TAX RATES, PERSONAL ALLOWANCES AND TAX DEDUCTION AT A GLANCE

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[¶8-0500] Overview

- A taxpayer may be subject to tax both in Hong Kong and overseas. The Ordinance provides that arrangements may be made with other territories to afford relief from double taxation when the other territory imposes a tax similar in character to a Hong Kong tax (s 49(1)).
- Hong Kong has entered into its first comprehensive double tax agreement with Belgium on 10 December 2003.
- The first comprehensive agreement on the avoidance of double taxation that Hong Kong had signed with an Asia-Pacific country was with Thailand on 7 September 2005.
- To prevent the double taxation of income between Hong Kong and Mainland China, the two parties have concluded a comprehensive arrangement on 21 August 2006 (see ¶8-6500 for details).
- Hong Kong has also concluded its fourth comprehensive agreement on the avoidance of double taxation with Luxembourg on 2 November 2007 and the fifth with Vietnam on 16 December 2008.
- During 2010, Hong Kong has further signed 13 comprehensive double tax agreements, including with Brunei, the Netherlands, Indonesia, Kuwait, Hungary, Austria, United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand and Switzerland. During 2011, four more comprehensive agreements were signed with Portugal, Spain, Czech Republic and Malta. In February 2012, a comprehensive agreement was signed with Jersey. Hong Kong has 23 comprehensive agreements signed with its business and trading partners.
- As another measure, specifically to protect international aircraft and shipping operators from double tax charges, Hong Kong has concluded:
  - (i) double tax relief arrangements with various countries which prevent the double taxation of international shipping income (see ¶8-2000); and
  - (ii) air services agreements with various countries which include provisions to prevent the double taxation of income arising from international air traffic operations (see ¶8-3500).

RELIEF FOR INTERNATIONAL SHIPPING AND AIRCRAFT INCOME

[¶8-2000] Shipping income — tax relief arrangement with various countries

Hong Kong has entered into agreements with various countries in respect of shipping income. These provisions have been specified as double taxation arrangements for the purposes of s 49 of the *Inland Revenue Ordinance* (Cap 112). Under the agreement with the United States, gross income derived from international operation of ships by taxpayers who are residents of Hong Kong (other than United States citizens) is exempt from income tax in the United States, and vice versa. Under the agreements with various other countries, generally income or profits derived from the operation of ships in international traffic by an enterprise of one country is taxable only in that country. The exemption applies to profits tax in Hong Kong for all agreements and also extends to salaries tax under some agreements such as those with the Netherlands, Singapore and Sri Lanka agreements.

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The arrangements were respectively declared effective in the following:

- *Double Taxation Relief (Income from Shipping Operations) (United States of America) Order*;
- *Specification of Arrangements (Government of the United Kingdom of Great Britain and Northern Ireland) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Kingdom of the Netherlands) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Kingdom of Norway) (Avoidance of Double Taxation on Income from Shipping Operation) Order*;
- *Specification of Arrangements (Government of the FederalRepublic of Germany) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Republic of Singapore) (Avoidance of Double Taxation on Income from Shipping or Aircraft Operations) Order*;
- *Specification of Arrangements (Government of the Democratic SocialistRepublic of Sri Lanka) (Avoidance of Double Taxation on Income from Shipping and Air Transport) Order*; and
- *Specification of Arrangements (Government of the Kingdom of Denmark) (Avoidance of Double Taxation on Income from Shipping Operation) Order*.

The relief from income tax of these contracting countries given under the agreements is only available to residents of Hong Kong who are not at the same time residents of these contracting countries. In the case of corporations, those which are controlled and managed in Hong Kong, and are not incorporated or managed in these contracting countries, are eligible for relief.

For relief from United States income tax, a corporation must also meet one of the following requirements in order to qualify:

- the corporation's stock must be primarily and regularly traded on a securities market in either Hong Kong, another country to which an equivalent exemption applies, or the United States; or
- more than 50% of its stock must be owned by: individuals resident in either Hong Kong or another country which grants a similar exemption; a corporation organised in a country which grants a similar exemption to United States corporations; another country which grants an equivalent exemption to United States corporations; or the United States (cl 2 of Agreement).

