Case No. D13/03

Profits tax – whether the sale of a property was trading in nature – it was crucial to ascertain the intention of the appellant at the time of acquisition of the property – the stated intention of the appellant was not decisive – actual intention had to be determined objectively – direct evidence of those involved at the time of the acquisition would be highly relevant – burden of proof on the appellant – incumbent on the appellant to substantiate its contention – sections 29(6), 51(1), 51(2), 51C, 51D, 59(2), 59(3), 59(4), 60(1), 60(2), 63K, 68(4), 70A, 79 and 80 of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Barry J Buttifant and Robert Michael Wilkinson.

Dates of hearing: 13 and 14 December 2002.
Date of decision: 10 May 2003.

This was an appeal against the determination of the Commissioner of Inland Revenue dated 23 August 2002 whereby:

(a) Profits tax assessment for the year of assessment 1998/99 showing net assessable profits of $5,978,524 (after set-off of loss brought forward of $5,922,829) with tax payable thereon of $956,563 was confirmed.

(b) Additional profits tax assessment for the year of assessment 1998/99 showing additional net assessable profits of $3,527,970 (after set-off of loss brought forward of $2,394,859) with additional tax payable thereon of $564,476 was reduced to additional net assessable profits of $2,212,816 (after set-off of loss brought forward of $3,710,013) with additional tax payable thereon of $354,051.

There are two issues in this appeal. The first issue was whether the Fourth Lots were capital assets. The second issue was whether, in the absence of fraud, the respondent can re-open a loss after more than six years.

The facts appear sufficiently in the following judgment.

Held:

1. Issue 1: capital assets?

(a) Section 2 defines 'trade' as including *'every trade and manufacture, and every adventure and concern in the nature of trade'*.

(b) Section 14(1) excludes profits arising from the sale of capital assets.

(c) The Board reminded itself of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

(d) The Board also reminded itself of what Mortimer J (as he then was) said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771.

(e) The intention, according to the evidence given by a former director of the appellant, was to build holiday resort houses of about 700 square feet each for rental. The appellant asserted that the total area of the house lots was about 12,000 square feet and the total area of the agricultural land was about 77,000 square feet.

(f) Whether the appellant's intention at the time of the first acquisition was to build holiday resort houses of about 700 square feet each and to hold them for an indefinite period for rental income was a question of fact. The Board decided against the appellant on this factual issue for the following reasons.

(g) The area of the house lots varied from 330 square feet to 484 square feet. The land between each of the three rows of the 24 house lots was government land. The Board had not been told anything about:

  (i) the intended location of the 17 holiday resort houses of about 700 square feet each;

  (ii) what the houses would look like;

  (iii) the use, if any, of the agricultural land with an area of about 77,000 square feet; or

(iv) what facilities, if any, would be built or developed for the use of the tenants of the resort houses.

(h) The first acquisition was on 3 January 1990. By letter dated 4 or 6 March 1990 (the date on the copies submitted to the Board was illegible), the appellant applied for certificates of exemption in respect of all the house lots.

(i) Within a matter of days, the appellant requested the District Lands Office by letter dated 12 March 1990 to 'withhold' its application because there were 'certain changes to the intended development'.

(j) On 2 May 1990, the appellant sold the First Lots. These were objective facts and they were objective facts which contradict the stated intention. The sale was important because it took place within four months of the first acquisition (and probably explains the request to the District Lands Office to withhold consideration of the appellant's application) and because the land sold, that is, the First Lots, lied in the heart of the appellant's land. The explanation given was that:

> ' Because at that time a friend of mine told me that he needed that piece of land. He liked it. And we have calculated that we have enough land for development. And one of the reasons is to cut down the cost of development.'

