Case No. D96/04

Profits tax – anti-avoidance – sections 61 and 61A of the Inland Revenue Ordinance ('IRO') – whether transaction artificial or fictitious – whether transaction entered into for the sole or dominant purpose of obtaining a tax benefit – interposition of company – relevance of Salomon v A Salomon and Co Ltd [1897] AC 22 in anti-avoidance cases.

Panel: Kenneth Kwok Hing Wai SC (chairman), Winnie Kong Lai Wan and Lo Pui Yin.

Date of hearing: 18 February 2005.
Date of decision: 18 March 2005.

The appellant was an entertainment artist who, together with his wife, were the sole shareholders and directors of Company A.

Company A entered into a number of agreements with entertainment companies under which the appellant in his personal capacity was to perform in certain dramas and movies. The performance of a substantial majority of these agreements was personally guaranteed by the appellant.

In the relevant years of assessment, Company A paid between 8.3% and 12.3% of the income received under these agreements to the appellant as salaries. However, with the interposition of Company A, the appellant did not receive the full amount of income otherwise receivable from the entertainment companies.

For the years of assessment 1996/97 to 1999/2000, the Deputy Commissioner invoked sections 61 and 61A of the IRO, and determined that the interposition of Company A in the relevant transactions should be disregarded. The appellant appealed to the Board against the Determination.

The issue before the Board was whether the interposition of Company A with respect to the various agreements was artificial or fictitious within the meaning of section 61 of the IRO, or alternatively, whether it constituted a transaction with the sole or dominant purpose to enable the appellant to obtain a tax benefit under section 61A of the IRO.

Held:

1. A transaction may be 'artificial' within the meaning of section 61 if it was unrealistic from a business point of view or commercially unrealistic. Seramco Trustees v ITC [1977] AC 287; CIR v DH Howe [1977] HKLR 436; Cheung Wah Keung v CIR [2002] 3 HKLRD 773 applied.

2. The Board held that there was no real role for Company A in the relevant transactions given that the appellant had personally guaranteed performance of most the agreements. By interposing Company A between the appellant and the other companies, the appellant reduced his assessable income and tax payable. The appellant was the person who had rendered all or substantially all the services under the agreements, but it was another legal entity which received all the income derived therefrom.

3. Accordingly, the Board held that the interposition of Company A between the appellant and the entertainment companies was artificial within the meaning of section 61, and that the interposition was to be disregarded.

4. Given the Board' s conclusion, while it was strictly unnecessary to consider section 61A, the Board considered that the sole or dominant purpose of the relevant transactions was the obtaining of a tax benefit. In particular the Board noted that:

   (a) The manner in which the transaction was entered into or carried out pointed strongly to the conclusion that the appellant was one of the persons who entered into or effected the interposition for the sole or dominant purpose of enabling himself to obtain a tax benefit.

   (b) The substance of the transaction was that the entertainment companies engaged the services of the appellant, which was distinct from the form or legal nature of the transaction. There was no real role for Company A.

   (c) But for section 61A, what would otherwise have been the income of the appellant in rendering services was all routed to Company A.

   (d) It made no commercial sense for the appellant to render all or substantially all the services under the agreements and for Company A to receive all the income.

5. Finally, it is misconceived in section 61 or 61A cases to cite Salomon v A Salomon and Co Ltd [1897] AC 22. If a transaction is fictitious or artificial within the meaning of section 61, that transaction is to be disregarded, whether or not a corporate entity or a natural person was a party to that transaction. Likewise, if a

transaction is caught under section 61A, it matters not whether the parties to the transaction were corporate entities or natural persons.

Appeal dismissed.

Cases referred to:

Salomon v A Salomon and Co, Ltd [1897] AC 22
Limpus v London General Omnibus Company (1862) 1 H & C 526
IRC v Duke of Westminster (1934) 19 TC 490
WP Keighery Proprietory Limited v Federal Commissioner of Taxation (1957) 100 CLR 66 High Court of Australia
CIR v Challenge Corporation Limited [1987] 1 AC 155
Case T4 No 1 Board of Review, 17 February 1986 Australian Tax Cases
Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381
Cheung Wah Keung v CIR [2002] 3 HKLRD 773
D110/98, IRBRD, vol 13, 553
D77/99, IRBRD, vol 14, 528
D47/00, IRBRD, vol 15, 422
D130/01, IRBRD, vol 16, 970
D86/02, IRBRD, vol 17, 1046
Seramco Trustees v Income Tax Commissioner [1977] AC 287
Commissioner of Inland Revenue v D H Howe [1977] HKLR 436

Tse Yuk Yip and Go Min Min for the Commissioner of Inland Revenue.
Alac L Ho of Essex Management Consultants Limited for the taxpayer.

Decision:

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 15 October 2004 whereby:

(a) Profits tax assessment for the year of assessment 1996/97 under charge number 3-2572568-97-1, dated 11 March 2002, showing assessable profits of $490,000 and tax payable of $73,500 was reduced to assessable profits of $338,123 and tax payable of $50,718.