International shipping income

The income to which the exemption applies is specified under each agreement and varies from one agreement to another. Generally, all income derived from the international operation of ships are included, such as:

- income from the rental of ships used in international transport on a full (time or voyage) or bare boat basis;
- income from the rental of containers and related equipment used in international transport which is incidental to income from the international operation of ships;
- income from the participation in marine transport pools which engage in international operation of ships; and
- gains from the sale, disposal or other alienation of ships by a person primarily engaged in international operation, lease or rental of ships.

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For those of the Netherlands, Germany, Singapore, Sri Lanka and Denmark, interest income on funds directly connected with that operation is also included. For that of the Netherlands, remuneration of an employment exercised aboard a ship operated in international traffic is further included (when documentary evidence is produced that tax has been paid in the other contracting country).

[¶8-3500] Aircraft income — tax relief arrangements with various countries

Hong Kong has entered into air services agreements with various countries. A number of these agreements include specific provisions to prevent the double taxation of international air traffic income. These provisions have been specified as double taxation arrangements for the purposes of s 49 of the *Inland Revenue Ordinance* (Cap 112).

Under the respective double taxation arrangements, income or profits, which are derived from the operation of aircraft in international traffic by an airline of one country, and which are subject to tax in that country, are exempt from income tax, profits tax and all other taxes on revenues, receipts, income or profits in the other country on a reciprocal basis.

The exemption generally applies to income, profits, revenues or gross receipts derived from the operation of aircraft for the carriage of persons, livestock, goods, mail or merchandise. Income from ticket sales, or from the provision of services connected with the carriage of persons, livestock, goods, etc are also included.

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The double taxation arrangements may also provide the following reciprocal exemptions:

- capital and assets of an airline of one country are exempt from taxes imposed by the other country on a reciprocal basis;
- gains from the alienation of aircraft operated in international traffic and movable property pertaining to the operation of such aircraft which are received by an airline of one country are exempt from tax in the other country;
- the operation of aircraft in international traffic carried on by an airline of one country is exempt from value-added tax and any similar tax imposed by the other country on a reciprocal basis; and
- property of a designated airline of one country relating to the operation of aircraft in the area of the other country is exempt from all taxes by the other country.

For the purposes of the double tax arrangements, "international traffic" generally means transport or carriage by an aircraft operated by an airline of a contracting party where the aircraft is not operated solely between places in the area of the other contracting party.

The double tax arrangements are contained in:

- *Specification of Arrangements (Government of Canada Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Republic of Korea Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of New Zealand Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Kingdom of the Netherlands Concerning Air Services) (Double Taxation) Order*;

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- *Specification of Arrangements (Government of the Federal Republic of Germany Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the United Kingdom of Great Britain and Northern Ireland Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the State of Israel Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Republic of Mauritius Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Russian Federation Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Kingdom of Norway Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Kingdom of Denmark Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Kingdom of Sweden Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the People's Republic of Bangladesh Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Republic of Estonia Concerning Air Services) (Double Taxation) Order*;
- *Specification of Arrangements (Government of the Republic of Croatia Concerning Air Services) (Avoidance of Double Taxation) Order*;
- *Specification of Arrangements (Government of the Macao Special Administrative Region) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Specification of Arrangements (Government of the Republic of Singapore) (Avoidance of Double Taxation on Income from Shipping or Aircraft Operations) Order*;
- *Specification of Arrangements (Government of the Democratic Socialist Republic of Sri Lanka) (Avoidance of Double Taxation on Income from Shipping and Air Transport) Order*;
- *Specification of Arrangements (Government of Hashemite Kingdom of Jordan) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Specification of Arrangements (Government of the Republic of Iceland) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Specification of Arrangements (Government of the Republic of Kenya) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Specification of Arrangements (Government of the State of Kuwait) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Specification of Arrangements (Swiss Federal Council) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (United Mexican States) Order*;
- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Republic of Finland) Order*;

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- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Federal Democratic Republic of Ethiopia) Order*;
- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Republic of Maldives) Order*;
- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (The Lao People's Democratic Republic) Order*; and
- *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (The Republic of the Fiji Islands) Order*.

Preventing Hong Kong residents from escaping tax

The *Inland Revenue Ordinance* (Cap 112) contains provisions to prevent Hong Kong resident aircraft owners from escaping tax completely.

