Case No. D85/02

Profits tax – sections 16(1), 17, 61 and 68(4) of the Inland Revenue Ordinance ('IRO') – whether or not an expense was incurred for the production of assessable profits – whether or not management fees are capable of sub-division and analysis – whether or not artificial transactions – burden of proof on taxpayer.

Panel: Anna Chow Suk Han (chairman), Jiang Zhaodong and Douglas C Oxley.

Dates of hearing: 19 April, 5, 12 June and 23 November 2001.
Date of decision: 12 November 2002.

The taxpayer is a solicitors' firm. The taxpayer has objected to the profits tax assessments and the additional profits tax assessments for the years of assessment 1992/93 and 1993/94 raised on it. The taxpayer claimed various expenses including management fees.

The assessor did not agree that the management fees claimed to have been paid to Company P, Company K, Company N or Company O should be deductible. Further, the assessor claimed that the management fees claimed to have been paid to Company F should be limited to those expenses in connection with services for the purposes of producing chargeable profits to the taxpayer.

It was the taxpayer's case that the limited companies such as Company F, Company P, Company K, Company H, Company G, Company O and Company N were companies independent from the taxpayer and were providing various services to the taxpayer. The Revenue's case was that the companies involved in this appeal were related to or controlled by the partners of the taxpayer or both and the transactions between them were artificial and fictitious and were for the sole purpose of obtaining tax benefits and should be ignored. Further and alternatively, the taxpayer had failed to prove the actual payments of the sums in dispute or the deductibility of those sums under section 16 of the IRO or both.

Held:

1. An expense is a deductible expense if it comes within section 16 of the IRO and is also not excluded under section 17. Section 16 permits deduction of all outgoings and expenses if they were incurred in the production of assessable profits during the basis period of the year of assessment in question. If a taxpayer fails to prove

that an expense was incurred for the production of his assessable profits, the whole of that expense will be disallowed.

2. But if an expense is capable of analysis and sub-division or where section 61 applies which allows dissection of expenses, then that expense can be allowed 'to the extent' that it was incurred to produce the taxable profits and the balance thereof be disallowed. In the present case, if the taxpayer is unable to prove that an expense in dispute was incurred in the production of its assessable profits, the whole of that expense would be disallowed and unless section 61 applies which allows dissection of an expense or if that expense was capable of sub-division or analysis, in which events such part of that expense which was incurred to produce the assessable profits would be allowed. Among the various disputed expenses, the management fees allegedly paid to Company F are apparently capable of sub-division and analysis (D77/99, IRBRD, vol 14, 528 considered).

3. The Board bears in mind that a properly and commercially structured service company arrangement is neither artificial nor fictitious. Also, a person is at liberty to organize his affairs so as to reduce or minimize his tax liability. Section 61 is only to catch artificial transactions whereby a taxpayer interposes a company in between himself and his own business for the deduction of expenses which are not otherwise deductible from his business.

4. Notwithstanding these legal principles, the burden of proof is on the taxpayer who is required to prove matters such as the actual services provided, the service fees paid for those services and whether they were genuine and commercially realistic and other matters which are relevant to the issue. The taxpayer is required to provide solid evidence and not just bare assertions in order to succeed in the appeal. The Board found the only witness called by the taxpayer who was the partner of the taxpayer an unreliable witness and his testimony did not carry weight in favour of the taxpayer's case.

5. The Board found that the taxpayer had failed to discharge the onus on it to prove that the sums had been incurred or if they were incurred, they were incurred for production of the taxpayer's assessable profits.

6. The Board further held the view that the arrangements under the consultancy agreement between the taxpayer and Company F were artificial and commercially unrealistic.

Appeal dismissed.

Case referred to:

D77/99, IRBRD, vol 14, 528

Steward Wong Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.
K S Liu of Messrs K S Liu & Co CPA Limited for the taxpayer.

Decision:

The appeal

1. This is an appeal by a solicitors' firm ('the Taxpayer') against the determination of the Commissioner of Inland Revenue of 1 March 2000.

The statement of agreed facts

2. The Taxpayer has objected to the profits tax assessments and the additional profits tax assessments for the years of assessment 1992/93 and 1993/94 raised on it. The Taxpayer claims that the assessments are excessive and not in accordance with the returns for those years.

3. The Taxpayer is a firm carrying on a legal practice in Hong Kong since 1 June 1989. During the years of assessment 1992/93 and 1993/94, the Taxpayer practiced under different names with different partners as follows:

Year of assessment	Firm name	Name of partners	Shares (As at 31-3)
1992/93	Name 1 of the Taxpayer	Mr A	20%
		Mr B	20%
		Mr C (From 8-2-1993)	20%
		Mr D (From 8-2-1993)	20%
		Mr E	20%

1993/94	Name 2 of the Taxpayer	Mr A	27%
		Mr B	27%
		Mr C	24%
		Mr D	22%
		Mr E	0%
		(Retired on 30-4-1993)	

4. By notice dated 23 June 1993, the assessor issued under section 50(3) of the IRO the following estimated assessment:

	$
Assessable profits	1,520,000
Tax payable thereon	228,000

5. By a letter dated 5 July 1993, the Taxpayer through the Second Representative objected to the estimated assessment for the year of assessment 1992/93 on the grounds that the Taxpayer did not attain the profit assessed. Copies of the Taxpayer's profits tax return and profit and loss account for the year ended 31 March 1993 are at bundle B1, pages 16 to 22.

6. The Taxpayer submitted a profits tax return for the year of assessment 1993/94 on 30 July 1994 (bundle A19, pages 18 and 19).

7. By notice dated 23 June 1994, the assessor issued under section 59(3) of the IRO the following estimated assessment:

	$
Assessable profits	1,600,000
Tax payable	240,000

8. By a letter dated 30 June 1994, the Second Representative objected to the estimated assessment for the year of assessment 1993/94 on the grounds that the assessment was not in accordance with the Taxpayer's return and was excessive. Copies of the Taxpayer's profits tax return and profit and loss account for the year ended 31 March 1994 are at bundle B1, pages 23 to 28.

9. In the Taxpayer's profits tax returns, the following assessable profits were declared:

Year of assessment	**1992/93**	**1993/94**
	$	$
Profit per return	423,844	394,503

10. In arriving at its profit as declared in its returns, the Taxpayer claimed various expenses including management fees in the amounts of $7,300,000 and $8,010,000 respectively for each of the years ended 31 March 1993 and 1994. The turnover for each of these two years of assessment was $10,342,763 and $9,299,270 respectively.

11. The assessor, on 10 February 1999, raised the following additional assessments on the Taxpayer:

Year of assessment	**1992/93**	**1993/94**
	$	$
Profits per return	423,844	394,504
Add: Management fee	7,300,000	8,010,000
	7,723,844	8,404,503
Less: Profit already assessed	1,520,000	1,600,000
Additional assessable profits	6,203,844	6,804,503
Tax payable thereon	930,576	1,020,675

12. By two notices dated 12 February 1999, the Third Representative objected to the additional assessments for the years of assessment 1992/93 and 1993/94 respectively on the grounds that the assessments were excessive and not in accordance with the returns.

