Case No. D78/06

Salaries tax – interposition of service company – whether the transactions are artificial or fictitious – sections 9A, 61 of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Simon S M Ho and Leung Lit On.

Date of hearing: 8 December 2006.
Date of decision: 12 January 2007.

The appellant was a director of a private company ('ServiceCo') and at all material times held 9,999 of the 10,000 shares issued by ServiceCo.

In the relevant years of assessment, ServiceCo entered into a series of agreements first with Person A and later Person B. Under those agreements, ServiceCo was engaged as 'Resident Engineer' for consecutive periods for Person A initially and later for Person B. The assessor raised on the appellant a number of salaries tax assessments which included all income paid to ServiceCo by Person A and Person B. The appellant objected to the inclusion.

Held:

1. The notice of appeal filed by the appellant contains no arguable ground.

2. The interposition of ServiceCo between the appellant and Person A or as the case may be Person B reduces or would reduce the amount of tax payable by the appellant. On the evidence, both Person A and Person B were after the appellant's personal services. Apart from the tax avoidance function, there was no real role for ServiceCo under any of the transactions or any of the agreements. Nor is there any commercial sense in them.

3. Despite the fact that ServiceCo had no real role under any of the agreements, it received substantial sums in the relevant years of assessments. No salary was charged in ServiceCo's financial statements in any of the relevant years of assessment. The appellant was the person who was to and did provide all the services to Person A or Person B, as the case may be. Yet, the appellant's emoluments, as reported by the appellant or as charged by ServiceCo in its financial statements, amounted to much lesser sums than what ServiceCo received in those

years. No person dealing on an arms length basis would have entered into the transactions and the agreements as the appellant did. The transactions are plainly artificial.

4. By virtue of section 61, the interposition of ServiceCo is to be disregarded and the appellant shall be assessed on the basis as if the remuneration paid by Person A and Person B (as the case may be) to ServiceCo had been received by the appellant as an employee of Person A and Person B (as the case may be). (Seramco Trustees v Income Tax Commissioner [1977] AC 287; Commissioner of Inland Revenue v D H Howe [1977] HKLR 436; Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773 considered.)

5. Section 9A also applies. As to whether the exclusion under section 9A(4) applies, the question here is whether at all material times the carrying out of the services was not in substance the holding by the appellant of an employment of profit with Person A or Person B (as the case may be). The focus here is on the substance.

6. Where, as here, the relationship has to be determined by an investigation and evaluation of the factual circumstances in which the work is performed, it must now be taken to be firmly established that the question of whether or not the work was performed in the capacity of an employee or as an independent contractor is to be regarded by an appellate court as a question of fact to be determined by the trial court. There is no single test or indicia. (Lee Ting Sang v Chung Chi Keung [1990] 2 AC 374 considered.)

7. On the evidence, the Board are not satisfied that the carrying out of the services was not in substance the holding by the appellant of an office or employment of profit with Person A or Person B (as the case may be). The exclusion under section 9A(4) does not apply.

Appeal dismissed.

Cases referred to:

Seramco Trustees v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436
Cheung Wa Keung v Commissioner of Inland Revenue [2002] 3 HKRLD 773, CA
Lee Ting Sang v Chung Chi Keung [1990] 2 AC 374

Michael Chan Yui Hang of Messrs Michael Chan & Co for the taxpayer.
Ng Yuk Chun and Lau Yuen Yi for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal against the Determination of the Deputy Commissioner of Inland Revenue dated 20 December 2004 whereby:

(a) Salaries tax assessment for the year of assessment 1996/97 under charge number 9-2612853-97-2, dated 13 January 2003, showing net chargeable income of $704,280 with tax payable thereon of $133,056 was confirmed.

(b) Salaries tax assessment for the year of assessment 1997/98 under charge number 9-4038595-98-A, dated 13 January 2003, showing net chargeable income of $753,296 with tax payable thereon of $125,873 [after giving effect to the Tax Exemption (1997 Tax Year) Order] was confirmed.

(c) Salaries tax assessment for the year of assessment 1998/99 under charge number 9-2212901-99-6, dated 14 March 2003, showing net chargeable income of $764,960 with tax payable thereon of $119,543 was confirmed.

(d) Salaries tax assessment for the year of assessment 1999/2000 under charge number 9-2127266-00-9, dated 14 March 2003, showing net chargeable income of $387,915 with tax payable thereon of $55,445 was confirmed.