(k) The Board rejected the explanation. The appellant claimed that the whole of the land (or pieces of land) acquired in the first acquisition was to be redeveloped. It was not a question of whether there would be 'enough' land left after selling the heart of the appellant's land. It was a question of how much the sale would cut into the original development plan and how the appellant intended to redevelop the leftovers. The Board had not been told how the leftovers fitted, if at all, into the original development plan, or how the original plan was modified to accommodate the sale of the First Lots.

(l) Having sold the First Lots on 2 May 1990, the appellant applied by letter dated 15 May 1990 for certificates of exemption in respect of six out of the 24 house lots on the basis of *in situ* redevelopment. This was an objective fact against the stated intention to build 17 houses of about 700 square feet each, bearing in mind that the area of these six house lots varies from 441 square feet to 484 square feet. Moreover, despite the fact that the certificates of exemption were issued on 29 August 1990, the appellant took no step to build any house. This belied the stated intention or any intention to build.

(m) The appellant's case was anything but coherent. The next event which the appellant chose to tell the Board about was an application more than one year later by letter dated 10 October 1991 to apply for certificates of exemption in respect of 16 more house lots. The Board had not been told why the appellant left out two house lots.

(n) The Board had yet another unexplained gap. About 11 months later, the appellant applied for land exchange by letter dated 4 September 1992. The Board had not been told why the appellant applied for land exchange. Nor had the Board been told why the appellant did not apply for land exchange until two years and eight months after the first acquisition. On 8 October 1992, the application was rejected on the ground that:

'[the] application for land exchange for development of New Territories Exempted Houses cannot be proceeded as no exempt buildings will be allowed in an exchange.'

(o) The appellant then skipped to a letter dated 1 September 1993, leaving the Board with an unexplained gap of about ten and a half months. By 13 February 1995, the application had not been approved because the District Lands Office required:

'Building plans/sketch plans showing the redevelopment proposal containing relevant information such as dimensions, area, height, position of staircase, stairhood, projections, entrance, position of septic tank, etc.'

(p) The appellant agreed that the set of plans said to be drawn up in 1992 fitted the description of the sketch plans called for. The appellant also agreed that this set of plans had not been submitted to the District Lands Office. The appellant's case on why the purported 1992 plans had not been submitted was that:

'Because there is no need to submit the plans for application for exemption.'

(q) With such evidence, the Board was unable to see how the appellant could succeed on the factual issue.

(r) The balance sheet of the appellant as at 31 December 1989 showed that it had net current liabilities of $7,760,774 and a net asset value of $1,504,110. The first acquisition was on 3 January 1990. The balance

sheet of the appellant as at 31 December 1990 showed that it had net current liabilities of $32,766,829 and a net deficit of $1,194,197.

(s) There was no evidence on the cash flow of the appellant as at the date of the first acquisition.

(t) There was no evidence on the personal net worth of the shareholders or directors of the appellant as at the date of the first acquisition. There was also no evidence on the cash flow of any of them.

(u) There was no evidence on the appellant's financial ability to build and hold the houses for an indefinite period. The reason given for the sale of the First Lots quoted above suggested that the appellant had to 'cut down the cost of development' within four months of the first acquisition.

(v) There was no evidence on the actual rental of any or any comparable 'resort' houses.

(w) For the above reasons, the appellant had not proved any of the following and its case of the first acquisition as capital assets failed:

(i) that at the time of the first acquisition, the intention of the appellant was to build holiday resort houses and to hold the houses on a long term basis;

(ii) that such intention was genuinely held, realistic or realizable;

(iii) its financial ability, with or without its shareholders, to build and retain the houses for an indefinite period.

(x) The appeal on the gain from the disposals of land acquired in the first acquisition failed.

(y) There was no allegation or evidence that the second acquisition was for long term holding or for redevelopment. There was no evidence on the intended use of the agricultural land. The Commissioner held that the Land Lots (which comprised land acquired in both acquisitions) were purchased by the appellant with the intention of reselling them at a profit. Any case of the second acquisition as capital assets failed at the outset.

2. Issue 2: revisiting a loss more than six years ago

(a) There was no suggestion of fraud in this case.