13. The Second Representative in their letter dated 22 August 1994 advised that Company F provided consultancy services, secretarial services, documentary control, office management and professional advisory service. The management fees were calculated on the basis of work performed and in accordance with the agreement at bundle B1, pages 29 to 32. By a letter dated 7 April 1999, the Second Representative advised the assessor of the following:

(a) Company F provided office premises located at various suites of a commercial building. The landlord of these premises required tenants to rent its premises under the names of body corporate. Company F was engaged for the purpose.

(b) Company F also provided its services such as staff management, recruitment, human resources, office appliances and law books.

(c) No remuneration or benefits were provided by Company F to the partners of the Taxpayer or their spouses.

14. According to the audited accounts of Company F, its income and expenses included the following items:

	1992/93 (Year ended 31-3-1993) $	**1993/94** (Year ended 31-3-1994) $
Income		
Management fees received	5,700,000	6,410,000
Other income	2,058	Nil
	5,702,058	6,410,000
Expenses		
Consultancy fees paid	1,889,222	(nil)
Entertainment	42,898	24,739
Electricity, water and gas	49,925	25,373
Insurance	65,048	60,315
Legal and professional fee	1,500	50,000
Miscellaneous expenses	25,270	35,920
Repairs and maintenance	96,886	18,198
Rent and rates	981,916	1,500,106
Staff welfare	80,564	21,846
Salaries and wages	1,861,500	3,787,273
Telephone and telex	130,677	52,469
Other expenses	751,409	437,638
	5,976,815	6,013,877
(Net loss) Net profit	(274,757)	396,123

The consultancy fees for the year of assessment 1992/93 were paid to the following persons:

	$
Company G	776,582
Company H	585,547
Company I	527,093
	1,889,222

The assessor accepted the fee paid to Company I for $527,093 to be deductible expenses.

The Taxpayer claimed $776,582 and $585,547 to be tax deductible. The assessor was of the view that such payments were not deductible.

Copies of Company F's financial statements for each of the above years of assessment are at bundle B1, pages 37 to 45 and 46 to 55.

15. According to the audited accounts of Company G, its income and expenses included the following items:

	1992/93 (Year ended 30-6-1992) $	**1993/94** (Year ended 30-6-1993) $
Income		
Consultancy fees received	776,582	776,582
Other income	(Nil)	23,400
	776,582	799,982
Expenses		
Consultancy fees paid	351,750	335,830
Consumable store	62,018	70,331
Entertainment	97,056	85,933
Messing	74,317	73,069
Other expenses	286,423	274,229
	871,564	839,392
(Net loss)	(94,982)	(39,410)

16. According to the Commissioner, a partner of the Taxpayer, Mr C, and another person by the name of Madam J were shareholders and directors of Company H in 1992 and were shareholders of Company H in 1993 and 1994. According to the Commissioner, Company H did not file any return or accounts to report its income and expenditures for the years of assessment 1992/93 and 1993/94.

17. According to the information provided by the Commissioner (bundle R1, pages 127 to 130):

(a) Mr C and Madam J were married;

(b) Mr C and Madam J derived pecuniary interest from Company H in the year of assessment 1993/94.

18. Mr C was admitted partner of the Taxpayer on 8 February 1993.

19. According to the audited accounts of Company K, its income and expenses included the following items:

	1992/93 (Year ended 31-3-1993) $	**1993/94** (Year ended 31-3-1994) $

Management fees received	54,850	17,600
Expenditure (Total)	17,215	6,250
Net profit	37,635	11,350

Copies of Company K's financial statements for each of the above years of assessment are at bundle B1, pages 76 to 84 and 85 to 92.

20. The shareholders and directors of Company K for the year of assessment 1993/94 were the following persons:

	(Partners of the Taxpayer)	**Shareholders**	**Directors**
Mr A	✓	✓	✓
Mr B	✓	✓	✓
Mr C	✓	✓	✓
Mr D	✓		✓
Mr E	✓	✓	✓
Mr L		✓	✓
Madam M			✓

Mr D was appointed as a director with effect from 13 January 1994. Mr L and Madam M resigned as directors with effect from 22 January 1994.

21. The shareholders of Company N were Company K and another company by the name of Company O.

22. From the information provided by the Commissioner, according to the profits tax return for the year of assessment 1992/93, Mr L, a director of Company N, declared that the company did not trade for the period (see bundle B1, page 93). Company N had not filed its accounts for the year ended 31 March 1994.

23. The directors of Company N for the year of assessment 1993/94 were the following persons:

	(Partners of the Taxpayer)	**Directors**
Mr A	✓	✓
Mr B	✓	✓
Mr C	✓	✓
Mr D	✓	✓
Mr E	✓	✓
Mr L		✓
Madam M		✓

Mr A was appointed as a director with effect from 12 November 1993. Mr D was appointed as a director with effect from 22 January 1994. Mr L and Madam M resigned as directors with effect from 22 January 1994.

24. The shareholders and directors of Company O for the year of assessment 1993/94 were the following persons:

	(Partners of the Taxpayer)	**Shareholders**	**Directors**
Company N		✓	
Company K		✓	
Mr C	✓		✓
Mr E	✓		✓
Mr B	✓		✓
Mr A	✓		✓
Mr D	✓		✓
Mr L			✓
Madam M			✓

Mr D was appointed as a director with effect from 22 January 1994. Mr L and Madam M resigned as directors with effect from 22 January 1994.

25. According to the Commissioner, they had by a letter dated 8 June 1999 asked for copies of audited accounts of Company N and Company H (bundle R1, page 33).

26. The assessor did not agree that management fees claimed to have been paid to Company P, Company K, Company N or Company O should be deductible. Further, the assessor claimed that the management fees claimed to have been paid to Company F should be limited to those expenses in connection with services for the purposes of producing chargeable profits to the Taxpayer. The assessor's computation of allowable and disallowable management expenses for the years of assessment 1992/93 and 1993/94 are at bundle B1, pages 95 and 96.

27. Taking into account the disallowable amounts of management expenses referred to in bundle B1, pages 95 and 96, the Commissioner determined that the assessable profits of the Taxpayer for the years of assessment 1992/93 and 1993/94 should be revised as follows:

	1992/93 (Year ended 31-3-1993) $	**1993/94** (Year ended 31-3-1994) $
Profit per return	423,844	394,503
Add: Management expenses disallowed*	4,664,574	5,762,204
Revised assessable profits	5,088,418	6,156,707

Less: Profits assessed	1,520,000	1,600,000
Revised additional assessable profits	3,568,418	4,556,707
Additional tax payable thereon	535,262	683,506
*Management expenses disallowed		
	$	$
Company F per bundle B1, pages 95 and 96	3,064,574	4,162,204
Company P	1,600,000	-
Company K	-	17,600
Company N (or Company O)	-	1,582,400
Total	4,664,574	5,762,204

The Taxpayer's case

28. It was the Taxpayer's case that the limited companies such as Company F, Company P, Company K, Company H, Company G, Company O and Company N were companies independent from the Taxpayer. The reasons as stated in its grounds of appeal are as follows:

> ' i) The Companies and [the Taxpayer] were all separate legal entities;
>
> ii) They ran their own business activities;
>
> iii) The Companies and [the Taxpayer] have their own commercial reasons and transacting commercially realistic transactions for their own set up;
>
> iv) [The Taxpayer] cannot exercise direct control over the operation of the Companies or vice versa;
>
> v) [The Taxpayer] will never take up any business risk so incurred by the Companies;
>
> vi) The Companies will never expose to business risk nor professional risk as incurred by [the Taxpayer];
>
> vii) [The Taxpayer], the Companies transacted amongst themselves according to commercially realistic negotiation at arm's length;
>
> viii) Work performed can be traced to job sheet or work scope listings as agreed by the parties so involved from time to time;
>
> ix) All activities and transactions so incurred by [the Taxpayer] or the Companies bear their own business risk;

x) [The Taxpayer] was an unincorporated partnership with unlimited liabilities;

xi) The Companies were individual entities incorporated with limited liabilities.'