2. This case was heard by a differently constituted panel of the Board of Review in the afternoon of 21 March 2005. Before producing any draft decision for the consideration of the other panel members, the panel chairman resigned on 7 July 2006.

3. Another panel has since been convened to hear the case starting anew.

The background facts

4. The relevant years of assessment in this appeal are 1996/97, 1997/98, 1998/99 and 1999/2000.

5. In four earlier years of assessment, the appellant was employed by his former employer ('Person A') and derived the following employment income:

Year of assessment	**$**

1990/91	395,910
1991/92	452,500
1992/93	513,951
1993/94	560,588

6. On 14 March 1994, the appellant was appointed a director of a private company incorporated in Hong Kong on 24 August 1993 ('ServiceCo'). At all material times he held 9,999 of the 10,000 shares issued by ServiceCo. One share was held by a younger sister of the appellant's wife.

7. On or about 30 April 1994, the appellant ceased to be employed by Person A.

8. In about April 1994, Person A was seeking a Resident Engineer for a project ('the Project'). Person A handled Phase I of the Project.

9. By a Consultancy Agreement dated 12 April 1994 made between Person A and ServiceCo ('the 1994 Agreement'), Person A engaged ServiceCo as 'Resident Engineer' for a term of two years from 1 June 1994 to 30 May 1996 to provide advice and service on civil engineering matters of the Project.

10. By letter dated 26 April 1996 from Person A and countersigned by the appellant on behalf of ServiceCo on 13 May 1996 ('the Extension Letter'), ServiceCo's consultancy agreement was extended from 1 June 1996 to 30 November 1996 on the same terms and conditions.

11. By letter dated 28 August 1996, Messrs X, a firm which described itself as 'Accounting, Taxation & Management Consultants', wrote to the Commissioner on behalf of the appellant as his duly authorised representatives as follows (*written exactly as in the original*):

> 'Enclosed please find a copy of Services Consultancy Agreement made between [Person A] and our above named client. Our client want your department to check all the terms under the contract, and reply us and our client whether the above Consultancy Agreement is approved as real service company agreement, it is not subject to any salaries tax.'

12. A limited company ('Person B') handled Phase II of the Project.

13. By a Consultancy Agreement dated 28 November 1996 made between Person B and ServiceCo ('the 1996 Agreement'), Person B engaged ServiceCo as 'Resident Engineer' for

a term of two years from 1 December 1996 to 30 November 1998 to provide advice and service on civil engineering matters of the Project.

14. By letter dated 21 February 1997, a Deputy Commissioner gave the following advance ruling:

> 'Having regard to the information available, I would express the opinion that the services in question will come within the scope of Section 9A(1) of the Inland Revenue Ordinance and the income so derived should be subject to Salaries Tax.'

15. By another Consultancy Agreement dated 28 November 1998 made between Person B and ServiceCo ('the 1998 Agreement'), Person B engaged ServiceCo as 'Resident Engineer' for a term of four months from 1 December 1998 to 31 March 1999.

16. By a third Consultancy Agreement dated 31 March 1999 made between Person B and ServiceCo ('the 1999 Agreement'), Person B engaged ServiceCo as 'Resident Engineer' for a term of eleven months from 1 April 1999 to 29 February 2000.

17. The 1994, 1996, 1998 and 1999 Agreements and the Extension Letter are referred to collectively as 'the Agreements'.

18. We interpose here to note that the Assistant Commissioner reviewed the tax position in respect of two earlier years of assessment, 1994/95 and 1995/96. The Assistant Commissioner was of the view that the interposition of ServiceCo between the appellant and Person A was caught by section 61A of the Inland Revenue Ordinance, Chapter 112, and that as from 18 August 1995, section 9A applied and on 30 April 1997 raised on the appellant salaries tax assessments which included income received by ServiceCo from Person A from 1 June 1994 to 31 March 1996. Through Messrs X, the appellant objected against these assessments. By her Determination dated 30 November 1999, the then Acting Deputy Commissioner upheld the assessments. There was no appeal from this Determination.

19. The assessor raised on the appellant a number of salaries tax assessments for the years of assessment 1996/97, 1997/98, 1998/99 and 1999/2000 which included all income paid to ServiceCo by Person A and Person B.