(b) Profits tax assessment for the year of assessment 1997/98 under charge number 3-3988091-98-1, dated 11 March 2002, showing assessable profits

of $1,567,993 and tax payable of $211,679 was reduced to assessable profits of $1,393,999 and tax payable of $188,189.

(c) Profits tax assessment for the year of assessment 1998/99 under charge number 3-2137766-99-4, dated 11 March 2002, showing assessable profits of $1,740,000 and tax payable of $261,000 was reduced to assessable profits of $1,580,235 and tax payable of $237,035.

(d) Profits tax assessment for the year of assessment 1999/2000 under charge number 3-2029577-00-0 dated 11 March 2002, showing assessable profits of $2,590,000 and tax payable of $388,500 was reduced to assessable profits of $1,123,818 and tax payable of $168,572.

The agreed facts

2. The following facts were agreed by the appellant and the respondent and we find them as facts.

3. Company A is a private company incorporated in Hong Kong on 16 March 1993 with an issued share capital of $2, divided into two shares of $1 each. On 19 March 1993, the appellant and his wife, Ms B ('Mrs C') became the shareholders of Company A, each holding one share in it. On 19 July 1993, 9,998 additional shares of Company A were allotted to Mrs C. The appellant and Mrs C were the only directors of Company A.

4. On 17 July 1993, Mrs C on behalf of Company A applied for a business registration to carry on a business, the nature of which was described as 'holding property'.

5. On 30 July 1993, Company A acquired a property known as Address D ('Property AA'). Property AA had since been let out for rental income to Company E, a related company of Company A in which Mrs C was a common director. The rental income derived from Company E was the only income of Company A until the sale of Property AA in October 1995. At the material times, the appellant, Mrs C and their two children resided in Property AA.

6. On 23 October 1995, Company A acquired another property known as Address F ('Property BB') which was later sold on 17 March 1997. At the relevant times, the appellant and his family resided in Property BB.

7. On 1 December 1995, Company G and Company A entered into an agreement ('the Company G Agreement'). Mrs C signed the Company G Agreement for and on behalf of Company A.

8. In consideration of Company G agreeing at the appellant's request to enter into the Company G Agreement, the appellant executed an undertaking on 1 December 1995 in favour of Company G guaranteeing the due performance by Company A of all its obligations under the Company G Agreement. Simultaneously, the appellant agreed to indemnify Company G against all and any losses or damage which it might sustain as a result of any breach by Company A of or under the Company G Agreement.

9. On 15 December 1995, Company H, Company A and the appellant entered into an agreement ('the Company H Agreement'). It was the appellant who signed on the Company H Agreement for and on behalf of Company A The appellant also signed on the Company H Agreement in the capacity of the artiste.

10. By a letter dated 23 April 1996 ('the 1st Company I Agreement'), Company I offered to engage, and Company A agreed, to procure the services of the appellant to serve as a story-maker for a thirty (30) one-hour episodes television drama tentatively titled 'Drama J'. Mrs C on behalf of Company A accepted the engagement and signed on the 1st Company I Agreement on 13 May 1996.

11. In consideration of Company I entering into the 1st Company I Agreement with Company A for the provision of his services as a story-maker in the television programme 'Drama J', the appellant signed an undertaking to the effect that he should in any event use his best endeavours to render his services in the programme to the satisfaction of Company I and indemnify Company I against any loss or damage if Company A had breached any of its obligations and warranties whatsoever under the 1st Company I Agreement or if he had breached his undertaking thereof.

12. Also on 13 May 1996, Company I, Company A and the appellant entered into an agreement ('the 2nd Company I Agreement'). The 2nd Company I Agreement was signed by Mrs C on behalf of Company A and the appellant in the capacity of the artiste.

13. On 13 May 1997, Company I, Company A and the appellant entered into another agreement ('the 3rd Company I Agreement'), the terms of which were almost identical to those of the 2nd Company I Agreement save for the contract period, the programmes and the fees. The 3rd Company I Agreement was signed by Mrs C on behalf of Company A and the appellant in the capacity of the artiste.

14. In consideration of Company I agreeing at the appellant's request to enter into the 3rd Company I Agreement with Company A, the appellant executed an undertaking in favour of Company I ensuring that Company A complied with all the provisions of the 3rd Company I Agreement and fulfilled all covenants and undertakings on the part of Company A set out therein. Simultaneously, the appellant agreed to indemnify Company I against any loss or damage suffered

by Company I or any claims, demands or proceedings made against Company I arising out of or connected with any breach by Company A of its obligations under the 3rd Company I Agreement.

15. By a letter dated 21 May 1997, ('the 4th Company I Agreement'), Company I offered to engage, and Company A agreed to procure the services of the appellant to serve as a story-maker for the thirty (30) one-hour duration episodes serial drama programme tentatively titled 'Drama JJ'. The title of the programme was subsequently renamed as 'Drama K'. Mrs C on behalf of Company A accepted the engagement and signed on the 4th Company I Agreement.

