they were incidental to the Appellant's trade? In other words, to what extent were such expenses made by the Appellant for the purpose of earning its chargeable profits?

28. The nature of the trade must be considered. In its profits tax return, the Appellant offered for assessment its trading profits (for the years of assessment 2000/01 and 2001/02) and rental income (for the years of assessment 2000/01 to 2005/06). None of its other revenue as shown in its financial statements, including dividend income from Company K and bank interest income, is chargeable profit.

29. What had Mr H done for which the Appellant incurred such expenses? Could sufficient connection be established so that such expenses incurred by the Appellant could be considered for the purpose of its trade that earned its chargeable profits?

30. The Appellant's case in this regard can be summarized as follow:

(a) Mr H was the only employee of the Appellant who was responsible for looking after the assets, including management of the leasing of the property owned. Although Ms F, his sister, has been appointed as a director, she has such a low level of academic education and limited business knowledge that she required guidance from Mr H. She was appointed mainly for the purpose of signing and handling the legal documents of the Appellant due to her domicile in Hong Kong.

(b) Mr H was hired to formulate business strategy, look for business opportunities, supervise investments, provide advice and suggestion to the board of directors and arrange funding for investments. In this connection, during 2000, Mr H was invited to look into Company K and evaluate its worth before the Appellant purchased 38.5% of its shares on 17 April 2001. A document headed 'Investment Proposal' was submitted by Mr H on 15 November 2004.

(c) Mr H frequently hosted telephone conference with the board of directors to discuss and resolve administration issues as the Appellant held a controlling

interest in Company K.

(d) Mr H also looked after the year-end AGM, annual audit, tax and secretarial matters of the Appellant.

(e) All these duties and responsibilities, as submitted by the Appellant and Mr H, could be performed in distance.

31. At all relevant times, the Appellant was the owner of an industrial property and a residential property. As shown by the undisputed facts, majority of the rental income from the two properties were derived from the Appellant's related companies without signing any tenancy agreement. No evidence has ever been adduced to show that such leasing required the involvement of Mr H.

32. From time to time, short-term casual tenancy was sought in respect of the industrial property from third parties. Ms F confirmed in her notes of interview that as the rental was not high (in our view, nominal) and that she had been authorized to handle such matters and so she did not contact Mr H frequently.

33. The Appellant failed to adduce any evidence to show that Mr H did conduct the alleged evaluation in connection with its purchase of shares in Company K during 2000. Even if Mr H did render such evaluation services, such expense incurred by the Appellant for his services would be of a capital nature and not be deductible by virtue of section 17(1)(c) of the IRO. This is analogous to, for example, legal fees incurred incidental to acquiring additional capital asset for a taxpayer. We formulate this analogy on the basis of the fact put forward by the Appellant in its notice and statement of grounds of appeal that part of Mr H's salary (in our view, a substantial part of it) for 2000/01 were actually paid by Company K. Such fact appears to suggest that Mr H was at best analogous to an independent service provider to the Appellant for the year 2000/01. Subsequent dividend paid by Company K, as explained, has never been chargeable profits in the hands of the Appellant.

34. With regard to the Investment Proposal, we note that it was only submitted by the Appellant after the objection against the 2005/06 assessment was lodged. The Investment Proposal was submitted together with a copy of the minutes of a meeting of the Appellant's board of directors held on 1 March 2005. However, as admitted by the Appellant subsequently in its letter dated 25 May 2007, no physical meeting had been held and the resolution in the March minutes was approved by circulation.

35. The resolution of the board was to accept a loan of AUD$28,566,026 from Mr A and his wife, Ms E, by 30 April 2005 to finance the proposed investment while the Investment Proposal made no reference to any amount whatsoever required. The figure, however, incidentally matched the principal plus interest of a fixed deposit at maturity on 25 October 2005, which was

only shown in a bank advice issued on 25 April 2005, a later date than the date of the resolution of the board.

36. While we make no attempt to enquire further into the genuineness of the Investment Proposal and the minutes, we note that the Investment Proposal had in fact not been carried through. The Appellant adduced no evidence to show that it had ever searched for potential investment properties as suggested in the Investment Proposal. No corroborative evidence has ever been adduced to support the claim that funds were injected to the Appellant with the intention to finance the proposed investment.

37. As to other services alleged by the Appellant, no evidence has been adduced to substantiate its claim since no record was kept and so none could be provided.

38. On such limited evidence made available before us, we cannot satisfy ourselves that such expenses incurred by the Appellant for services, if any, rendered by Mr H were connected with the trade of the Appellant in such a way as required under Strong v Woodifield. We find therefore that such expenses were not incurred in the production of the chargeable profits of the Appellant.

39. To conclude with regard to this claim, the Appellant must fail either because it did not incur such expenses or such expenses, if ever incurred, were not incurred in the production of its chargeable profits. The expenses, in our view, might even be capital in nature.

Annual Fee and related bank charges

Whether the Appellant incurred such expenses

40. It is not in dispute that the Appellant paid such Annual Fee and hence, also the related bank charges.

41. In her written submission, Miss Lau challenged, that the statements issued and attached to the relevant vouchers were addressed to a Madam V and that no evidence had been adduced to show that the Appellant was liable to pay for and on behalf of this Madam V.

42. Mr A, in his reply, submitted that this Madam V was the contact person of the Appellant for these purposes. We were provided prior to the hearing a copy of the Club Membership Agreement bearing the name of the Appellant. In our view, the Appellant could have also provided its membership certificate showing its membership number which matched with that appeared on those statements. However, we do not hold against the Appellant simply for the absence of such evidence.

To what extent such expenses were incurred in the production of chargeable profits of the Appellent

43. The Appellant's case has been that the membership with the Golf Club would be essential to the Appellant's intended expansion and development in Country U, particularly in City Q. The Appellant also claimed that the membership was used by Company K to entertain clients of the latter.

44. The maintenance of the membership has no direct relevance to the Appellant's chargeable profits in the relevant years of assessment. The Appellant only offered for profits tax assessment in those years of assessments after its acquisition of the membership its rental income from its landed properties in Hong Kong. The Golf Club, however, is in City Q. The Appellant made no attempt to show how the membership was connected to the production of its chargeable profits in those years. Similarly, the Appellant failed to adduce any evidence to show that its development in Country U, if any, would be in any way connected to any profit chargeable to profits tax in Hong Kong.

45. With regard to its claim that the facilities were used by Company K to entertain its clients and hence indirectly connected to the Appellant as its controlling shareholder, we accept the submission of the representative for the Commissioner that as any dividend income received by the Appellant from Company K would be excluded from profits tax assessment in the hands of the Appellant by section 26 of the IRO, such expenses incurred by the Appellant for the business of Company K could not be deducted in the account of the Appellant. In fact, the Appellant's claim is a misconceived one. The Appellant and Company K are after all separate legal entities, however closely related they are. Expenses incurred in the production of chargeable profits of Company K cannot be deducted in the account of the Appellant and vice versa.

46. The Appellant must, therefore, also fail in this claim.

Conclusion

47. From the above analysis, we hold that the Appellant fails both of its claims and confirm all the assessments as set out in paragraph 1 above appropriate and correct.