20. The appellant objected against the inclusion of such income.

21. The Deputy Commissioner was of the view that section 9A was applicable and made his determination accordingly.

22. After the appellant had filed the notice of appeal in this case and about three months before the abortive hearing before the other panel, the assessor gave notice to Messrs X by letter dated 24 February 2005 that the revenue intended to rely also on section 61.

The grounds of appeal

23. By letter dated 29 December 2004, Messrs Michael Chan & Co gave notice of appeal on behalf of the appellant on the following 'grounds' (*written exactly as in the original*):

> '(1) [The appellant] do not agree the determination and opinion issued by the commissioner of Inland Revenue Department.
>
> (2) [The appellant] do not accept the interpretation about the sub-contract agreement with his custom, and considered that all sub-contracted income from [ServiceCo] are salaries Income to [the appellant].
>
> (3) [The appellant] declare that all sub-contracted contracts signed with different customers' and Companies are not services income of salaries.'

NO ARGUABLE GROUND OF APPEAL

24. In our Decision, the notice of appeal contains no arguable ground of appeal.

25. On the first 'ground', whether the appellant agrees with the Determination or the Deputy Commissioner's opinion is quite beside the point. It is trite law that what the Board of Review is concerned is whether the assessment appealed against is incorrect or excessive. An assessment appealed against is not incorrect or excessive just because a taxpayer disagrees.

26. On the second 'ground', whether the appellant agrees with the Deputy Commissioner's interpretation is also quite beside the point. The issue is not whether the taxpayer disagrees with the Deputy Commissioner's interpretation, or whether the Deputy Commissioner's interpretation is correct. It is not clear what Messrs Michael Chan & Co were driving at in the second phrase. The issue is not whether the appellant's income from ServiceCo is chargeable income under section 8, but whether the interposition of ServiceCo between the appellant and Person A or Person B (as the case may be) is caught by any of the anti-avoidance provisions.

27. On the third 'ground', an assessment appealed against is not incorrect or excessive just because a taxpayer declares in his 'ground' of appeal that his income is not salary income.

28. Section 66(3) provides that:

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

29. No application has been made to rely on any other ground of appeal.

30. Since the notice of appeal contains no arguable ground of appeal, this appeal falls to be dismissed.

DECISION ON APPLICATION OF SECTION 61

31. We turn now to consider section 61, in case our decision on there being no arguable ground of appeal is wrong.

32. Ms Ng Yuk-chun relied on section 61. She cited a number of Board decisions on that section. We are sure she did that in deference to the Board. As a general rule, the Board is not bound by decisions of the Board but is bound by judgments of the Court of First Instance and higher courts. Where a point has been decided in a Court judgment, the Court judgment should be cited.

33. Mr Michael Chan Yui-hang made no attempt to respond to the submission of Ms Ng Yuk-chun on section 61, or on section 9A, and cited no authority.

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

35. Section 12(1)(a), the provision on deduction of expenses for salaries tax purposes, provides that:

> *'(1) In ascertaining the net assessable income of a person for any year of assessment, there shall be deducted from the assessable income of that person –*
>
> *(a) all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income'.*

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

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

37. Section 61 provides that:

'Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.'

38. We remind ourselves of the observations made by Lord Diplock, delivering the advice of the Privy Council in Seramco Trustees v Income Tax Commissioner [1977] AC 287 at pages 297-8 in relation to section 10(1) of the Jamaican Income Tax Law 1954, in similar terms to our section 61:

'It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10 (1). Whether it can properly be so described depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.

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

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

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

> *'What then are the arrangements and the circumstances in which they were made and carried out that I must examine in order to see whether or not they are artificial? Simply they are these. By two separate agreements the taxpayer effectively transferred all his existing and future earnings as an author to a limited company. The consideration in each case was valuable in the technical sense but by no stretch of the imagination otherwise. If that were all, the agreements would have been, as counsel for the Commissioner suggests, in the words of their Lordships (p. 294) quite "unrealistic from a business point of view". But there is one other circumstance to consider. The limited company which is the beneficiary of the taxpayer's apparent generosity is controlled by the taxpayer himself. That was a fact found by the Board of Review and I assume it to mean that the taxpayer holds all or substantially all of the shares therein. In this situation it does not necessarily follow that the transactions are commercially unrealistic. The overall position remains the same. What the taxpayer loses on the roundabouts he makes up on the swings. Looked at purely from the aspect of gross income the transactions seem unnecessary and unproductive. But the taxpayer may well have other matters in mind. I find nothing on the face of things that makes the agreements artificial in the way that their Lordships approached the Seramco situation. To my mind they are artificial only in the sense e.g. that a limited company is artificial. It is not the product of nature, it is the outcome of man's inventive mind. I am satisfied that the Board of Review came to a correct conclusion on this question.'*