29. The Taxpayer claimed that the said companies involved in this appeal were not controlled by Mr A and Mr B, the current partners of the Taxpayer, but were controlled in the following manners:

(a) Company P was controlled by Mr Q;

(b) Company G was controlled by Madam R;

(c) Company H was controlled by Madam J;

(d) Company O was controlled by Mr L and Madam M at the material time;

(e) Company K was controlled by Mr L and Madam M;

(f) Company N was controlled by Mr L and Madam M at the material time; and

(g) that those persons in control of the said companies were not partners of the Taxpayer.

30. The Taxpayer claimed that the services provided by the companies to the Taxpayer were as follows:

	Company name	**Commercial activities**
(a)	Company F	Provision of accommodation, staff and equipment for the Taxpayer
(b)	Company P	Computers and services
(c)	Company K	Corporate secretarial work
(d)	Company O	Nominee and other services
(e)	Company G	Architectural and clerical services
(f)	Company H	Storage, searches and clerical services

31. As to the Taxpayer's failure to reply to the enquiries made by the assessor, the Taxpayer claimed that it was not privy to the acts of the companies nor was it obliged to disclose information regarding those companies to the assessor.

The Revenue's case

32. The Revenue's case was that each of the companies, namely Company F, Company O, Company K, Company P, Company G, Company H and Company N, was related to or controlled by the partners of the Taxpayer at the material times and as to the payment to Company S, no evidence had been adduced in relation to it. The payments allegedly made to each of those companies, whether by the Taxpayer or Company F, and the alleged transactions for which those payments were allegedly made were artificial or fictitious or both under section 61 of the IRO. They were only made or allegedly made in an attempt to obtain tax benefits.

33. Further or alternatively, since it was its case that the expenses were not only incurred but were also paid, the Taxpayer had failed to adduce sufficient evidence to prove that the alleged payments were actually made, or the purposes for which they were allegedly made or both. The Taxpayer had failed to bring those payments within section 16 of the IRO.

34. In the premises, $1,600,000 to Company P, consultancy fee of $776,582 paid by Company F to Company G, consultancy fee of $585,547 by Company F to Company H, $17,600 to Company K, $1,582,400 to Company O and the total consultancy fees of $320,000 by Company F to Company O, Company G, Company H and Company S were not deductible under both section 16 and section 61 of the IRO. As for the management fees paid by the Taxpayer to Company F, they were deductible only to the extent to which the same were proved to have been incurred for the production of the Taxpayer's assessable profits.

35. The time and purpose of the alleged payments made by Company F to various legal practitioners of the Taxpayer totalling $727,000 in the year of assessment 1993/94 had not been sufficiently proved. In any event, some of the recipients were partners of the Taxpayer at the material time and thus payments to them were not deductible under section 17(2) of the IRO.

36. Further or alternatively, the alleged payments to Company P by the Taxpayer purportedly made for the various computer programmes prepared for the Taxpayer's legal practice even if they were made (which was not admitted) must be capital in nature and thus cannot be deducted by virtue of section 17(1)(c) of the IRO.

37. Further or alternatively, Mr A had confirmed that the amount put in as 'turnover' in the accounts in each of the years of assessment 1992/93 and 1993/94 of the Taxpayer was the profit costs of the Taxpayer, and did not include disbursements. Thus those alleged payments which represented disbursements made by the Taxpayer (whether directly or through Company F) to any of the payees on behalf of the Taxpayer's clients could not be deducted even if truly made (which was not admitted), because those payments were not taken out of the Taxpayer's own pocket or

profit costs which made up the turnover. They were disbursements of which the Taxpayer was reimbursed by their clients. Under this circumstance, the expenses paid to Company G, Company H, Company O and Company K were not deductible expenses of the Taxpayer.

38. As for the following items allegedly paid by Company F,

(a) audit fee and business registration fees were not incurred to produce assessable profits for the Taxpayer. They were incurred solely for Company F's own corporate purposes. They are not deductible as far as the Taxpayer was concerned;

(b) donations and gratuities: $37,500 for the year of assessment 1992/93 (that is, $20,000 for office design and $17,500 for 'Logistic location setup') was conceded by the Third Representative to be not deductible under section 16 (see its letter dated 4 June 1994 at bundle R1, page 74); as for the $21,000 for the year of assessment 1993/94, it was for the same purpose as the said $20,000 (that is, as 'honorarium for office design, partitioning, equipment layout and match') and a fortiori was also not deductible. Further, for the said $21,000 claimed for the year of assessment 1993/94, no receipt was produced in support of the same;

(c) as for the alleged legal and professional fee of $50,000 for the year of assessment 1993/94, there was no evidence as to what it stood for. Mr A in his evidence did not refer to this payment. The Revenue requested information about this sum but no further information was provided. Since no information was forthcoming, this expense should not be allowed; and

(d) as for the medical insurance premia, the sums in question were $60,660 and $44,196 for the years of assessment 1992/93 and 1993/94 respectively. The Revenue accepted that if the same were paid for the benefit of employees of the Taxpayer or Company F, the same would be deductible. However, if the same were paid for the benefit of the partners of the Taxpayer, they would not be deductible, being expenses of private and domestic in nature. The burden was on the Taxpayer to prove that the two sums represented the premia for the employees only and not those of the partners. However, the Taxpayer had failed to do so and no sensible apportionment was possible.