16. In consideration of Company I entering into the 4th Company I Agreement with Company A for the provision of his services as a story-maker in 'Drama JJ' (later renamed as 'Drama K') television programme, the appellant signed an undertaking in favour of Company I which was identical to the undertaking furnished in respect of the 1st Company I Agreement.

17. By another letter dated 3 June 1997, ('the 5th Company I Agreement'), Company I offered to engage, and Company A agreed to procure the services of the appellant to serve as a story-maker for a forty (40) one-hour duration episodes serial drama programme. Mrs C on behalf of Company A accepted the engagement and signed on the 5th Company I Agreement.

18. In consideration of Company I entering into the 5th Company I Agreement with Company A for the provision of his services as a story-maker in the forty one-hour duration episodes serial drama television programme, the appellant signed an undertaking in favour of Company I which was identical to the undertakings furnished in respect of the 1st and 4th Company I Agreements.

19. By letter dated 4 August 1997, Company I informed Company A that the serial drama as mentioned in the 4th Company I Agreement had been revised to 32 one-hour episodes and that it was agreed between Company I, Company A and the appellant that Company I would pay Company A an additional fee of $20,000 for the extra two one-hour episodes.

20. By another letter also dated 4 August 1997 from Company I to Company A, Company I confirmed that it had assigned the appellant to perform in the serial drama 'Drama K' by virtue of the 3rd Company I Agreement. Company I further confirmed that it would pay Company A an additional fee of $60,000 for the extra two episodes on or before 9 October 1997. The letter was agreed and accepted by Company A and the appellant.

21. On 6 October 1997, Company L, Company A and the appellant entered into an agreement ('the Company L's Agreement'). The Company L's Agreement was signed by Mrs C on behalf of Company A and by the appellant in the capacity of the artiste.

22. On 20 January 1998, Company I and Company A entered into an agreement ('the 6th Company I Agreement'). The 6th Company I Agreement was signed by Mrs C on behalf of Company A.

23. In consideration of Company I agreeing at the appellant's request to enter into the 6th Company I Agreement with Company A, the appellant signed an undertaking in favour of Company I guaranteeing the due performance by Company A of all its obligations under the 6th Company I Agreement, agreeing that he should in any event use his best endeavours to render his services to the satisfaction of Company I and agreeing to indemnify Company I against all and any losses or damage which it might sustain as a result of Company A's breach of the 6th Company I Agreement or his breach of the undertaking.

24. By a letter dated 4 September 1998, ('the 7th Company I Agreement'), Company I offered to engage, and Company A agreed to procure the services of the appellant to serve as a story-maker for a thirty (30) one-hour duration episodes serial drama programme tentatively titled 'Drama M'. Mrs C on behalf of Company A accepted the engagement and signed on the 7th Company I Agreement.

25. In consideration of Company I entering into the 7th Company I Agreement with Company A for the provision of his services as a story-maker in the serial drama television programme 'Drama M', the appellant signed an undertaking in favour of Company I which was identical to the undertakings furnished in respect of the 1st, 4th and 5th Company I Agreements.

26. Also on 4 September 1998, Company I and Company A entered into an agreement ('the 8th Company I Agreement') whereby Company I engaged Company A to procure the appellant's services, on a project basis, for a thirty (30) one-hour duration episodes of Company I serial drama programme tentatively titled 'Drama M'.

27. On divers dates, the appellant filed his individual tax returns for the years of assessment 1996/97 to 1999/2000 declaring the following details of income derived from Company A in the capacity of director:

Year of assessment	**Particulars of income**	**Period**	**Amount**
			$
1996/97	Bonus	1-4-1996 – 31-3-1997	185,000
1997/98	Salary	1-4-1997 – 31-3-1998	214,000
1998/99	Salary	1-4-1998 – 31-3-1999	214,000
1999/2000	Salary	1-4-1999 – 31-3-2000	214,000

The appellant also declared that he was provided with quarters at 'Address N' ('Property CC') throughout the two years 1998/99 and 1999/2000.