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

> *'The term "commercially unrealistic" appears in CIR v Howe (1977) 1 HKTC 936 at p.952 in the sense of "unrealistic from a business point of view". We are of the view that whether a transaction which is commercially unrealistic must necessarily be regarded as being "artificial" depends on the circumstances of each particular case. We agree with the submission of Mr Cooney, however, that commercial realism or otherwise can be one of the considerations for*

deciding artificiality. In the present case, the Board found as a fact that there was no "commercial reality in the transaction" and that there "simply was no commercial sense in the transaction"; thus it was open to the Board to reach the conclusion that the transaction was artificial under s.61.'

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

'60 The relevant word used in s.61 is "disregard" and not "annihilate", "avoid" or "annul". Where a transaction is found by the assessor to contravene s.61, he may 'disregard' it and 'the person concerned shall be assessable accordingly'. The "person concerned", as can be seen in the earlier part of the section, is the person "the amount of tax payable by" whom is reduced or would be reduced by the transaction. We think the meaning of "accordingly" is clear enough, which is the situation where the transaction is disregarded. The taxpayer in the present case is the person whose tax was reduced by intervention of the contracts and the interposition of First-Rate. When the transaction was disregarded by the assessor pursuant to s.61, the real nature of the remuneration that had been paid by Sun Ling to First-Rate was exposed. The remuneration was paid for the provision of the services that the taxpayer, and he alone to the exclusion of First-Rate and anyone else, made to Sun Ling, and as such, is assessable as his own income. Indeed, the transaction apart, the real relationship between Sun Ling and the taxpayer in the circumstances of this case has been well demonstrated to be that between employer and employee. It is unnecessary to deem the remuneration as the taxpayer's income. It suffices where the transaction has been disregarded to look at the reality of the remuneration and the relationship. Mr Cooney draws our attention to passages in the judgments of the judges in the majority in Bunting v Commission of Taxation (1989) 20 ATR 1579 at p.1585 per Beaumont J and at p.1590 per Gummow J. The judges were considering what the Revenue was entitled to do where arrangements that offended s.260 of the Income Tax Assessment Act had been annihilated. They held that "the exercise is necessarily a hypothetical one" and the fact was exposed that the income had been earned by the appellant's own exertions and that the Revenue was entitled to "treat the taxpayer as having derived the income which was the return from his own activities." Support can also be found in Seramco Superannuation Fund Trustees v Income Tax Commissioners [1977] AC 287 at p.300 where a similar method was employed by Lord Diplock.

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

43. The relevant transactions in this case are:

(a) the interposition of ServiceCo between the appellant and Person A; and

(b) the interposition of ServiceCo between the appellant and Person B.

44. The first question is whether:

(a) the interposition of ServiceCo between the appellant and Person A; or

(b) the interposition of ServiceCo between the appellant and Person B

reduces or would reduce the amount of tax payable by the appellant.

45. The criteria for deduction under section 12(1)(a) is notoriously stringent. The regime under section 16(1) is more relaxed. Many items which are not deductible under section 12(1)(a) are deductible under section 16(1).

46. We illustrate our point by referring to ServiceCo's financial statements. We do so without expressing any view on the deductibility of any of the expenses charged in ServiceCo's financial statements.

47. ServiceCo's accounts for the years ended 31 March 1997, 1998, 1999 and 2000 showed the following income and expenditures:

Year ended 31 March	**1997** $	**1998** $	**1999** $	**2000** $
Consultancy fees received	904,960	1,042,976	1,200,866	408,760
Less: Direct expenses				
Raw materials	-	228,225	563,418	276,796
Tools consumption	-	20,705	57,330	-
Sub-contracting charges	-	30,000	83,075	-
Gross profit		764,046	497,043	131,964
Less: Operating expenses				
Accountancy fee	5,000	5,000	3,000	5,000
Auditor's remuneration	9,000	10,000	8,000	-
Bank interest and charges	320	200	700	230