The sums in dispute

39.	(a)	Year of assessment 1992/93	$	$
		(i) Management fee to Company P		1,600,000

	(ii)	Management fee to Company F of $5,700,000 of which the following items in its accounts are in dispute:		
		(1) audit fee	15,000	
		(2) business registration fee	4,600	
		(3) consultancy fee to Company G	776,582	
		(4) consultancy fee to Comapny H	585,547	
		(5) donations and gratuity of $40,700, (amount now disputed)	37,500	
		(6) insurance of $65,048, (amount now disputed)	60,600	
		(7) salaries and wages of $1,861,500 (which has now been accepted by the Revenue)	Nil	1,479,829
(b)	Year of assessment 1992/93		$	$
	(i)	Management fee to Company K		17,600
	(ii)	Management fee to Company O		1,582,400
	(iii)	Management fee to Company F of $6,410,000 of which the following items in its accounts are in dispute:		
		(1) audit fee	19,850	
		(2) business registration fee	5,000	
		(3) donations and gratuity	21,000	
		(4) insurance of $60,315, (amount now disputed)	44,196	
		(5) legal and professional fee	50,000	
		(6) salaries and wages of $3,787,273, (of which the following items are disputed):		
		to various solicitors	727,000	
		to Company O	140,000	
		to Company G	60,000	
		to Company H	60,000	
		to Company S	60,000	1,187,046

The law

40. The deduction of outgoings and expenses is governed by section 16(1) of the IRO.

> *' 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 …'*

41. However, section 17(1) of the IRO restricts the deduction of certain outgoings and expenses.

> *' For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of –*
>
> *(a) domestic or private expenses, including –*
>
> *(i) the cost of travelling between the person's residence and place of business; and*
>
> *(ii) …*
>
> *(b) subject to section 16AA, any disbursements or expenses not being money expended for the purpose of producing such profits;*
>
> *(c) any expenditure of a capital nature or any loss or withdrawal of capital;*
>
> *(d) …'*

42. Section 17(2) of the IRO also restricts deduction of salaries or remuneration to a sole proprietor or partners of a business.

> *' In computing the profits or losses of a person carrying on a trade, profession or business, no deduction is allowable for –*
>
> *(a) salaries or other remuneration of the person's spouse; or*
>
> *(b) …*
>
> *(c) …*
>
> *(d) in the case of a partnership –*
>
> *(i) salaries or other remuneration of a partner or a partner's spouse; or*
>
> *…'*

43. Furthermore, section 61 of the IRO provides that if a transaction is found to be artificial or fictitious, the transaction may be disregarded.

> *'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 assessed accordingly.'*

44. Section 68(4) of the IRO states the onus of proof in the assessment:

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

Our findings

45. It is the Revenue's case that the companies involved in this appeal were related to or controlled by the partners of the Taxpayer or both and the transactions between them were artificial and fictitious and were for the sole purpose of obtaining tax benefits and should be ignored and further and alternatively, the Taxpayer had failed to prove the actual payments of the sums in dispute or the deductibility of those sums under section 16 of the IRO or both.

46. Some legal principles on 'artificial' and fictitious' transactions drawn from certain previous Board of Review decisions were summarized by the Board in D77/99, IRBRD, vol 14, 528 as follows:

> *'(a) The words "artificial" and "fictitious" are to be given the ordinary meaning. We note the equivalent descriptions in the Chinese text of section 61. Similarly they should be given the ordinary dictionary meaning. We also have regard to section 10B of the Interpretation and General Clauses Ordinance. We are satisfied that both the English and the Chinese texts intended to and bear the same meaning.*
>
> *(b) "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.*
>
> *(c) All the circumstances of the particular transaction have to be examined in order to see if it is artificial or fictitious.*
>
> *(d) A transaction is not artificial by reason of the fact that it is between related parties.*
>
> *(e) A transaction is not artificial by reason of the fact that it is intended for tax planning purpose.*
>
> *(f) 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".'*

47. An expense is a deductible expense if it comes within section 16 of the IRO and is also not excluded under section 17. Section 16 permits deduction of all outgoings and expenses if they were incurred in the production of assessable profits during the basis period of the year of assessment in question. If a taxpayer fails to prove that an expense was incurred for the production of his assessable profits, the whole of that expense will be disallowed. But if an expense is capable of analysis and sub-division or where section 61 applies which allows dissection of expenses, then that expense can be allowed 'to the extent' that it was incurred to produce the taxable profits and the balance thereof be disallowed. In the present case, if the Taxpayer is unable to prove that an expense in dispute was incurred in the production of its assessable profits, the whole of that expense would be disallowed and unless section 61 applies which allows dissection of an expense or if that expense was capable of sub-division or analysis, in which events such part of that expense which was incurred to produce the assessable profits would be allowed. Among the various disputed expenses, the management fees allegedly paid to Company F are apparently capable of sub-division and analysis.

48. In considering this appeal, we bear in mind that a properly and commercially structured service company arrangement is neither artificial nor fictitious. Also, a person is at liberty to organize his affairs so as to reduce or minimize his tax liability. Section 61 is only to catch artificial transactions whereby a taxpayer interposes a company in between himself and his own business for the deduction of expenses which are not otherwise deductible from his business. Notwithstanding these legal principles, the burden of proof is on the Taxpayer who is required to prove matters such as the actual services provided, the service fees paid for those services and whether they were genuine and commercially realistic and other matters which are relevant to the issue.

49. Having identified the applicable legal principles, we propose to deal with the expenses in dispute in the following manners:

(a) firstly, the service fees allegedly paid by the Taxpayer to various companies, namely

(i) $1,600,000 to Company P in the year of assessment 1992/93;

(ii) $17,600 to Company K in the year of assessment 1993/94;

(iii) $1,582,400 to Company O in the year of assessment 1993/94;

(b) secondly, those disputed sums allegedly paid by Company F to the various companies, namely

(i) in the year of assessment 1992/93

(1) $776,582 to Company G;

(2) $585,547 to Company H;

(ii) under the item of 'salaries and wages' in the year of assessment 1993/94

(1) $140,000 to Company O;

(2) $60,000 to Company G;

(3) $60,000 to Company H;

(4) $60,000 to Company S;

(5) $727,000 to various solicitors; and

(c) thirdly, the remaining disputed items of Company F's expenses in the years of assessment 1992/93 and 1993/94, namely the audit fees, business registration fees, the legal and professional fees and medical insurance premia.

50. The onus of proof rests upon the Taxpayer. The Taxpayer is required to provide solid evidence and not just bare assertions in order to succeed in the appeal. The Taxpayer initially intended to call two witnesses, namely Mr B and Mr A. Both are partners of the Taxpayer. However, in the course of the hearing, due to constraints of time on the part of the Taxpayer, the Taxpayer decided not to call Mr B. Hence Mr A was the only person called to give evidence on behalf of the Taxpayer. Regrettably, we were not impressed by Mr A as a witness. He was neither frank nor forthcoming in his answers to the questions put to him. He was reluctant to confirm where he once lived and he also said he could not remember when he got married. We find him an unreliable witness and his testimony does not carry weight in favour of the Taxpayer's case.

$1,600,000 to Company P in the year of assessment 1992/93

51. At the beginning of the investigation the Taxpayer alleged that a management fee of $7,300,000 was paid to Company F in the year of assessment 1992/93 but later on in the investigation its tax representative informed the Revenue that only $5,700,000 was paid to Company F and the balance of $1,600,000 was to Company P. When cross-examined on this inconsistency, Mr A could not explain how this error occurred.

52. The Taxpayer claimed that Company P was controlled by one Mr Q who designed and prepared all the computer software for the Taxpayer's legal practice. Mr A said that in order to prepare the software, Mr Q used to come to the Taxpayer's office almost daily and talked to the staff members to understand the Taxpayer's requirements on the programmes required. Mr A was

questioned on the exact works done by Mr Q. Mr A described to us some of the programmes comprised in the conveyancing and probate software. However, from Mr A's description of those programmes, we do agree with Mr Wong, Counsel for the Revenue, that those programmes amounted to no more than database programmes.