28. In its profits tax returns for the years of assessment 1996/97 to 1999/2000, Company A declared the nature of its business as follows:

Year of assessment	**Nature of business**
1996/97	Property investment and the provision of film production and artiste performance services
1997/98	Provision of film production services
1998/99	Provision of film production and artiste services
1999/2000	Production services : provision of artist and production services

29. Company A closed its accounts on 30 April annually. The following income and expenditure were shown in its accounts for the years ended 30 April 1996, 1997, 1998 and 1999:

Year ended	**30-4-1996**	**30-4-1997**	**30-4-1998**	**30-4-1999**	
				Onshore	Offshore
Film production income	$	$	$	$	$
(i) Income derived by the appellant's personal services	490,000	1,567,993	1,740,000	1,260,000	1,330,000
(ii) Other income	-	-	48,000	127,950	-
Rental income	300,000	-	-	-	-
Total income	790,000	1,567,993	1,788,000	1,387,950	1,330,000
Less: Expenses-					
Accountancy fee	10,800	11,000	15,800	11,000	-
Audit fee	12,000	13,000	13,000	14,000	-
Bank charges	19,585	375	755	970	-
Bank overdraft interest	-	2	265	17	-
Building management fee	-	18,133	27,600	24,450	-
Building repairs & maintenance	-	39,538	-	-	-
Business registration fee	2,250	2,250	2,250	2,250	-
Business suit	21,961	-	-	-	-
Cleaning	-	-	500	5,000	-
Costume	-	34,704	12,885	21,381	143,242
Cosmetic	-	10,553	-	-	-
Depreciation	156,783	80,365	325,715	376,867	-
Director's quarters					

expense	-	32,204	600,000	-	-
Director's quarters rental	-	100,000	-	525,000	-
Director's remuneration	62,000	330,194	379,000	379,000	-
Donation	2,000	1,000	114,500	28,800	-
Electricity, water & gas	30,304	43,344	37,982	29,946	-
Entertainment	179,899	180,032	53,054	50,721	48,604
Loss on disposal of fixed assets	-	-	-	116,566	-
Flower arrangement	-	2,620	-	-	-
Hire purchase interest	1,285	15,417	28,076	26,310	-
Insurance	3,200	8,800	-	-	-
Legal & professional fee	20,000	5,043	-	-	-
Medical expenses	18,436	-	-	-	-
Messing	53,749	71,095	15,426	2,714	2,601
Mortgage loan interest	270,553	323,753	-	-	-
Motor vehicle expenses	24,350	51,463	116,570	117,923	-
Newspaper & magazine	-	5,009	971	1,015	-
Postage & courier	-	112	1,674	1,800	-
Printing & stationery	3,385	4,198	4,167	1,482	1,420
Rates	11,049	11,334	18,397	13,644	-
Repair & maintenance	1,893	1,195	470	38,123	-
Salary	-	-	-	28,800	-
Secretarial fee	13,199	4,700	6,810	4,435	-
Sundry expenses	33,376	13,094	14,477	23,445	-
Taxation service fee	2,000	2,000	1,500	1,500	-
Telephone charges	19,962	32,014	26,018	42,988	-
Transportation	-	-	-	16,000	-
Travelling – fee	2,222	7,025	3,884	4,239	-
Travelling – overseas	-	6,628	-	-	19,167
Total expenses	975,241	1,462,194	1,821,656	1,910,386	215,034
Net profit/(loss) for the year	(185,241)	105,799	(33,656)	(522,436)	1,114,966

30. After making statutory and other adjustments, Company A declared the following assessable profits/adjusted losses, as the case may be:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
Assessable profits/(Adjusted loss)	($224,445)	$66,521	$201,650	($549,236)*

* The declared adjusted loss for the year of assessment 1999/2000 was subsequently revised to $466,486.

31. The fixed assets purchased by Company A included landed property, leasehold improvement, motor vehicles, some household furniture and fixtures and electrical appliances, details of which were as follows:

	1996/97	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Property BB (Note)	8,078,670	-	-	-
Property at Address O ('Property DD') (Note)	-	-	-	6,409,677
Leasehold improvement	318,552	-	-	-
Motor vehicle (acquired under Hire purchase)*	243,350	-	299,055	-
Furniture, fixtures and electrical appliances	161,176	66,519	57,103	468,981
	8,801,748	66,519	356,158	6,878,658

Note

Property BB was sold in the year 1997/98. Property DD was purchased by Company A on 23 March 2000 which has since been used as the appellant's residence until its sale in May 2002.

* Vehicle P was acquired in the year 1996/97 and Vehicle Q was acquired in the year 1998/99.

32. In reply to the assessor's enquiries, Company G stated the following:

(a) '[The appellant] provided his service to [Company G] through [Company A] during the period from January 1, 1996 to December 31, 1996. No other contract copies can be provided other than [the Company G Agreement].'

(b) 'It was under [the appellant's] request to work for [it] through a company' (This was in response to the assessor's enquiry on why Company G entered into agreement with Company A instead of the appellant for his personal services)

(c) During the contract period, the appellant performed in the following programmes:

Name of programme	Working period
Drama R	27-2-1996 – 13-4-1996
Drama S	26-7-1996 – 5-9-1996
Drama T	16-9-1996 – 29-11-1996

(d) 'In addition to the contract terms, [the appellant] had to comply with the rules and regulations set in the studios. All artistes are not allowed to smoke in the studios of [Company G] unless it is required during the programme production and are required to follow the directions of Production Executive. No copy of such rules and regulations is available for your perusal.'

(e) '[The appellant] was not required to provide his own equipment and facilities or to employ his own assistant in performing his duties.'