Building management fee	4,100	4,200	4,200	-
Business registration fee	2,250	2,250	2,250	2,250
Depreciation	94,139	86,139	56,416	48,496
Director' s emoluments	180,000	200,000	300,000	-
Electricity and water	4,690	4,696	5,500	4,518
Entertainment	115,527	80,434	53,878	16,756
Hire purchase interest	9,914	9,914	6,747	11,567
Legal and professional fee	6,330	-	-	-
Local travelling	1,782	-	-	-
Motor Vehicle expenses	47,014	23,840	12,277	13,723
Overseas travelling	74,967	43,577	21,104	24,492
Paging fee	3,975	2,796	1,512	758
Printing and stationery	1,282	3,443	158	76
Rent and rates	2,524	4,164	4,406	4,808
Repairs and maintenance	3,497	-	8,059	4,378
Sundry expenses	3,844	538	2,314	1,624
Telephone and fax	8,413	11,647	8,172	5,377
Insurance	-	2,736	8,211	9,924
Subscription	-	2,147	-	-
Transportation	-	2,460	-	-
Postage and stamps	-	-	270	150
Net profit (loss)	326,392	263,865	(10,131)	(22,163)

48. Had the appellant claimed the same deductions in his salaries tax returns, the probabilities are that his claims would be rejected outright by the assessor. At best, he would stand no chance of any of the deductions being allowed without rigorous questioning by the assessor.

49. The tax reduction requirement is satisfied in respect of all the transactions.

50. The next question is whether the transactions are artificial or fictitious.

51. By letter dated 20 December 1996, Person A wrote to the Commissioner stating that:

> '[The appellant] left [Person A] on 30 April 1994. At that time he was employed in the ... Unit ... At that point in time we were seeking a Resident Engineer for [the Project] Advertisements were placed in the press etc. [The appellant] was interviewed and selected as the most suitable candidate. He was then appointed on consultancy terms as [ServiceCo].'

52. In his testimony, the appellant asserted that the application was made in the name of ServiceCo. We reject his assertion. No document was produced in support of his assertion. Had Person A been looking for a corporate consultant, it would have said so in its letter to the assessor. Clause 1 the 1994 Agreement which provided that:

> '[ServiceCo] shall during the continuance of this Agreement or any extension thereof procure the services of [the appellant] and ensure that [the appellant] will render and perform the services ...'

showed that what Person A was after was the appellant's personal services.

53. By letter dated 24 December 2002, Person B wrote to the Commissioner stating that:

> 'We were interested in employing [the appellant's] service as he was very experienced working on [Person A] projects and he requested that we employ him via [ServiceCo].'

54. Clause 1 of the 1996 Agreement, 1998 Agreement and 1999 Agreement all provided that:

> '[ServiceCo] shall during the continuance of this Agreement or any extension thereof procure the services of [the appellant] and ensure that [the appellant] will render and perform the services ...'

55. Clause 2 of the 1998 Agreement and 1999 Agreement both provided that:

> 'During the period of this Agreement ... [Person B] will pay directly to [the appellant] a monthly salary of [HK$82,324.00 under the 1998 Agreement and HK$57,000.00 under the 1999 Agreement]'.

56. All these showed that what Person B was after was the appellant's personal services.

57. Apart from the tax avoidance function, there was no real role for ServiceCo under any of the transactions or any of the Agreements.

58. The amounts paid by Person A and Person B to ServiceCo during these four years of assessment are as follows:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
By Person A to ServiceCo	584,960	-	-	-
By Person B to ServiceCo	320,000	972,576	1,004,528	626,955
Total	904,960	972,576	1,040,528	626,955

59. In his tax returns, appellant declared the following income from ServiceCo:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Income from ServiceCo as declared by the appellant	180,000	200,000	-	-

60. In its financial statements, ServiceCo charged the following amounts as director's [the appellant's] emoluments:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Director's emoluments charged in ServiceCo's financial statements	180,000	200,000	300,000	-

61. The total amount of married person's allowance and child allowance for the appellant's two children in these four years of assessment are as follows:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Married person's allowance	180,000	200,000	216,000	216,000
Child allowance for the first and second child	49,000	54,000	60,000	60,000
Total	229,000	254,000	276,000	276,000

62. There is no commercial sense in any of the transactions or any of the Agreements. Despite the fact that ServiceCo had no real role under any of the Agreements, it received $904,960, $972,576, $1,040,528 and $626,955 in the four years of assessments. No salary was charged in ServiceCo's financial statements in any of the four relevant years of assessment. In his testimony, the appellant accepted that ServiceCo had no staff apart from him. The appellant was the person who was to and did provide all the services to Person A or Person B, as the case may be. Yet, the appellant's emoluments, as reported by the appellant or as charged by ServiceCo in its financial statements, amounted to $180,000, $200,000, nil (or $300,000) and nil respectively. No person dealing on an arms length basis would have entered into the transactions and the Agreements as the appellant did.