It is specifically provided under the Ordinance that income from international air traffic earned by Hong Kong aircraft owners in territories outside Hong Kong with whom Hong Kong has concluded air service agreements ("arrangement territories") will be taxable in Hong Kong if it is not taxable in the territory in which it is earned (s 23C(2A)–(2D); see further ¶6-7980).

TAX TREATIES

[¶8-5000] Comprehensive tax treaties

The comprehensive agreement for the avoidance of double taxation signed between the Hong Kong Special Administrative Region Government and Belgium on 10 December 2003 represents an important milestone for Hong Kong. This agreement is the first comprehensive agreement for the avoidance of double taxation concluded by the government with another economy. In line with the government's objective to continue its discussions with countries outside the region and to start negotiations with some of Hong Kong's major regional partners, Hong Kong has signed a series of comprehensive double tax treaties with other countries. Please refer to the tax treaty table at the next page for further details.

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Finality of ruling

Once a ruling has been made it is final, irrespective of whether it is advantageous to the applicant or not. It is not subject to appeal and no further correspondence will be entertained by the Commissioner (DIPN No 31 (Revised), para 40).

Disclaimer of liability

A taxpayer who applies for an advance ruling cannot hold the Government, the Commissioner or any other public officer liable in respect of the *bona fide* exercise of any power or performance of any duty in accordance with Sch 10 (s 88A(8)).

Documentation

The Commissioner can request for documentation and other information on the completed transaction which was the subject of the advance ruling to ensure that it has been carried out in accordance with the ruling request (DIPN No 31 (Revised), para 53).

All documentation submitted to support a request for an advance ruling will be retained by the Commissioner, irrespective of whether a ruling is issued or the request is subsequently withdrawn (DIPN No 31 (Revised), para 37).

ANTI-AVOIDANCE MEASURES

[¶13-3000] Overview

- A variety of measures designed to counteract deliberate tax avoidance schemes are contained within Pt X of the Ordinance. These measures prevent taxpayers from authorised their tax liabilities through:
  - (i) the use of "artificial or fictitious transactions" (see ¶13-5200);
  - (ii) the implementation of transactions with the sole or dominant purpose of producing a tax benefit (see ¶13-5800); or
  - (iii) the sale of loss companies (see ¶13-6700).
- Taxpayers are also specifically prevented from avoiding their Hong Kong profits tax liability through the use of transfer pricing. Provision is made in Pt IV of the Ordinance for profits tax to be charged on a non-resident when profits have been authorise overseas through transfer pricing arrangements (see ¶13-3700).
- Measures were introduced in August 1995 to curb the avoidance of tax through the use of service companies, in particular:
  - (i) the disguise of employer/employee relationships by the involvement of service companies; and
  - (ii) the deduction by unincorporated businesses of inflated management fees paid to service companies which they control (see ¶13-4300ff).

[¶13-3300] Commercial purpose or fiscal nullity principle

United Kingdom case law has developed what may be referred to as the commercial purpose principle or the principle of fiscal nullity, or the "*Ramsay*" principle. According to that principle, where there has been a pre-ordained series of transactions, or one single composite transaction, into which steps have been inserted which have no commercial purpose other than to avoid tax, then the inserted steps are disregarded for tax purposes (*Furniss v Dawson* (1984) AC 474; *IRC v Burmah Oil Co* (1982) BTC 56; *WT Ramsay Ltd v IR Commrs* (1981) 54 TC 101).

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Courts in Australia and Canada have found that the commercial purpose or fiscal nullity principle does not apply when taxation legislation contains anti-avoidance measures (*FC of T v Patcorp Investments Ltd* 76 ATC 4225; *Oakey Abattoir Pty Ltd v FC of T* 84 ATC 4718; *Stubart Investments Ltd v R* (1984) DTC 6305). The Board of Review, following these cases, has rejected the commercial purpose principle for Hong Kong tax cases in relation to the *Inland Revenue Ordinance* (Cap 112).

In *D52/86* IRBRD Vol 2, 314, the Board of Review found that the Hong Kong situation is similar to that in Australia and adopted the reasoning of the Patcorp Investments and *Oakey Abattoirs* cases. In view of the availability of anti-avoidance legislation in Hong Kong under the *Inland Revenue Ordinance* (Cap 112), it was found that the *Furniss v Dawson* principle had no application. To date *D52/86* has been the only Hong Kong decision on this issue.