(f) '[The appellant] was not required to incur outgoings and expenses in the performance of his duties.'

(g) '[The appellant] was only entitled to transportation fee reimbursement in accordance with respective terms and conditions under the service agreements.'

(h) '[The appellant] was not entitled to fringe benefits such as annual leave, medical and life insurance etc.'

(i) Except for the deposit of $70,000 which was paid by cheque to Company A, all other payments were credited into Company A's bank account in the Bank U ('the Company A's Bank Account') through auto-pay.

33. In reply to the assessor's enquiries, the Bank U confirmed that either the appellant or Mrs C was the signatory to the Company A's Bank Account.

34. In reply to the assessor's enquiries, Company I stated the following:

(a) '[Company I] had never employed [the appellant] or engaged his services in his personal capacity ... as this was requested by [the appellant] to enter into agreements with [Company A].'

(b) 'Yes, the guarantee of [the appellant] was the pre-requisite for taking out the service agreements with [Company A].'

(c) The appellant had taken part in the following programmes under various agreements with [Company I]:

Name of programme	Working period
Drama J	5-1996 – 3-1997
Drama K	14-7-1997 – 25-9-1997
Programme V	12-2-1998 – 5-3-1998
Drama M	1-12-1998 – 28-2-1999

(d) All the service fees were made payable to Company A by cheques.

(e) 'Generally, [the appellant] is not required to provide his own equipment and facilities, employ his own assistant, or incur his own expenditure in the performance of the work. Therefore, there is no need to reimburse for expenses in connection with his performance.'

(f) 'Generally, [Company I] only provided the travel insurance to him in case the location of performance /shooting was outside the territory of Hong Kong.'

(g) '[The appellant] or [Company A] was not entitled to any fringe benefits of [Company I].'

35. Company A, through Essex Management Consultants Limited ('the Representative'), provided the following information in relation to the income recorded and various expenses charged in its accounts:

(a) A breakdown of Company A' s income for the four years ended 30 April 1996, 1997, 1998 and 1999 was as follows:

	1996/97	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Rental	300,000	-	-	-
Film production income –				
(i) Income derived by the appellant's personal service from				
- Company G	190,000	367,993	-	-
- Company H	300,000	-	-	-
- Company I	-	1,200,000	1,740,000	1,260,000
- Company L	-	-	-	1,330,000
	490,000	1,567,993	1,740,000	2,590,000

(ii) Other income	-	-	48,000	127,950
	790,000	1,567,993	1,788,000	2,717,950

(b) The rental income of $300,000 for year 1996/97 was derived from Property AA during the period from 1 May 1995 to 30 October 1995.

(c) Company A paid the following director's remuneration during the four years ended 30 April 1996, 1997, 1998 and 1999:

	1996/97	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
The appellant	53,000	185,000	214,000	214,000
Mrs C	9,000	*145,194	165,000	165,000
	62,000	330,194	379,000	379,000

* The amount included medical expenses of $5,194.

(d) By a tenancy agreement dated 31 January 1997, Company A rented Property CC at a monthly rent of $50,000 for a term of two years commencing on 15 February 1997. All the director's quarter expenses and director's quarter rental expenses charged in Company A's accounts for the years ended 30 April 1997, 1998 and 1999 were incurred in relation to Property CC which was provided to the appellant as director's quarters at the relevant times.

(e) Mortgage loan interests, building management fees, rates and electricity, water and gas expenses were incurred in relation to Property AA, Property BB and/or Property CC.

(f) The telephone charges included phone charges for certain mobile phones and for certain telephone sets fixed at Property CC and Property DD.

(g) Insurance charges for the years 1996/97 and 1997/98 were incurred in respect of fire insurance policies took out in respect of Property BB.

(h) '[Messing expenses] were incurred during the course of artist performing his duties. The expenses including causal meals and catering among the colleagues. They were sundries expenses.'

(i) '[The entertainment expenses] were incurred by the directors during the course of ordinary business. [Company A's] principal business was engaged in film production services and the provision of artist service. Entertainment expenses were necessarily incurred during the course of business especially for

meeting potential cooperative film production companies and clients. Besides, [Company A] also incurred expenses in entertaining its business associates as it is commonly known that a successful entertainer is heavily relied on good relationship with the participants in the media industry and exposes himself in most social gatherings in which entertainment expenses have to be incurred. Furthermore, most of the sources of incomes are derived from good connection with the various business associates. All expenses were incurred in having meals with colleagues, business associates and clients, and were wholly for the production of chargeable profits.'

(j) 'Most of the time [Company A] had to provide its own costume for its artist's performance in earning the assessable production income. Particularly, [Company A's] artist had to use its own cosmetic material during the course of his performance. Even though the principal may provide the cosmetic, in order to avoid allergic effect and protect its artist, [Company A] would use its own cosmetic. This is very common in the entertainment industry. The artist never use the cosmetic in his normal daily life except in carrying out his duties in the show business.'