63. In our decision, the transactions are plainly artificial.

64. By virtue of section 61, the interposition of ServiceCo is to be disregarded and the appellant shall be assessed on the basis as if the remuneration paid by Person A and Person B (as

the case may be) to ServiceCo had been received by the appellant as an employee of Person A and Person B (as the case may be).

65. The appeal fails and must be dismissed.

DECISION ON APPLICATION OF SECTION 9A

66. We turn now to consider section 9A, in case our decision on there being no arguable ground of appeal and our decision that the transactions are artificial within the meaning of section 61 are wrong.

67. Section 9A, so far as relevant, provides as follows:

> *'(1) Where a person ('relevant person') carrying on (or deemed under this Ordinance to be carrying on) a trade, profession or business, or prescribed activity, has entered into an agreement, whether before, on or after the appointed day, under which any remuneration for any services carried out under the agreement on or after that day by an individual ('relevant individual') for the relevant person or any other person is paid or credited on or after that day to –*
>
> *(a) a corporation controlled by –*
>
> *(i) the relevant individual;*
>
> *(ii) ... or*
>
> *(iii) ...*
>
> *(b) ... or*
>
> *(c) ...*
>
> *then, subject to subsections (3) and (4), for the purposes of this Ordinance –*
>
> *(i) the relevant individual shall be treated as having an employment of profit with the relevant person –*
>
> *(A) commencing on –*

(I) in the case of the trade, profession or business, the day the relevant individual commenced to carry out any of those services or the appointed day, whichever is the later;

(II) ...

(B) until the agreement terminates without the relevant individual continuing to carry out any of those services as an employee of the relevant person;

(ii) the relevant individual shall be treated as an employee of the relevant person, and the relevant person shall be treated as the employer of the relevant individual, whilst the relevant individual is treated, under paragraph (i), as having an employment of profit with the relevant person; and

(iii) any such remuneration shall be treated as being –

(A) income derived by the relevant individual from an employment of profit with the relevant person; and

(B) received by and accrued to the relevant individual at the time that it is paid or credited to the corporation or trustee concerned referred to in paragraph (a), (b) or (c),

and the other provisions of this Ordinance (including section 52) shall be construed accordingly.

(2) ...

(3) Paragraphs (i), (ii) and (iii) of subsection (1) shall not apply where –

(a) neither the agreement referred to in that subsection nor any related undertaking (and whether or not the agreement refers to that undertaking) provides for any remuneration for any of those services to include or to be the provision of annual leave, passage allowance, sick leave, pension entitlements, medical payments or accommodation, or any similar benefit, or any benefit (including money) in lieu thereof;

(b) if the agreement referred to in that subsection or any related undertaking (and whether or not the agreement refers to that undertaking) requires any of the services referred to in that subsection to be carried out personally by the relevant individual, the relevant individual carries out the same or similar services –

(i) for persons other than any person for whom those first-mentioned services are carried out under that agreement; and

(ii) during the term of that agreement or undertaking, as the case may be;

(c) the performance by the relevant individual of any of those services is not subject to any control or supervision –

(i) which may be commonly exercised by an employer in relation to the performance of his employee's duties; and

(ii) by any person (including the relevant person) other than the corporation or trustee concerned referred to in subsection (1)(a), (b) or (c);

(d) the remuneration referred to in that subsection is not paid or credited periodically and calculated on a basis commonly used in relation to the payment or crediting and calculation of remuneration under a contract of employment;

(e) the relevant person does not have the right to cause any of those services to cease to be carried out in a manner, or for a reason, commonly provided for in relation to the dismissal of an employee under a contract of employment; and

(f) the relevant individual is not held out to the public to be an officer or employee of the relevant person.

(4) Paragraphs (i), (ii) and (iii) of subsection (1) shall not apply where the relevant individual establishes to the satisfaction of the Commissioner that at all relevant times the carrying out of the services referred to in that subsection was not in substance the holding by him of an office or employment of profit with the relevant person.'