Note, in the context of stamp duty and estate duty, that the *Stamp Duty Ordinance* (Cap 117) and *Estate Duty Ordinance* (Cap 111) do not contain any general anti-avoidance provisions. Accordingly, the commercial purpose/fiscal nullity principle set out in *Furniss v Dawson* may be applicable to schemes undertaken to ▯ uthoriz stamp duty and estate duty liability. As a result of the *Revenue (Abolition of Estate Duty) Ordinance 2005*, no estate duty will be charged on the estates of those people dying on or after 11 February 2006.

For more on anti-avoidance, refer to ¶14-8000 in Chapter 14.

Transfer pricing

[¶13-3700] Countering effects of transfer pricing

Transfer pricing is concerned with prices charged between associated enterprises for the transfer of goods, services and intangible property.

The Commissioner is authorised to prevent profits tax from being avoided through the authorised of assessable profits out of Hong Kong by a resident taxpayer through pricing arrangements entered into with a non-resident. When a non-resident carries on business in close connection with a Hong Kong resident and the business is arranged so as to produce no profits for the resident, or less than the ordinary profits that could be expected to be sourced in Hong Kong, the business is deemed to have been carried on in Hong Kong (s 20(2)). The non-resident person is then assessable and chargeable to tax on the business' profits in the name of the resident. The non-resident is taxed, as if the resident were his or her agent, on the whole of the profits he or she derived from the business.

A "close connection" must exist between the two parties to the arrangement for this anti-avoidance provision to apply. The Commissioner has the discretion to decide if such a connection exists. Parties are regarded as being "closely connected" if the Commissioner considers, in his discretion, that they are substantially identical or that their controlling interests are owned (or deemed to be owned) by the same person or persons (s 20(1)(a)).

For the purposes of this provision, the controlling interest of a company is deemed to be owned by the beneficial owners of its shares held either directly or through nominees. Shares in one company held by or on behalf of another company are considered to be held by the shareholders of the latter company (s 20(1)(b)).

The Inland Revenue Department issued DIPN No 46: Transfer Pricing Guidelines — Methodologies and Related Issues in December 2009. In general, when transfer pricing does not follow the arm's length principle such that the profits or tax liabilities of associated enterprises are distorted, the Inland Revenue Department will seek to impose transfer pricing adjustments to reallocate profits or adjust deductions by

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substituting an arm's length consideration. The arm's length principle refers to the allocation of profits and expenses relating to transactions between associated enterprises, having regard to how independent enterprises deal with each other in the same circumstances. While an adjustment may be initiated by the Inland Revenue Department as authorized under the *Inland Revenue Ordinance* (Cap 112), an adjustment may also be made pursuant to the double taxation arrangements between Hong Kong and other jurisdictions.

DIPN No 46 includes extensive discussion of tax schemes aiming at tax evasion through related party transactions without any commercial reason. If transfer pricing is used to siphon profits to offshore companies, the Inland Revenue Department will invoke s 61A to combat the tax benefit obtained. For profits transferred to a "closely connected" non-resident enterprise in a transfer pricing scheme, the Inland Revenue Department can invoke s 20(2).

[¶13-4000] Residence of relevant parties

The anti-avoidance provision for transfer pricing under s 20(2) only operates when it involves a resident and a non-resident who are closely connected. It does not operate when both parties are residents or non-residents.

A company is normally considered to reside at the place where its central management and control is located. This is a matter to be decided on the facts of the case (*De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes)* (1906) AC 455). The place of central control is often the place where the directors of the company meet to do business (*Koitaki Para Rubber Estates Ltd v FC of T* (1940) 6 ATD 42). The place where the company's decisions are made is also important for determining the residence (*Esquire Nominees Ltd v FC of T* 73 ATC 4114). In the case of *Malayan Shipping Co Ltd v FC of T* (1946) 8 ATD 75, a company in which the resolutions of directors were subject to approval by the company's shareholders was found to reside in the place where the shareholders met to approve the resolutions.

A company may have a residence in more than one place (*Swedish Central Railway Co Ltd v Thompson (Inspector of Taxes)* (1925) 9 TC 342).

For the factors which may be taken into account to determine where an individual "resides", see ¶4-1200.