(k) All the furniture, fixtures and electrical appliances acquired were kept at Properties AA, BB, CC or DD during the relevant years.

36. Upon review, the Assistant Commissioner was of the opinion that the interposition of Company A in the appellant's artiste business during the period from 1 January 1996 to 28 February 1999 was a scheme entered into or carried out for the sole or dominant purpose of enabling the appellant to obtain a tax benefit. Pursuant to section 61A(2) of the IRO, the Assistant Commissioner raised on the appellant as the sole proprietor of his artiste business the following profits tax assessments for the years 1996/97 to 1999/2000 in respect of the income received through Company A:

	1996/97	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Service income per Company A's accounts [see paragraph 29]	490,000	1,567,993	1,740,000	2,590,000
Tax payable	73,500	211,679	261,000	388,500

37. The Representative on behalf of the appellant objected to the above assessments.

38. In response to the assessor's enquiries, the Representative confirmed that all the work in connection with the serial drama in the name of 'Drama W' (subsequently renamed as 'Drama X') under the Company L's Agreement was not conducted in Hong Kong.

39. By letter dated 26 June 2002, the assessor explained to the Representative the reasons why she considered section 61A of the Ordinance was applicable to the appellant's case and proposed that the 1996/97 to 1999/2000 profits tax assessments be revised to allow certain expenses charged in Company A's accounts.

40. In response, the Representative, by letter dated 20 August 2002, put forth various contentions to support its claim that section 61A of the Ordinance was not applicable.

41. By determination dated 15 October 2004, the Deputy Commissioner of Inland Revenue determined that the profits tax assessments for the years of assessment 1996/97, 1997/98, 1998/99 and 1999/2000 be revised as follows:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
	$	$	$	$
Assessable profits	338,123	1,393,999	1,580,235	1,123,818
Tax payable	50,718	188,189	237,035	168,572

The determination

42. The Deputy Commissioner invoked section 61A and section 61. In revising the assessments, the Deputy Commissioner excluded the income under the Company L's Agreement and allowed the deduction of the expenses according to the computations shown on pages 20 – 24 of his determination.

The grounds of appeal

43. By letter dated 26 October 2004, the Representative gave notice of appeal on behalf of the appellant on the following grounds (written exactly as it stands in the original):

> (1) The income derived by [Company A] from the provision of the artiste's ***(taxpayer's)*** services to certain companies ('***the companies***') was the business receipt of [Company A] only and should not be assessed to Profits Tax in the taxpayer's own name.
>
> (2) Section 61A of the IRO was not applicable and that the income derived by ***[Company A]*** from its engagements with ***the companies*** should not be assessed as the ***taxpayer***' s personal income under profits tax.
>
> (3) Section 61 of the IRO was not applicable and that the interposition of ***[Company A]*** between the ***taxpayer*** and ***the companies*** was not artificial.

(4) Amendment and further statement of facts submitted had not been taken into consideration in arriving at the determination.

44. It is clear from these grounds that there is no dispute on the computations.

The appeal hearing

45. The appellant lodged a bundle of the following authorities prior to the hearing of the appeal:

(a) Salomon v A Salomon and Co, Ltd [1897] AC 22

(b) Limpus v London General Omnibus Company (1862) 1 H & C 526

(c) IRC v Duke of Westminster (1934) 19 TC 490

(d) WP Keighery Proprietory Limited v Federal Commissioner of Taxation (1957) 100 CLR 66 High Court of Australia

(e) CIR v Challenge Corporation Limited [1987] 1 AC 155

(f) Case T4 No 1 Board of Review, 17 February 1986 Australian Tax Cases

46. The respondent lodged a bundle of the following authorities prior to the hearing of the appeal:

(a) Inland Revenue Ordinance (Chapter 112), sections 14, 16, 17, 61, 61A and 68

(b) Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381

(c) Cheung Wah Keung v CIR [2002] 3 HKLRD 773

(d) D110/98, IRBRD, vol 13, 553

(e) D77/99, IRBRD, vol 14, 528

(f) D47/00, IRBRD, vol 15, 422

(g) D130/01, IRBRD, vol 16, 970

(h) D86/02, IRBRD, vol 17, 1046

47. At the hearing of the appeal, the appellant was represented by Mr Alac L Ho of the Representative and the respondent by Ms Tse Yuk-yip. Mr Alac L Ho called the appellant to give evidence. No witness was called by Ms Tse Yuk-yip.

The Board's decision

The law

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

49. Section 61 of the IRO 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.'*

50. 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 which is similar 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.'*

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

52. In Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441 [(1977) 1 HKTC 936 at 952], Cons J. (as he then was) considered whether the impugned transaction was 'unrealistic from a business point of view' or '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.'*

53. Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKRLD 773, CA, is an interesting case. Woo JA, said at paragraph 41 that:

> *'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.'