68. 18 August 1995 is the appointed day, see section 9A(8) and Inland Revenue (Amendment) (No. 2) Ordinance 1995 (54 of 1995) (Commencement) Notice 1995.

Treatment under section 9A(1)

69. Both Person A and Person B carried on business.

70. Person A ('the relevant person' under section 9A) had entered into the 1994 Agreement under which remuneration for services carried out under the agreement on or after the appointed day by the appellant (the 'relevant individual' under section 9A) for Person A was paid or credited on or after that day to ServiceCo, a corporation controlled by the appellant.

71. By the Extension Letter, Person A had entered into another agreement under which remuneration for services carried out under the agreement on or after the appointed day by the appellant for Person A was paid or credited to ServiceCo, a corporation controlled by the appellant.

72. Person B ('the relevant person' under section 9A) had entered into the 1996 Agreement, the 1998 Agreement and the 1999 Agreement under which remuneration for services carried out under the agreement by the appellant for Person B was paid or credited to ServiceCo, a corporation controlled by the appellant.

73. Thus, subject to subsections (3) and (4):

(a) the appellant shall be treated as having an employment of profit with Person A and Person B (as the case may be);

(b) the appellant shall be treated as an employee of Person A and Person B (as the case may be);

(c) Person A and Person B (as the case may be) shall be treated as the employer of the appellant;

(d) the remuneration paid or credited to ServiceCo shall be treated as being income derived by the appellant from an employment of profit with Person A and Person B (as the case may be); and

(e) the remuneration shall be treated as received and accrued to the appellant at the time that it was paid or credited to ServiceCo.

Exclusion under section 9A(3)

74. To invoke section 9A(3), the appellant must satisfy **all** the paragraphs, that is, paragraphs (a) to (f) inclusive.

75. Clause 2 of the 1994, 1996, 1998 and 1999 Agreements provided that:

> 'During the period of this Agreement, [the appellant] may take annual leave totalling twenty five working days without loss of fees on the part of [ServiceCo] ...'

76. As the Agreements provided for the remuneration to include the provision of annual leave, paragraph (a) is not satisfied.

77. As noted in paragraphs 52 and 54 above, the Agreements required the services to be carried out personally by the appellant. There is no evidence of the appellant having carried out for persons other than Person A or Person B the same or similar services carried out under the Agreements.

78. Paragraph (b) is not satisfied.

79. Clause 2 of the 1994 Agreement provided for payment by Person A to ServiceCo annual fees of $774,840 (subject to annual review and an increase by reference to the cost of living index published by the Government) payable in twelve equal instalments monthly in arrears. Clause 2 of the 1996 Agreement provided for payment by Person B to ServiceCo annual fees of $960,000 (subject to an annual review and an increase by reference to the cost of living index) payable in twelve equal instalments monthly in arrears. Clause 2 of the 1998 Agreement provided for the payment by Person B directly to the appellant a 'monthly salary' of $82,324. Clause 2 of the 1999 Agreement provided for the payment by Person B directly to the appellant a 'monthly salary' of $57,000.

80. ServiceCo' s remuneration accrued on a month to month basis. No certification was required. It depended neither on progress of the Project nor on quantities.

81. ServiceCo invoiced Person B for 'Monthly Consultant Fee' of $80,000 for December 1996, January 1997, February 1997, March 1997 and April 1997.

82. As noted in paragraph 18 above, the Assistant Commissioner invoked sections 61A and 9A and issued salaries tax assessments on 30 April 1997.

83. From May onwards, ServiceCo stopped issuing invoices and issued so-termed applications for interim payment. Take 'Interim Payment No. 6' dated 21 May 1997 as an example. ServiceCo submitted the following application:

> '**Application Summary**

Total Contract Sum	960,000.00
Total Work Done up to now (50%)	480,000.00
Less Previous Certification	(400,000.00)
Amount for I.P No. 6	80,000.00'

84. As from 'Interim Payment Application No. 8' the amounts applied for varied but the total applied for by ServiceCo and paid by Person B at the end of the day was precisely the same as the total amount of ServiceCo's contractual entitlement under the 1996, 1998 and 1999 Agreements.

85. No plausible explanation has been given for this change.

86. In our decision, this is a disguise, one which does not help the appellant. The contractual entitlement remained unchanged. The difference between the contractual entitlement and the amount paid by Person B to ServiceCo was no more than an advance by Person B to ServiceCo (where more than the amount of contractual entitlement had been paid) or an amount due by Person B to ServiceCo (where less than the amount due had been paid).