(b) The respondent accepted that the gain of $3,490,917 derived by the appellant from the resumption of the Third Lots accrued to the appellant in the year of assessment 1993/94 instead of 1996/97. The correct net assessable profits for the year of assessment 1993/94 are $1,315,154, after setting off the loss per return of $2,175,763.

(c) The respondent could not assess the profits of $1,315,154 for the year of assessment 1993/94 under section 60 of the IRO because more than six years had elapsed since the year of assessment 1993/94.

(d) Instead of assessing the appellant on the correct net assessable profits of $1,315,154, or leaving the reported loss of $2,175,763 undisturbed, the respondent attributed a nil balance to the 'loss carried forward' for the year of assessment 1993/94. The respondent approached it on the basis that there was 'nothing in the IRO which prevents the Assessor from revising the statements of loss previously issued' to the appellant ('the respondent's approach').

(e) To start with, the nil balance was artificial, fictitious, and mathematically wrong. The correct amount was $1,315,154.

(f) Further, the respondent asked the wrong question.

(g) The question was not whether there is any provision in the IRO which prevents the assessor from taking a certain course. The correct question was whether there is a provision in the IRO which empowers or requires the assessor to take such a course.

(h) The power of the respondent and her assessors to assess was conferred by statute. Their work was by its nature quite intrusive. They probed into private matters of taxpayers and assessed them to tax. The Board was not aware of any inherent jurisdiction on the part of the respondent or her assessors and the respondent had not argued that there was any. The respondent had not been able to point to any provision in the IRO or any other ordinance empowering or requiring the respondent or an assessor to revisit a loss more than six years ago. In the Board's decision, the respondent's approach was neither authorized nor required by statute. It also exceeded the powers under Parts IX and X of the IRO, including section 60(1) and (2) in particular.

(i) Section 51(1) confers on an assessor the power to give notice in writing to any person requiring him to furnish tax returns.

(j) Section 51(2) imposes on every person chargeable to tax to inform the respondent that he is so chargeable.

(k) In respect of any year of assessment, where a person has furnished a return in accordance with the provisions of section 51 the assessor may either (a) accept the return and make an assessment accordingly, or (b) if he does not accept the return, estimate the sum in respect of which such person is chargeable to tax and make an assessment accordingly under section 59(2). Where a person has not furnished a return and the assessor is of the opinion that such person is chargeable with tax, he may estimate the sum in respect of which such person is chargeable to tax and make an assessment accordingly under section 59(3). In the case of profits from a trade or business, if accounts of such trade or business have not been kept in a satisfactory form, the assessor may assess the profits or income of such trade or business on the basis of the usual rate of net profit on the turnover of such trade or business under section 59(4).

(l) Whether or not a person has furnished a return and whether or not an assessor has assessed under section 59, an assessor may assess, or additionally assess, under section 60(1) which provides that:

'Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, and the provisions of this Ordinance as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to the tax charged thereunder:'

(m) Section 60(1) is subject to the proviso on fraud which provides that:

'where the non-assessment or under-assessment of any person for any year of assessment is due to fraud or wilful evasion, such assessment or additional assessment may be made at any time within 10 years after the expiration of that year of assessment.'

(n) The respondent could not proceed under section 60(1) in this appeal because of the six-year limit and because there was no suggestion of fraud.

(o) Section 60(1) was against the respondent's contention for two reasons.

(i) The Board tested the respondent's case by assuming (contrary to the facts in this case) that the appellant had reported a profit (instead of a loss) of $5,688,446 for the year of assessment 1994/95, and assuming further that more than six years after the expiration of the year of assessment 1994/95 had elapsed by the time of the determination. Adopting the respondent's approach, the appellant's loss for the year of assessment was 'nil' and the appellant should therefore be assessed or further assessed for the year of assessment 1994/95 on re-opening the loss in the year of assessment 1993/94. But the respondent was out of time under section 60(1) by the time of the determination. If the respondent had power to re-open a loss at any time, there is no or no valid reason why such power should depend on whether more than six years had since elapsed from the time when profits first exceeded the corrected amount of loss (if any).