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Service companies

[¶13-4300] Counteracting tax avoidance arrangements

Two types of arrangements involving service companies, which are designed to reduce the overall tax liability of the parties involved, have been of particular concern to the Inland Revenue Department, namely:

(i) where an employer/employee relationship is disguised by the involvement of a service company ("Type I" arrangements); and

(ii) where an unincorporated business claims deductions for inflated management fees paid to a service company which is controlled by the proprietor or partners of the business ("Type II" arrangements).

The first of these arrangements has been targeted by anti-avoidance legislation under which remuneration which is paid to a service company for the services of an individual who (or whose associate) controls it is deemed to be income derived by that individual from employment which is assessable to salaries tax (see ¶13-4600 and ¶2-0550). This type of arrangement is the subject of DIPN No 25 (Revised): Service Company "Type I" Arrangements, Salaries Tax.

The second type of arrangement is the subject of DIPN No 24 (Revised): Profits Tax — Service Company "Type II" Arrangements (see ¶13-4900).

[¶13-4600] Disguised employer/employee relationship

The following example demonstrates how tax liability is reduced by disguising an employee/employer relationship through the involvement of a service company.

Example 1

(I) Direct employment situation

In the direct employment situation, Company A pays Mr X an annual remuneration package of $960,000, comprising the following elements:

		$	
☐	salary:	635,000	(in terms of costs to the employer)
☐	accommodation:	280,000	
☐	holidays:	45,000	
	Total:	960,000	

For the assessment of tax, the salary of $635,000 is fully taxable and, in accordance with the *Inland Revenue Ordinance* (Cap 112), the Inland Revenue Department takes 10% of this amount to be the taxable value of Mr X's accommodation (ie $63,500). The Ordinance specifically exempts the value of his holiday passage for tax assessment purposes (though with effect from the 2003/04 year of assessment, the exemption for holiday warrant and passage has been removed). As a result, Mr X's total taxable income would be $698,500, on which he has to pay $104,775 as salaries tax*.

(II) Service company situation

This situation involves the introduction of a service company, S C Ltd, to which Company A pays a fee of $960,000. (NB Company A pays the same amount direct to Mr X as the cost of his remuneration package in the first situation.) S C Ltd in turn provides Mr X and Mrs X with generous employee benefits.

For the assessment of tax, S C Ltd has no tax liability as it uses its entire income of $960,000 to remunerate Mr X and Mrs X in a tax efficient manner and to meet secretarial and audit costs.

For Mr X the only taxable elements of his remuneration are his salary ($220,000) and the value of his accommodation of $22,000 (ie 10% of $220,000). After deducting salaries tax allowances of $130,000* for two dependent children and two dependent parents from the total chargeable income of $242,000, Mr X has a net taxable income of $112,000 on which he has to pay $16,200 as salaries tax.

As for Mrs X, after deducting the basic allowance of $56,000* she has a net taxable income of $44,000 on which she has to pay $2,560 as salaries tax.

The overall tax liability in this situation is $18,760, that is $86,015 (or 82%) less than the tax payable in the direct employment situation.

In both the direct employment situation and the service company situation, the cost to Company A is the same, ie $960,000.

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Minimum requirements for deductibility of management fee

There are essentially two requirements for deductibility set down by the Inland Revenue in DIPN No 24 (Revised):

(i) *Arm's length basis*. The service company and the business claiming the deduction must function separately, on an arm's length basis.

(ii) *Commercially realistic amount*. The amount claimed must be commercially realistic. It should reflect the costs of the service company directly attributable to the qualifying services provided to the taxpayer (plus an appropriate mark-up for operating expenses and a reasonable profit margin). "Qualifying services" are the services required by the taxpayer in order to produce chargeable profits.

If a taxpayer does not establish that a deduction claimed for a management fee is commercially realistic, the Inland Revenue will presume that the fee was paid, at least in part, for a purpose unrelated to the production of chargeable profits. If it can be ascertained or reasonably estimated, the amount of the deduction that is not commercially realistic will be denied. If this is not possible, the Inland Revenue may disallow the whole claim.

The Inland Revenue's minimum requirements for the deductibility of service company management fees are examined in more detail in ¶6-5740.

Application of general anti-avoidance provisions

DIPN No 24 (Revised) emphasises the importance of a commercial rationale for a service company arrangement and the need for the parties to act on an arm's length basis (para 11 and 12). Taxpayers are warned that s 61 may be applied (as in *Case* D47 (*D32/94*)) if a service company is not operated on a commercial basis and s 61A may be applied if the sole or dominant purpose of the arrangement is to obtain a tax benefit.