54. Section 61A(1) provides that:

'*(1) This section shall apply where any transaction has been entered into or effected after [14 March 1986] ... and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person (in this section referred to as "the relevant person"), and, having regard to –*

(a) the manner in which the transaction was entered into or carried out;

(b) the form and substance of the transaction;

(c) the result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction;

(d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;

(e) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;

(f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and

(g) the participation in the transaction of a corporation resident or carrying on business outside Hong Kong,

> *it would be concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.'*

55. Subsection (3) provides that 'tax benefit' means 'the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof' and 'transaction' includes a 'transaction, operation or scheme'.

56. As Rogers JA laid down in Yick Fung Estates Limited v CIR [2000] 1 HKLRD 381 at page 399:

> '*... the tests set out in s.61A have to be applied objectively.*
>
> *There are seven matters (a) to (g) to which the section requires that regard must be had. On a clear construction of the subsection, the section would not be relevant or the subject matter of consideration unless there was a tax benefit, in other words, the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof. In this case, it is said that there has been an avoidance of tax in respect of HK$108,327,586 profits or at any rate, there has been a reduction in the amount of tax that would otherwise have been payable. On that basis, the various matters at (a) to (g) have to be considered and if upon that exercise, the conclusion would be arrived at that the person who entered into or carried out the transaction did so for the sole or dominant purpose of obtaining a tax benefit, the Assistant Commissioner may exercise one of the two powers set out in sub-s.(2).*
>
> *In this Court, there was some discussion as to whether it is necessary for more than one item in matters (a) to (g) to indicate the sole or dominant purpose for it to be possible that that conclusion be arrived at. In my view, the posing of the question itself possibly indicates an erroneous approach to the section. Clearly, what must happen is that those matters must be considered and the strength or otherwise of the various resulting conclusions from considering those matters must be looked at globally. On the basis of that assessment, it must be decided whether the sole or dominant purpose was the obtaining of a tax benefit. It may be observed, for example, that one or other of the matters in (a) to (g) may be strongly or weakly suggestive of a purpose of obtaining a tax benefit or may be strongly or weakly suggestive of some other purpose. The Assistant Commissioner who undertakes such task has to use his own common sense and apply the results of his deliberations in respect of each matter and come to an overall conclusion.*

> *... The Board approached the matter on the basis that the word 'form' related to the legal effect or, as I would put it, the legal nature of the transaction and that the substance related to the practical or commercial end result of the transaction. In that respect, I would have no cause to disagree with the way in which this was put.'*

Section 61

57. It is clear from a perusal of each of the relevant agreements entered into by Company A (that is, the Company G Agreement, the Company H Agreement, the 1st Company I Agreement, the 2nd Company I Agreement, the 3rd Company I Agreement, the 4th Company I Agreement, the 5th Company I Agreement, the 6th Company I Agreement, the 7th Company I Agreement and the 8th Company I Agreement) that what the other contracting parties (that is, Company G, Company H and Company I) sought and contracted for was the services of the appellant and that there was no real role for Company A. As helpfully summarised by Ms Tse Yuk-yip, his services were as follows:

Company G Agreement	personal services to act, to perform and to play any role in drama programmes
Company H Agreement	personal artiste's services in a named movie
1st Company I Agreement	services of the appellant as a story-maker for a named TV drama
2nd Company I Agreement	services of the appellant to perform in the same TV drama named under the 1st Company I Agreement
3rd Company I Agreement	services of the appellant to perform 30 one-hour episodes and 40 one-hour episodes
4th Company I Agreement	services of the appellant as a story-maker in a serial drama programme
5th Company I Agreement	services of the appellant as a story-maker for 40 one-hour episodes
6th Company I Agreement	services of the appellant in a named programme
7th Company I Agreement	services of the appellant as a story-maker in a named serial drama programme
8th Company I Agreement	services of the appellant as an artiste in the same TV drama named under the 7th Company I Agreement

58. With the exception of Company H Agreement and the 8th Company I Agreement, the appellant personally guaranteed performance of all the other agreements. The appellant was also a party to the Company H Agreement and he was clearly bound by it. In our Decision, it is

more probable than not that the absence of a personal undertaking in respect of the 8th Company I Agreement was due to oversight rather than design.

59. If the appellant had contracted directly with Company G, Company H and Company I, all the income under the agreements would have formed part of his assessable income. By interposing Company A between the appellant and Company G, Company H and Company I, the income which he would otherwise have received from Company G, Company H and Company I would have been received by Company A instead of him. Thus, his income was reduced and the amount of tax payable by him was also reduced.

60. The question is whether the interposition of Company A between the appellant and Company G, Company H and Company I was artificial.