(ii) Even in a case of fraud, the respondent's hands were tied after ten years. If the respondent's contention was correct, there would be no time limit so far as loss was concerned. It was absurd that a taxpayer who fraudulently or wilfully evaded tax may get away with tax after ten years but an honest but mistaken taxpayer was forever liable to have his loss re-opened.

(p) Where tax had been repaid by mistake, whether of fact or law, the assessor may assess under section 60(2) to claim back the mistaken repayment. The word used in this subsection is 'repaid' whereas the word used in section 63K is 'refund'. The Board had considered the difference in wording but concluded that there was no material difference between repayment and refund. Where provisional tax paid in the preceding year of assessment was repaid or refunded because of the mistake of fact that the taxpayer had suffered a loss when in truth and in fact the taxpayer had earned a profit, the assessor may assess under section 60(2) which provides that:

'Where it appears to an assessor that the whole or part of any tax repaid to a person (otherwise than in consequence of an assessment having been determined on objection or appeal) has been repaid by mistake, whether of fact or law, the assessor may, within the year of assessment to which the repayment relates or within 6 years after the

expiration thereof, assess such person in the amount of tax so repaid by mistake, and the provisions of this Ordinance as to notice of assessment, objection, appeal and other proceedings shall apply to such assessment and to the tax charged thereunder.'

(q) Assume a taxpayer reported a loss in a year of assessment. Also assume that the assessor accepted the return as correct, and the provisional tax paid by the taxpayer during the preceding year of assessment was then refunded under section 63K which provides that:

'When any person has paid provisional profits tax in respect of any year of assessment, the Commissioner shall, not later than when he gives notice of assessment of profits tax, apply the amount of provisional profits tax so paid in payment first of –

(a) the profits tax payable by that person for that year of assessment; then

(b) the provisional profits tax payable in respect of the year of assessment succeeding that year of assessment,

and shall refund to the person paying the provisional profits tax the amount thereof not so applied.'

(r) Assume further that subsequently, the assessor discovered that the repayment or refund was by mistake. Upon discovering the repayment by mistake, the assessor may assess under section 60(2) to offset the repayment or refund, and, if necessary, assess under section 60(1). However, both subsections were subject to the six-year limit and the respondent could not get back any tax repaid or refunded more than six years ago.

(s) The appellant's tax computation for the year of assessment 1992/93 reported net assessable profits of $7,606,599 and tax thereon of $1,331,154 and provisional tax of $2,463,027 for the year of assessment 1993/94.

(t) The Board did not know whether the appellant had paid provisional tax for the year of assessment 1993/94. Nor did the Board know whether any provisional tax for the year of assessment 1993/94 had been refunded under section 63K in view of the loss reported for the year of assessment 1993/94 and the issue of the statement of loss by the assessor. If tax had in fact been

repaid, the assessor could not proceed under section 60(2) because of the six-year limit. Since the assessor could not get back the tax repaid and could not assess the appellant for the year of assessment 1993/94, there was no reason why the appellant could assign an artificial nil figure for the year of assessment 1993/94.

(u) Irrespective of whether there was a tax refund in this case and irrespective of whether section 60(2) covers a refund of provisional tax because of a mistaken acceptance of a loss, the six-year limit appears in both subsections (1) and (2) of section 60. Not only is there no provision in the IRO empowering or requiring the respondent to re-open a statement of loss issued by an assessor in respect of a year of assessment more than six years ago, the respondent's approach was contrary to the statutory scheme that, in the absence of fraud, there was finality in tax matters after six years.

(v) Section 29(6) provides that any revocation of a claim for married person's allowance for a couple living apart must be made within six years after the expiration of the year of assessment.