53. The Taxpayer chose to produce only after the commencement of the hearing of this appeal several bundles of copy documents in support of its case. Among them there is this bundle A14 comprising allegedly copies of the official receipts and invoices issued by Company P to the Taxpayer at the material times. As opposed to the usual practice that a receipt or invoice is signed by the party which issues it, these copy receipts and invoices produced were not signed but were only chopped with Company P's company chop. While these receipts and invoices were not signed, they were however certified to be true and correct by Mr T for and on behalf of Company P on 6 April 2001. Mr T was a clerk once worked for the Taxpayer. It is noted from these copy receipts that all the payments were purportedly made by cash of amounts ranging from $30,000 to $110,000, totalling $1,600,000, being the alleged consultancy fee to Company P in dispute. Upon questioning by Mr Wong on the reasons why those payments were made in cash, Mr A claimed that at the material time, the Taxpayer's clients favoured cash payments especially in conveyancing transactions and that he had even dealt with a cash payment of $500,000. We find Mr A's claim unrealistic and we have reservations on the truthfulness of his statement. Even if Mr A's claim were true and the Taxpayer's clients preferred making payments in cash, those cash payments unless were made in settlement of the Taxpayer's costs would have been monies belonged to its clients and using those monies for the Taxpayer's own payments would be a breach of professional rules on the part of the Taxpayer.

54. Mr A claimed that he knew his wife, Madam U, through Mr Q. He denied that Madam U had ever been a director of Company P. However, a notification of change of secretary and directors of Company P produced by the Revenue shows that Madam U was a director and that both Madam U and Mr T resigned from their directorship of Company P on 25 June 1995.

55. The directors and shareholders of Company P at the material time were Mr Q and Mr T. Mr T worked for the Taxpayer as a clerk at the material time. Although the Taxpayer produced a copy of a declaration of trust dated 18 January 1992 whereby Mr T declared that he was holding his one share in Company P for Mr Q, we do not believe this document is a contemporaneous document. The declaration was dated 18 January 1992 but it was only adjudicated and stamped on 18 April 2000. The address of Mr T appeared in this declaration is at '[Property 1]'. From an annual return of Company G as at 31 December 1992, Mr T's address was at '[Property 2]' (bundle R1, page 142) and Property 1 was stated as his residential address in the annual returns of Company G for the subsequent years ended 31 December 1993 and 12 November 1994 respectively (bundle R1, pages 144 and 146). In this connection, the Revenue produced a land search record on Property 1 which shows that Mr T entered into an agreement to purchase Property 1 on 2 March 1992 and he became the owner of the property only on 26 March 1992.

On the basis of Mr T's address on the declaration, we have no hesitation to find that the declaration of trust is not a contemporaneous document.

56. Mr A was queried by Mr Wong on Mr Q's ability to design computer software for a legal practice. However, Mr A said that Mr Q had a bachelor degree in computer science from the United Kingdom and perhaps even a law degree. However, the Revenue produced a copy of an affidavit for the Commissioner in respect of the estate of Mr Q. It transpires from this affidavit that Mr Q was a retired civil servant and died on 17 July 1994 aged 71 in China. More so, the Taxpayer not only acted for the executrix of the estate of Mr Q in her application for a grant of probate of Mr Q's estate, but the executrix also swore that affidavit before Mr A. Earlier on, when Mr A was questioned on the whereabouts of Mr Q, he replied that his partner, Mr B, did look for Mr Q in about 2001 but could not find him. Mr A did not see fit to disclose Mr Q's death to us. The revelation of Mr Q's death strongly undermines Mr A's credibility in our mind.

57. Finally, from the copies of Company P's profit and loss accounts as at 31 March 1994, 31 March 1993 and 31 March 1992 produced by the Taxpayer, we note that the turnover of the company for the year ended 1993 was only $583,825 and those for the years ended 1992 and 1994 were $735,160 and $281,015 respectively. Mr Wong drew our attention to the fact that these three figures incidentally came to $1,600,000. We also observe that Company P's accounts were also prepared by Messrs K S Liu & Company CPA Limited, the Taxpayer's tax representative. All these accounts were approved on 30 September 1997 by Mr T as the chairman of the board of directors of Company P, although as mentioned earlier, Mr T already resigned from his directorship of the company together with Madam U on 25 June 1995. Mr Wong suggested to us that these accounts were only prepared subsequently for the purpose of the Taxpayer's claim.

58. For all the above-mentioned flaws in the evidence relating to this alleged payment, we find that the Taxpayer has failed miserably to discharge the onus on it to prove that it had incurred and paid $1,600,000 to Company P for the services allegedly performed by Mr Q as claimed. Accordingly, this sum is not allowed as a deduction.

$17,600 to Company K in the year of assessment 1993/94

59. Mr A claimed that Company K was set up by Mr L, an assistant solicitor engaged by the Taxpayer at the relevant time, and that Company K was controlled by him and later jointly by him and Madam M, also an assistant solicitor engaged by the Taxpayer at the material time for the period after incorporation of Company K, and that apart from the shareholdings, the Taxpayer's partners had no interest nor control over the company. He said that Company K was set up by Mr L for the provision of secretarial services to the Taxpayer's clients and also secretarial and other services to Company K's own clients.

60. We have the following documentary evidence before us. There was a service agreement dated 1 April 1992 made between the Taxpayer and Company K whereby Company K

agreed to provide secretarial and clerical services to the Taxpayer at a monthly fee of $4,500 commencing on 30 April 1992 until determination by one month's written notice given by either party to the other and the Taxpayer would reimburse Company K all expenses and disbursements properly supported by receipts incurred in performance of its duties under the agreement. The agreement was signed by Mr B on behalf of the Taxpayer and Mr A on behalf of Company K. In support of its claim, the Taxpayer produced some copies of the bills allegedly issued by Company K for secretarial services rendered by the company. All the copy bills produced were not addressed to the Taxpayer but to limited companies of different names and under the same reference. The Revenue produced extracts of the annual returns of Company K made up to 3 December 1992 and 31 December 1993 respectively which showed that Mr A, Mr E, Mr B, Mr C and Mr L each holding one share in the company. There were also the company's directors' report and accounts for the period from 4 June 1991 (date of incorporation) to 31 March 1993 showing that Mr A, Mr E, Mr B, Mr C and Mr L were appointed as directors on 12 August 1991 and Madam M on 4 December 1992, and for the period ended 31 March 1994, showing that Mr D was appointed as a director on 13 January 1994 and both Mr L and Madam M resigned on 22 January 1994. The first directors' report appeared to be signed by Mr E as the chairman of the board and the second report by Mr A and the profit and loss accounts were approved by the partners of the Taxpayer.