61. Ms Tse Yuk-yip helpfully summarised the income which Company A received from Company G, Company H and Company I and the salaries paid by Company A to the appellant as follows:

Year of assessment	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
Income ($)	490,000	1,567,993	1,740,000	2,590,000
Salaries paid by Company A to the appellant ($)	53,000	185,000	214,000	214,000
% of salaries to income	10.8	11.8	12.3	8.3

62. We have not been told about the arrangement/agreement, if any, between the appellant and Company A and the remuneration (if any) paid or agreed to be paid by Company A to the appellant in consideration of the appellant's services under the agreements. All we have is the amounts of salaries paid by Company A to the appellant. Even assuming that all the salaries were paid in consideration of the appellant's services under the agreements, the percentage of his remuneration ranges from 8.3% to 12.3% of the income received by Company A from Company G, Company H and Company I. The appellant was the person who rendered all or substantially all the services under the agreements. Yet it was another legal entity, that is, Company A, which received all the income from Company G, Company H and Company I.

63. It was argued that the interposition was not artificial because Company A procured the agreements. We reject this argument for two reasons:

(a) It begs the question why the appellant requested that Company A be named as the contracting party.

(b) There is scant evidence on the time and efforts, if any, on the part of Mrs C in securing the agreements. There is in effect no evidence to show that such time and efforts were of any significance compared with the services of the appellant under the agreements.

64. It was also argued that the appellant was concerned about personal liability. We reject this contention. The appellant gave his personal undertaking under all but Company H and the 8th Company I Agreements. As noted above, he was a party to the Company H Agreement and was personally liable under it. Under the 8th Company I Agreement, his role was an artiste. No attempt has been made to identify any possible personal liability under the 8th Company I Agreement.

65. In our Decision, the interposition of Company A between the appellant and Company G, Company H and Company I was artificial within the meaning of section 61.

66. The interposition is therefore to be disregarded under section 61. The respondent was and is content to allow some deduction of expenses which were said to have been incurred by Company A. In view of the respondent's position, we assume in favour of the appellant (without deciding the point) that the deduction was in order. The appeal fails.

Section 61A

67. Strictly speaking, it is not necessary for us to consider section 61A since we have decided against the appellant under section 61. In deference to the arguments before us, we will deal briefly with section 61A.

68. Ms Tse Yuk-yip contended that the appellant was the relevant person and the transaction was the interposition of Company A between the appellant and Company G, Company H and Company I.

69. By interposing Company A between the appellant and Company G, Company H and Company I, the income which the appellant would otherwise have received from Company G, Company H and Company I was received by Company A instead of him. His income was reduced and the amount of tax payable by him was also reduced. There was thus a tax benefit within the meaning of section 61A(3) in that there was a reduction in the amount of tax. We note that Mr Alac L Ho agreed that there was a tax benefit in this case.

70. The transaction would have had, but for section 61A, the effect of conferring a tax benefit on the appellant.

71. The question is whether the sole or dominant purpose was to enable the appellant to obtain a tax benefit.

72. What Company G, Company H and Company I sought and contracted for was the services of the appellant. There was no real role for Company A Yet, Company A was interposed between the appellant and Company G, Company H and Company I and Company A was the legal entity which received all the payments under the agreement. The manner in which the transaction was entered into or carried out pointed strongly to the conclusion that the appellant who was one of the persons who entered into or effected the interposition, did so for the sole or dominant purpose of enabling himself to obtain a tax benefit.

73. The form or legal nature of the transaction was that Company G, Company H and Company I contracted with Company A. The substance or the practical or commercial end result of the transaction was that Company G, Company H and Company I engaged the services of the appellant.

74. But for section 61A, what would otherwise have been the income of the appellant in rendering services to Company G, Company H and Company I was all routed to Company A and the appellant would have obtained a reduction in the amount of tax.

75. In our Decision, persons dealing with each other at arm' s length of the kind in question would not have entered into the transaction. It made no commercial sense for the appellant to render all or substantially all the services under the agreements and for Company A to receive all the income.

76. Factors (a), (b), (c) and (f) all point strongly to the conclusion that the appellant who was one of the persons who entered into or effected the interposition, did so for the sole or dominant purpose of enabling himself to obtain a tax benefit.

77. The other facts are either inapplicable or at best marginally relevant.

78. Looking at the matters globally, our overall conclusion is that the sole or dominant purpose was the obtaining of a tax benefit.

79. In our Decision, section 61A was correctly invoked against the appellant.

80. This is another reason why the appeal must fail.

81. Before we leave this appeal, we must make the point that it is misconceived in section 61 or section 61A cases to cite Salomon v A Salomon and Co, Ltd. If a transaction is fictitious or artificial within the meaning of section 61, that transaction is to be disregarded, whether or not a

corporate entity or a natural person was a party to that transaction. Likewise, if a transaction is caught by section 61A, it matters not whether the parties to the transaction were corporate entities or natural persons. Take for example, it would have made no difference if Mrs C (in place of Company A) had been the party who contracted with Company G, Company H and Company I in this case.

Disposition

82. We dismiss the appeal and confirm the assessments as reduced by the Deputy Commissioner.