(w) Section 60 is the second provision with a six-year limit.

(x) An application under section 70A to correct errors must be made within six years after the end of a year of assessment or within six months after the date on which the relative notice of assessment was served. While on this section, the Board noted that it must be established to the satisfaction of the assessor that 'the tax charged for that year of assessment is excessive'. As there was no tax charged for the year of assessment 1996/97, the application concerned was clearly misconceived.

(y) Any application under section 79 for refund of tax in excess of the amount with which a taxpayer was properly chargeable for a year of assessment must be made within six years of the end of a year of assessment or within six months after the date on which the relevant notice of assessment was served, whichever is the later.

(z) Section 80(3) provides that no person shall be liable to any penalty under section 80 unless the complaint concerning such offence was made in the year of assessment in respect of or during which the offence was committed or within six years after the expiration thereof.

(aa) The time limit of six years from the end of a year of assessment runs through the provisions referred to above. Consistent with this is the duty to keep records for seven years.

(ab) The duty of every person carrying on a trade, profession or business in Hong Kong to keep and retain sufficient records under section 51C is limited to not less than seven years after the completion of the transactions, acts or operations to which they relate.

(ac) Likewise, the duty of every person who is the owner of land or buildings or land and buildings situated in Hong Kong to keep and retain sufficient records under section 51D is limited to not less than seven years after the completion of the transactions, acts or operations to which they relate.

(ad) The power under section 51D to require a taxpayer to furnish an assets betterment statement cannot go beyond seven years before the commencement of the year of assessment in which the notice is given.

(ae) Last but not least, although lapse of time affected both the appellant and the respondent, it was more likely that long lapse of time would prejudice the appellant rather than the respondent because of onus of proof under section 68(4) which falls on the appellant. Since the legislature has seen fit to restrict the duty to keep and retain records to seven years, there is no reason why the respondent and her assessors should be permitted to revisit a loss more than six years ago.

3. For the above reasons, the appellant succeeded only in respect of the gain from the resumption of the Third Lots.

4. The Board believed that the original profits tax assessment for the year of assessment 1998/99 should be confirmed and that the additional profits tax assessment for the year of assessment 1998/99 as reduced by the Commissioner should be reduced from additional net assessable profits of $2,212,816 (made up of the 1993/94 loss of $2,175,763 and the gain of $37,053 on disposal of the Second Lot) to additional net assessable profits of $37,053.

5. But as the Board had not heard the parties on the outcome of the appeal in the event the appellant succeeded only on the gain from the resumption of the Third Lots, the better course was to remit.

6. The appeal succeeded in part, but only to the extent that the respondent should not have interfered with loss of $2,175,763 for the year of assessment 1993/94. The

Board remitted both assessments appealed against to the respondent to revise to give effect to its decision.

Appeal remitted to the Commissioner for re-assessment.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750

Tse Yuk Yip for the Commissioner of Inland Revenue.
V Robert Lew of BKR Lew & Barr Limited for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 23 August 2002 whereby:

(a) Profits tax assessment for the year of assessment 1998/99 under charge number 1-1105059-99-3, dated 10 August 2000, showing net assessable profits of $5,978,524 (after set-off of loss brought forward of $5,922,829) with tax payable thereon of $956,563 was confirmed.

(b) Additional profits tax assessment for the year of assessment 1998/99 under charge number 1-1107785-99-3, dated 18 October 2000, showing additional net assessable profits of $3,527,970 (after set-off of loss brought forward of $2,394,859) with additional tax payable thereon of $564,476 was reduced to additional net assessable profits of $2,212,816 (after set-off of loss brought forward of $3,710,013) with additional tax payable thereon of $354,051.

The admitted facts

2. The facts in the ' Facts upon which the determination was arrived at' in the determination were admitted by the Appellant and we find them as facts.

3. For the purpose of our decision, the following statement of those facts suffices.

4. The Appellant objected to the original and additional profits tax assessments raised on it for the year of assessment 1998/99, claiming that the profits derived by it from the disposal of certain land lots were capital in nature and should not be assessable to tax.