61. Mr A gave evidence that the service agreement with Company K lasted only for two months, April and May 1992, because no business was brought in by Mr L, and a notice of termination was accordingly served. Mr A was queried on the fact that he himself signed the service agreement for Company K notwithstanding his claim of no control over the company. He explained that the service agreement was signed by him on behalf of Company K only as to show sincerity on the part of the Taxpayer but he did not control or operate the company.

62. The Taxpayer claimed that $17,600 was paid to Company K for its services but documentary evidence has not been produced to substantiate this alleged payment. Neither were we supplied with details of the alleged services provided by Company K to the Taxpayer. Also contrary to the Taxpayer's claim that Company K was controlled by Mr L and Madam M, the evidence before us shows that the company in fact belonged to the partners of the Taxpayer. We believe that the day-to-day operation of Company K might well have been the responsibilities of Mr L and Madam M but the ultimate control and interest of the company were in the hands of the partners. As can be seen, the partners were the ones to sign the directors' report and profit and loss accounts of the company and also the service agreement and not Mr L or Madam M. Mr L and Madam M resigned as directors after they left the Taxpayer. The shareholdings and directorship remained vested in the partners of the Taxpayer after Mr L and Madam M left the Taxpayer although one share remained vested in Mr L after he resigned as a director. On the evidence, Company K was a company under the control of the partners of the Taxpayer and it was most probably used by them as a tax-saving device. In any event, we need not decide whether section 61 applies to the arrangement between Company K and the Taxpayer, since the Taxpayer has failed to prove that the sum of $17,600 had been incurred or if it were incurred (which we do not

accept), it was incurred for production of the Taxpayer's assessable profits. Thus, the sum is not allowed as a deduction.

$1,582,400 to Company O in the year of assessment 1993/94

63. The shareholdings and directorship of Company O are detailed under paragraph 24 above. Its directors during the year of assessment 1993/94 were the partners of the Taxpayer and also Mr L and Madam M and its shareholders were Company N and Company K. The shareholders and directors of Company N are detailed under paragraphs 21 and 23 respectively, and the shareholders and directors of Company K under paragraph 20. In essence, the shareholdings of Company O were essentially vested in the partners of the Taxpayer.

64. By a letter of 9 April 1999, the Taxpayer's tax representative informed the Revenue that the management fee in the sum of $1,582,000 was paid by the Taxpayer to Company N for the year of assessment 1993/94 but subsequently it alleged that the sum was paid to Company O. Mr A was unable to explain how this error came about.

65. Mr A gave evidence that Company O and Company N were companies controlled initially by Mr L and later by Mr L and Madam M. Mr A told us that he had no knowledge whatsoever about the business activities or the client base of Company O and that only after Mr E left the Taxpayer as a result of a partnership dispute, he started making enquiries about the activities of the company and eventually in about November 1993, to enable him to understand Company O's activities, Mr L let him become a director of Company O and Company N. Mr L and Madam M resigned as directors in January 1994 when they left the Taxpayer. Mr A explained that when Mr L and Madam M left the Taxpayer, they, instead of the partners of the Taxpayer, were asked to resign from Company O, Company N and Company K because the partners wished to investigate into the matters of the companies so as to find out whether the Taxpayer had been saddled with any liabilities from the operation of those companies by Mr L and Madam M. He further said that after he became a director of Company O he found out that Company O acted as nominee shareholders and nominee directors of some of the Taxpayer's clients. He explained that in those transactions the Taxpayer billed its clients for the fees charged by Company O and the Taxpayer then made payments to Company O when there was an invoice from Company O and its client had money with the Taxpayer. He further explained that those fees charged by Company O effectively came under the Taxpayer's bills to those clients as disbursements. Mr A claimed that since Company O and Company N were controlled by Mr L and not by the partners of the Taxpayer, the Taxpayer thus had no interests in any of the payments to Company O.

66. The Taxpayer also produced the following documents in support of its claim regarding Company O. It produced samples of a bill by Company O to its customer, a declaration of trust issued by Company O in favour of its customer and a deed of indemnity by its customer to Company O to demonstrate the kind of business operation carried on by Company O at the time. There was also a list of management fees from 5 April 1993 to 27 March 1994, showing a total sum

of $1,582,400 paid to Company O as management fees. Four copies of official receipts allegedly issued by Company O to the Taxpayer in respect of the first four payments on that list were also produced for our reference. These official receipts were not signed but were only chopped with a chop bearing the name '[Company O]'. They were allegedly receipts in favour of the Taxpayer for payments of management fees. Mr A told us that the list of management fees was compiled by the Taxpayer's account department but he was also unable to tell us the source from which the list was compiled. Apart from a list of alleged payments which was compiled from an unknown source, there is no other evidence to substantiate the alleged payments by the Taxpayer. Furthermore, even if there was proof of payments by the Taxpayer to Company O (which we do not accept), according to Mr A's own evidence, they were nothing but payments of disbursements made by the Taxpayer to Company O on its clients' behalf. Thus they did not represent management fees to Company O as claimed. A copy of the service agreement dated 1 April 1992 between the Taxpayer and Company N whereby the Taxpayer retained Company N as a consultant to perform market research on investments in Hong Kong at a monthly fee of $90,000 was also produced. However, Mr A informed us that this agreement had never taken effect.

67. As to the Taxpayer's claim that they had no control over the companies, Company O, Company K and Company N which were allegedly set up by Mr L and Madam M, from the appointment of first directors and sold and bought notes of Company O submitted, we can see that Company K and Company N were the first directors and shareholders of Company O and from a notice of change of directors, Mr E, Mr B, Mr C, Mr L and Madam M were appointed directors of Company O on 7 May 1992 when Company K and Company N resigned from the company. The annual returns and records of Company K and Company N also show that the directorship of these companies in fact vested in the partners of the Taxpayer and the shareholdings effectively vested in the partners even though Mr L held one share in each of those companies. We are not convinced by Mr A's explanation that the partners of the Taxpayer remained shareholders and directors of Company O even after Mr L and Madam M left the Taxpayer because they wished to find out whether the operation of the company by Mr L and Madam M had burdened the Taxpayer with any liabilities. On the basis of the evidence before us, we find that the Taxpayer has failed to prove that a sum of $1,582,000 was paid to Company O as management fees and even if it was paid (which we do not accept), it was incurred in production of the Taxpayer's assessable profits. Hence, the claim for deduction of this sum to Company O must fail.

Company F

68. We now come to consider the arrangements between the Taxpayer and Company F. We hold the view that there is nothing fictitious about the existence of Company F, or the existence of the consultancy agreement between the Taxpayer and Company F. However, we do hold the view that the arrangements under the consultancy agreement between them were artificial and commercially unrealistic. The following factors persuaded us to this conclusion.

(a) The shareholders and directors of Company F were the partners of the Taxpayer.

(b) Company F had no other clients. Its income came entirely from the Taxpayer.

(c) The reasons for setting up Company F as given by Mr A were not genuine and unrealistic. It is inconceivable that a landlord would prefer limited liabilities from a corporate tenant as opposed to full liabilities from the partners of a professional firm. Also, from the evidence before us, despite the Taxpayer's declared purpose of passing the management responsibility to Company F, the firm was actively managed by firstly, Mr E and later, Mr C.