87. The remuneration was paid or credited periodically on a basis commonly used in relation to the payment or crediting under a contract of employment.

88. Paragraph (d) is not satisfied.

89. It is common to provide for dismissal of an employee on the grounds of material breach of the terms of the agreement, being guilty of conduct likely to bring the employer into disrepute, inability to pay debts as they fall due or failure to provide the services (except in case of short periods of illness or incapacity). Clause 7 of the 1994 Agreement and Clause 6 of the 1996, 1998 and 1999 Agreements provided for termination by Person A or Person B (as the case may be) of the relevant Agreement by notice in writing in any of the above circumstances.

90. Paragraph (e) is not satisfied.

91. The appellant fails to satisfy paragraphs (a), (b), (d) and (e) and the exclusion under section 9A(3) does not apply.

Exclusion under section 9A(4)

92. The question here is whether at all material times the carrying out of the services was not in substance the holding by the appellant of an employment of profit with Person A or Person B (as the case may be). The focus here is on the substance.

93. Where, as here, the relationship has to be determined by an investigation and evaluation of the factual circumstances in which the work is performed, it must now be taken to be firmly established that the question of whether or not the work was performed in the capacity of an employee or as an independent contractor is to be regarded by an appellate court as a question of fact to be determined by the trial court, Lee Ting Sang v Chung Chi Keung [1990] 2 AC 374 at page 384. There is no single conclusive test or *indicia*. Factors which may be of importance are (at page 382):-

> *'... whether the workman was working as an employee or as an independent contractor ... has proved to be a most elusive question and despite a plethora of authorities the courts have not been able to devise a single test that will conclusively point to the distinction in all cases. Their Lordships agree with the Court of Appeal when they said that the matter had never been better put than by Cooke J. in Market Investigations Ltd. v. Minister of Social Security [1969] 2 Q.B. 173, 184-185:*
>
> *"The fundamental test to be applied is this: "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no," then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases. The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task."'*

94. Clause 10 of the 1994 Agreement and Clause 9 of the 1996, 1998 and 1999 Agreements provided that the appellant agreed not to be or become an employee of Person A or Person B (as the case may be). However, as noted above, what matters under section 9A(4) is the substance. In April 1994, Person A was recruiting a Resident Engineer for the Project; selected the appellant as the most suitable candidate; and then appointed him on consultancy terms. Person B was 'interested in employing [the appellant' s] service as he was very experienced on [Person A] projects' and at the appellant' s request the appellant was 'employed' via ServiceCo. ServiceCo had to procure and ensure personal services by the appellant. Remuneration (termed 'monthly salary' in the 1998 and 1999 Agreements) was payable monthly in arrears. Except for annual review and adjustment, remuneration was fixed. Neither ServiceCo nor the appellant ran any

financial risk and had no opportunity of profiting from sound management. The Agreements provided for 25 working day's annual leave for the appellant. Person A or Person B (as the case may be) controlled when the appellant was to take the annual leave. Clause 4 of the 1994 Agreement and Clause 3 of the 1996, 1998 and 1999 Agreements provided for further control by Person A or Person B (as the case may be) by requiring the appellant to carry out assignments nominated by Person A or Person B (as the case may be). Person A was obliged under clause 3 of the 1994 Agreement to make available office space and support. Person B in fact arranged to have space at or near the site of the Project made available to the appellant. Neither ServiceCo nor the appellant provided its or his own equipment or hired its or his own helpers. Person B included, the appellant in its project organisation chart of the Project for the period 1997 – 1999. The Agreements provided for summary termination (or dismissal) on the grounds of material breach of the terms of the agreement, being guilty of conduct likely to bring Person A or person B (as the case may be) into disrepute, inability to pay debts as they fall due or failure to provide the services (except in case of short periods of illness or incapacity).

95. The Deputy Commissioner was not satisfied that the carrying out of the services was not in substance the holding by the appellant of an office or employment of profit with Person A or Person B (as the case may be). Nor are we. The exclusion under section 9A(4) does not apply. This is another reason why this appeal fails.

CONCLUSION AND DISPOSITION

96. As Ms Ng Yuk-chun has not relied on section 61A, we express no view on its application to this case.

97. For reasons given above, this appeal is a pretty hopeless case and must be dismissed.

98. We dismiss the appeal and confirm the assessments appealed against as confirmed by the Deputy Commissioner.