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Artificial or fictitious transactions

[¶13-5200] Artificial and fictitious transactions disregarded

To counteract tax avoidance, an assessor is authorised to disregard any transaction or disposition if he or she believes that the transaction reduces or would reduce a taxpayer's liability and the transaction is artificial or fictitious, or the relevant disposition is not given effect to (s 61). The power to disregard an apparently artificial transaction or ineffectual disposition is discretionary. If an assessor chooses to exercise this power, the taxpayer whose liability would have been reduced is assessed as if the transaction or disposition had never been conducted.

The general power to disregard artificial or fictitious transactions which is provided under sec 61 has been largely superseded by more comprehensive and effective anti-avoidance powers provided under sections introduced to the Ordinance at a later stage (s 61A and 61B; see ¶13-5800 and ¶13-6700). Section 61, however, may still be used to counteract tax avoidance schemes which were entered into before the introduction of the additional powers and to catch those schemes which on certain occasions do not fall within their scope.

However, while s 61 applies to artificial or fictitious transactions and s 61A applies to transactions with the sole or dominant purpose of obtaining a tax benefit, it will be an error of law in applying s 61 and 61A simultaneously. The correct approach is to apply s 61 first, failing which s 61A may be applied.

For s 61 to apply, three essential factors are:

(i) there must be a transaction;

(ii) the transaction has the effect of reducing the tax payable by the taxpayer concerned; and

(iii) the transaction is artificial or fictitious, or that any disposition is not in fact given effect to (DIPN No 15 (Revised), para 25).

[¶13-5500] When is a transaction "artificial" or "fictitious"?

To determine if a transaction should be disregarded, an assessor must determine whether it is "artificial" or "fictitious". The whole transaction should be considered (*Rico Internationale v Commissioner of Inland Revenue* (1965) 1 HKTC 229). "Transaction" for the purposes of sec 61 includes the whole transaction, not merely part of it (*Kum Hing Land Investment Co Ltd v Commissioner of Inland Revenue* (1967) 1 HKTC 301).

In the *Rico International* case, it was held that a taxpayer's "ulterior object" may be taken into consideration. A later Privy Council decision relating to Jamaican tax law indicates, however, that it is only the transaction itself which needs to be looked at (*Seramco Ltd Superannuation Fund Trustees v ITC* (1977) AC 287). The later view was accepted in Hong Kong in the case of *Commissioner of Inland Revenue v Douglas Henry Howe* (1977) 1 HKTC 936.

In the *Douglas Henry Howe* case, Cons J, quoting from the *Seramco* case, indicated that a "fictitious transaction" is one which was never intended to be carried out by those who were ostensibly the parties to it. An "artificial transaction" was regarded to be of wider import. Transactions which have been carried out but are commercially unrealistic are normally considered to have been "artificial" (*Cheung Wah Keung v Commissioner of Inland Revenue* (2003) HKRC ¶90-124).

Commercially realistic transactions not struck down

Commercially realistic transactions or schemes will not be struck down under s 61. This was clear in Board of Review *Case* F31 (1996) HKRC ¶80-409 (*D67/95* IRBRD Vol 11, 44) in which the Board ruled that a commercially realistic corporate reorganisation scheme with "incidental" tax benefits could not be struck down by the anti-avoidance provisions of the *Inland Revenue Ordinance* (Cap 112).

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Transactions with tax benefit purpose

[¶13-5800] Transactions with sole or dominant purpose of tax benefit

When a transaction has been entered into which has the effect of conferring a tax benefit upon a taxpayer, and it can be concluded that the taxpayer entered into or carried out the transaction for the sole or dominant purpose of obtaining that benefit, s 61A, an anti-avoidance provision of broad scope, operates. When this section applies, the relevant taxpayer's tax liability is assessed either:

- as if the whole transaction, or part of it, had not been entered into or carried out; or
- in any other manner considered appropriate to counteract the tax benefit (s 61A(2)).

The former involves the Assistant Commissioner disregarding all of the consequences of either the whole, or a part of, the transaction. The latter normally involves the Assistant Commissioner making an assessment on the basis that the transaction was entered into in a manner normally employed when that type of transaction is carried out at arm's length.

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