(d) The terms of the consultancy agreement between the Taxpayer and Company F were commercially unrealistic and not at arm's length. It was a term of the agreement that Company F was to provide managerial and secretarial services to the Taxpayer including but not limited to provision of premises, staff, all office appliances, stationery and professional books and in return the Taxpayer was to pay Company F a monthly fee of $550,000. However, the extent or details of such services to be provided by Company F was not specified. The readiness of the parties to adopt this vague approach in the extent of a party's obligations under an agreement is commercially unrealistic and not at arm's length. It highlights the artificiality of the arrangement.

(e) Furthermore, the terms of the consultancy agreement were not carried out into effect by the parties. Throughout the years of assessment in question, Company F was only paid three times the agreed monthly fee of $550,000, that is, in April, August and September 1993. Mr A explained that Company F was not paid the agreed fee because of the fluctuation of salaries and other expenses incurred by Company F and also the cash flow of the Taxpayer. The actual performance and implementation of the arrangements by the parties were nothing but a sham.

69. Having decided that section 61 of the IRO applies to the arrangements between Company F and the Taxpayer, we could have disposed of the appeal in relation to the alleged management fees paid by the Taxpayer to Company F. However, since the management fees are capable of analysis and sub-division and section 61 permits dissection of the expenses, we thus look into the various disputed expenses of Company F separately and see whether they are deductible expenses of the Taxpayer. They are deductible expenses only if they were incurred and were incurred in production of the Taxpayer's assessable profits.

$776,582 from Company F to Company G in the year of assessment 1992/93

70. Mr A's evidence in relation to Company G is as below. Company G was beneficially owned by a lady named Madam R whom was introduced to Mr A by Mr T in about October 1991. Madam R emigrated to Germany in about June 1992. None of the partners of the Taxpayer had any control or beneficial interest in Company G. Madam R appointed Mr A as a nominated director and shareholder of Company G. Company G was established for the purpose of performing works subcontracted to it by the Taxpayer and other companies. Those works included architectural services, survey, valuation and investment of landed properties, services to remedy water leakage and also land, bankruptcy and winding-up searches. Company F outsourced the Taxpayer's works to Company G as to relieve Company F's overload of work. Three ladies, Madam V, Madam W and Madam X, performed works on behalf of Company G for the Taxpayer. These ladies occasionally attended the Taxpayer's office. When Company G's services were required, Mr T liaised with Madam R and subsequently with Madam W.

71. There were produced to us a copy list of alleged jobs performed by Company G for Company F for the months of April to December 1992, January and February 1993, totally $776,582 and copy receipts purportedly issued by Company G for each of the months between April 1992 and February 1993, also totally $776,582. We also have before us a copy declaration of trust dated 16 December 1991 made by Mr A, declaring that he was holding one share in Company G in trust for Madam R. This copy declaration of trust bore an adjudication stamp of 3 April 2000 and also a stamp for payment of a penalty of $100 for late stamping. We also have before us the balance sheets of Company G for the periods from 12 November 1991 to 30 June 1992, the year ended 30 June 1993 and the year ended 30 June 1994 respectively. They show that the turnovers of Company G for those respective periods were $776,582, $776,582 and $434,347. In the profit and loss accounts of Company G, there was an item of expenditure of 'rent and rates' on some properties. Among them are '[Property 3]' and '[Property 4]'. We note that the address of Property 3 was given by Mr A as his residential address in several other documents produced for the purpose of this appeal, such as the aforesaid declaration of trust dated 16 December 1991 and a declaration of 9 November 1992 contained in a profits tax return of the Taxpayer. When Mr A was cross-examined on why Company G paid the rates of Property 3 which in fact was his own property, he explained that because Madam R was leaving Hong Kong, and she used Property 3 for storage, consequently Company G bore the rates of this property. We also note from the annual return of Company G for the year 1994 made up to 12 November 1994 (bundle R1, page 146) that '[Property 4]' was given by Mr A as his residential address. Company G also bore the Government rent and rates of this property (bundle A15, page 70).

72. Mr A was cross-examined on how the fees to Company G were determined. Mr A explained that a fee was fixed for each particular job required. When a fee was considered to be too high, Mr T negotiated such fees on behalf of the Taxpayer with Madam V, Madam W or Madam X. However, he said on the question whether a fee was acceptable or not, the ultimate decision fell upon the partners of the Taxpayer and the directors of Company F. In relation to the list of jobs purportedly to have been performed by Company G on the Taxpayer's behalf, Mr A was unable to tell us the kind of jobs performed. Mr A was also unable to tell us how the Taxpayer

recovered Company G's fees from their clients. Mr A was asked to produce invoices issued by Company G for jobs performed or evidence of payment of such fees to Company G. Nothing however was produced in this regard.

73. Save a bare assertion on the part of the Taxpayer, no evidence was adduced to prove that Company G rendered services to the Taxpayer's clients in the year of assessment 1992/93, the fees of which amounted to $776,582. We have a list of those purported works which supposedly had been compiled from certain records. However, apart from producing this list, Mr A was unable to give us any information on it. He did not know the source from which the list was compiled. The invoices or receipts in respect of those payments on the list were never produced. Mr A's explanation as to why Company G bore the rates of his property was unconvincing. It is doubtful whether the declaration of trust given by Mr A in favour of Madam R was a contemporaneous document. Mr A, a lawyer by profession, ought to know that if a document needs to be stamped, it should be stamped within time and yet the declaration of trust was only adjudicated for stamping in 2000, a few years after the alleged making thereof. This strongly indicates that the document was not contemporaneous. Mr A claimed that Company G belonged to Madam R, but from the annual returns produced, Mr T was also a director and a shareholder of the company. We were not told that there was also a declaration of trust by Mr T in favour of Madam R. We were told that Company F outsourced the works of the Taxpayer to Company G. If it were true, it does not stand to reason that Madam R should appoint Mr A as her nominated director and shareholder of Company G since such an appointment would put Mr A in a situation of conflicting interests. Mr A's interests in Company F as a shareholder and a director and in the Taxpayer as a partner no doubt clashed with those of his in Company G as a director, since Company F and ultimately the Taxpayer were the fee-payers and Company G was the fee-recipient. Finally, although the amount of the turnover of Company G was the same as the amount of the fees allegedly paid by Company F to Company G, the fiscal years of these two companies were different. Company G ended its year on 30 June 1993 while Company F on 31 March 1993. Thus, we have grave doubts as to the genuineness of those fees which were alleged to have been paid. From the evidence before us, we find that the alleged arrangement between Company F and Company G was a sham. Company G was nothing but a tax-saving device used by Mr A to obtain tax benefits which he was otherwise not entitled. The Taxpayer has also failed to prove that the sum of $776,582 was incurred and that it was incurred in production of the Taxpayer's assessable profits.

