

LO Tim-fat

(Appellant)

and

Commissioner of Inland Revenue

(Respondent)

Court of First Instance
(Inland Revenue Appeal No. 13 of 2005)

Mr. Recorder Edward Chan, SC in Court

Date of Hearing : 22 March 2006

Date of Judgment : 28 April 2006

Inland Revenue Ordinance (Cap. 112) – Profits Tax – section 14 – construction of contract – whether amount received beneficially in the course of trade was trading receipt on the day of receipt even though there was a possibility of refunding certain part of the amount received in the future – section 16

The Appellant carried on a trade, profession or business as an insurance agent. He entered into a contract evidenced by a Letter of Understanding dated 6 November 2001 with an insurance company agreeing to be its insurance agent for a minimum of 5 years. The insurance company was to make Initial Signing Fee, Balance of Initial Signing Fee and Monthly Bonus of 12 months to the Appellant on the terms set out in the Letter of Understanding. On 9 November 2001, the Appellant received a lump sum of \$1,757,433 (representing Initial Signing Fee, Balance of Initial Signing Fee and Monthly Bonus of 12 months) from the insurance company by way of loan on terms set out in a Letter of Undertaking dated 7 November 2001. By the terms of the Letter of Undertaking, the loan was repayable by setting off the amounts payable to the Appellant under the Letter of Undertaking for year 1.

The Appellant argued that only 20% instead of the entire amount of his Initial Signing Fee, Balance of Initial Signing Fee and Monthly Bonus should be subject to Profits Tax in year of assessment 2002/2003 as he had to refund part of the lump sum

to the insurance company if the engagement was terminated within 5 years.

The Board of Review decided that of the amount of \$1,757,433, Initial Signing Fee (\$585,811) and the 1st (\$48,818) of the 12 monthly bonuses had accrued to the Appellant on 1 March 2002 and 31 March 2002 respectively. As to the balance sum of \$1,122,804, being the amount of the Balance of Initial Signing Fee (\$585,811) and the remaining 11 monthly bonuses (\$536,993), the decision of the Board of Review was that it should be treated as trading receipts for the year of assessment 2002/2003.

The Appellant appealed to the Court of First Instance.

Held:

- (1) The lump sum had been advanced to the Appellant on 9 November 2001. By the terms of the advance, the amount was repayable by way of set off the amounts payable to him under the Letter of Understanding. Hence it was when the amounts became due and payable to the Appellant under the Letter of Understanding that it could be said that the Appellant had received the Initial Signing Fee, the Balance of Initial Signing Fee and the monthly bonuses as the case might be.
- (2) Under the Letter of Understanding, in the event that had happened the Appellant was entitled to be paid the Balance of Initial Signing Fee (\$585,811) on 1 March 2003. As on 1 March 2003, this amount would belong to him beneficially and he could use it for whatever purpose he deemed fit. All the contingencies giving rise to the obligation to refund part of the sum had not occurred at all during the year of assessment 2002/2003 (i.e. 1 April 2002 to 31 March 2003). Although there was a possibility that he might have to repay part of the amount to the insurance company in the future, on the authority of Smart v Lincolnshire Sugar Co. Ltd., the amount should properly be considered to be part of the Appellant's trading receipt for the year when the sum was received and accrued to him.
- (3) All the 11 monthly bonuses payable to the Appellant during the period between 1 April 2002 and 28 February 2003 were money properly accrued to him and would belong to him beneficially. They should be treated as his trading receipts in the year of assessment 2002/2003.
- (4) The position may well be different if the amounts were received by the Appellant as loan or money paid on account or as security to satisfy the

liability of the payer (the insurance company) in the future.

- (5) Section 16 envisages that there is a possibility that a certain profit for one year of assessment may be the result of certain expenses incurred in other assessment years. The corollary is that the fact that expenses may have to be incurred in a number of years does not necessarily mean that the profit resulted from such expenses must be treated as profits for the years when the expenses are incurred.

Appeal dismissed.

The Appellant, unrepresented, appeared in person

Mr. Eugene Fung (instructed by the Department of Justice) for the Respondent

Case referred to in the judgment:

Smart v Lincolnshire Sugar Co. Ltd. (1937) 20 T.C. 643