$585,547 from Company F to Company H in the year of assessment 1992/93

74. Mr A gave evidence in relation to the payments by Company F to Company H as follows. Some time in 1991, Mr C, who was then not a partner of the Taxpayer, suggested to him to sub-contract non-legal work such as file control for storage and retrieval, data formatting and compilation, typesetting and company searches to Company H. Mr C declared to him that he had no control or interest in Company H. Mr A claimed that he did not know that Company H belonged to Mr C and his wife until he received the information from the Revenue. Mr A told us that a number of people occasionally attended their office and provided the necessary services to the

Taxpayer. A job list of Company H purportedly containing particulars of the jobs performed by Company H for the Taxpayer for the period between 1 April 1992 and 31 March 1993 and also one for the subsequent year of assessment were produced. These lists contain particulars such as dates and reference, job and serial numbers but those particulars do not reveal the jobs performed because the nature of those jobs was described in code by way of alphabets, and Mr A did not offer any explanation in this regard. No other evidence was adduced to support the Taxpayer's claim that works were performed by Company H for the Taxpayer for which Company F incurred the sum of $585,547.

75. Mr C and his wife were the directors and shareholders of Company H at the material times. We note that the registered office of Company H was at '[Property 5]', which was the business address of the Taxpayer. Mr A's evidence that he was unaware that Company H was a company belonged to Mr C and his wife was thus questionable. Also, Mr A's evidence of the alleged subcontracting of works by Company F to Company H was inconsistent with his testimony during the hearing that apart from some entertainment expenses of Company F which the Taxpayer refused to bear, occasionally the Taxpayer also refused to bear some of the salaries paid out by Company F because Company F over-employed staff for the Taxpayer. In any event, even if it were true that Mr A was unaware that Company H was a company belonged to Mr C and his wife, to qualify as a deduction under section 16, the sum in question must be incurred in production of the Taxpayer's assessable profits. On the basis of the oral and documentary evidence available before us, the Taxpayer has failed to prove that there were payments by Company F to Company H and even if there were (which we do not accept), they were incurred in production of the Taxpayer's assessable profits. We cannot admit the expense only on the basis of the lists produced and especially when Mr A was unable to tell us anything further on them. We would expect information, such as how or on what basis the lists were compiled, what jobs or clients they related to, and how the fees were charged. The Taxpayer cannot expect the Board to admit the alleged outgoings as deductible expenses simply by relying on a purported list of jobs, particulars of which were unknown. Furthermore, even if there were payments of such fees (which we do not accept), Mr A had given evidence that those fees were recovered as disbursements by the Taxpayer from the respective clients, as in the case of Company O.

$60,000 from Company F to Company G in the year of assessment 1993/94

76. This sum was categorized as a payment under 'Salaries and Wages' in Company F's accounts. However, Mr A gave evidence that this sum of $60,000 was in fact not salaries to employees but it represented fees paid by Company F to Company G for some tasks on survey and design works carried out in relation to a redevelopment project and that this redevelopment project belonged to a client of the Taxpayer. No other evidence was adduced, apart from Mr A's oral testimony. Thus we find that this expense does not qualify as a deduction on the basis of a mere assertion on the part of the Taxpayer.

$60,000 from Company F to Company H

77. This sum was also classified as 'salaries' under Company F's accounts. Upon investigation and during the hearing, we were given to understand that this sum represented a fee paid by Company F to Company H for works such as typing and 'handling of documents' on the same development project mentioned earlier of which fees were also claimed to have been paid to Company O and Company G. Again, Mr A was unable to elaborate further on the works said to have been performed by Company H. He could not explain the types of works comprised in 'handling of documents' or how the fee was arrived at. He did not provide us with any information on this payment. Hence, we also find this expense inadmissible for lack of evidence that this sum was incurred in production of the Taxpayer's taxable profits.

$140,000 and $60,000 from Company F to Company O and Company S respectively

78. Similarly, these payments came under the category of 'salaries' in Company F's accounts. Upon investigation, the Revenue was informed that the respective sums of $140,000 and $60,000 were consultancy fees paid by Company F to Company O and Company S for certain services rendered on behalf of Company F. No other information was given in respect of these payments. Thus, the admissibility of these sums as deductible expenses of the Taxpayer must fail for the obvious reason that the Taxpayer has failed to prove that these payments were incurred and that they were incurred for production of the Taxpayer's profits.

Salaries to partners and assistant solicitors of $727,000

79. We are not satisfied with Mr A's explanation as to the alleged payments by Company F to the various solicitors of the Taxpayer. Since we have decided that Company F was a tax-saving device of the Taxpayer, the payments to the partners of the Taxpayer must be disregarded and they do not qualify as deductible expenses of the Taxpayer. As to the alleged payments to the other solicitors of the Taxpayer, we do not accept Mr A's evidence that because those solicitors performed non-legal works on behalf of the Taxpayer, they were remunerated by Company F separately for such non-legal works. Mr A described some of those non-legal works as typing letters on a client's file after office hours. We do not accept this explanation. Firstly, lawyers or other professionals working overtime is only a norm and letters on a client's file must also be connected with legal works. Secondly, it is commercially unrealistic to engage a solicitor to do non-legal work, such as typing. Thus, it is inconceivable that those solicitors should be separately remunerated for performance of non-legal work. Save the records which were allegedly compiled by the tax representative of the Taxpayer, we have no proof of such payments. Thus, for the above reasons, we are in no position to admit those alleged payments to the various solicitors as deductible expenses of the Taxpayer.

Company F' s other expenses in the years of assessment 1992/93 and 1993/94

80. We agree with the Revenue that the other expenses, namely audit fees, business registration fees, legal and professional fees, must also fail to qualify as deductions because they were expenses to maintain Company F or for Company F's business purpose and not for production of the Taxpayer's chargeable profits.

Conclusion

81. For the aforesaid reasons, the Taxpayer's appeal must fail and is hereby dismissed.

82. Finally, the Board would like to express its concern and regrets over the manners in which this appeal was handled by the Taxpayer and its tax representative. Much valuable time of all the parties involved in this appeal had been wasted due to the Taxpayer's lack of co-operation or failure to take heed of this Board's directions. By a letter of 5 March 2001, the Taxpayer was notified by the clerk to the Board that the hearing of the appeal was on 19 April 2001 and if the Taxpayer intended to adduce written evidence, the Taxpayer should prepare six copies of those paginated documents for distribution to the parties concerned and such documents should reach the office of the clerk to the Board on or before 4 April 2001. However, the Taxpayer did not see fit to adhere to these directions. The Taxpayer failed to produce its documents until 11 April 2001 and those documents continued coming in as late as the morning of the hearing on 19 April 2001. The Taxpayer intended to call two witnesses but no written statements from the witnesses were prepared. After the resolution of some preliminary matters, not surprisingly, it was necessary to adjourn the hearing on 19 April 2001 in order that the Board and the Revenue could have an opportunity to peruse the documents produced. Again, despite the Taxpayer's agreement to supply the Board and the Revenue with two written witnesses' statements, the Taxpayer failed to do so until further direction from the Board. More so, we were surprised that the Taxpayer's tax representative saw it proper to produce after the close of the hearing of this appeal further documents in support of the Taxpayer's case together with its written submission. The Taxpayer and its tax representative ought to know that this manner of conducting its case was improper and unacceptable and should not be allowed nor be repeated.