5. The Appellant was incorporated as a private company in Hong Kong on 4 December 1984. At all relevant times, its authorised and paid-up capital were $10,000 and $2 respectively. By a resolution dated 23 December 1998 the Appellant increased its issued share capital to $100.

6. (a) By an assignment dated 3 January 1990 ('the first acquisition') the Appellant purchased 24 house lots and 16 lots of agricultural land in the New Territories at a total consideration of $15,253,200.

(b) By an assignment dated 4 March 1991 ('the second acquisition') the Appellant purchased two more lots of agricultural land at a consideration of $750,000.

(c) The land lots set out in (a) and (b) above are hereinafter referred to collectively as 'the Land Lots'.

7. Since acquisition, the Land Lots were classified in the Appellant's accounts as 'Land held for development'.

8. (a) On 2 May 1990 the appellant sold two lots of agricultural land acquired in the first acquisition ('the First Lots') and derived a gain of $321,616. The gain was treated by the Appellant in its accounts as an exceptional item and not offered for assessment.

(b) The Appellant's accounts for the year ended 31 December 1996 included a total gain of $3,527,970 from the disposal of land. The gain comprised $37,053 from the sale of one lot of agricultural land acquired in the first acquisition ('the Second Lot') and $3,490,917 from the resumption by the Government of part of the agricultural land acquired in the second acquisition ('the Third Lots'). The Appellant did not offer the gain for assessment.

(c) By assignment dated 14 January 1998 the Appellant sold 13 lots of agricultural land and all 24 house lots ('the Fourth Lots') for a consideration of $27,000,000. The Appellant derived a gain of $15,479,734 from the sale. It did not offer the gain for assessment.

9. The Appellant's claim that the profit on disposal of the First Lots was capital in nature was then accepted by the assessor.

10. In a note attached to the proposed tax computation for the year of assessment 1998/99, the Appellant explained why it considered the gain on disposal of the Fourth Lots was not assessable to tax.

11. On various dates the assessor issued the following statements of loss to the Appellant:

(a) Year of assessment 1993/94

	$
Loss per return and carried forward	2,175,763

(b) Year of assessment 1994/95

	$
Adjusted loss for the year	5,688,446
Add: Loss brought forward	2,175,763
Loss carried forward	7,864,209

(c)	Year of assessment 1995/96	$
	Profit per return	463,728
	Less: Loss brought forward set off	463,728
	Net assessable profits	Nil

	Statement of loss	$
	Loss brought forward	7,864,209
	Less: Loss set-off	463,728
	Loss carried forward	7,400,481

(d)	Year of assessment 1996/97	$
	Assessable profits for the year	2,677,503
	Less: Loss brought forward set-off	2,677,503
	Net assessable profits	Nil

	Statement of loss	$
	Loss brought forward	7,400,481
	Less: Loss set-off	2,677,503
	Loss carried forward	4,722,978

(e)	Year of assessment 1997/98	$
	Adjusted loss for the year	1,199,851
	Add: Loss brought forward	4,722,978
	Loss carried forward	5,922,829

(f)	Year of assessment 1998/99	$
	Adjusted loss for the year	3,578,381
	Add: Loss brought forward	5,922,829
	Loss carried forward	9,501,210

The Appellant did not express any disagreement with the above statements of loss.

12. On 10 August 2000 the assessor issued to the Appellant the following profits tax assessment:

Year of assessment 1998/99	$
Loss per return	3,578,381
Less: Gain on disposal of the Fourth Lots	15,479,734
Assessable profits	11,901,353
Less: Loss brought forward set-off	5,922,829
Net assessable profits	5,978,524
Tax payable thereon	956,563

13. On 18 October 2000 the assessor issued to the Appellant the following revised statements of loss and additional profits tax assessment:

(a)	Year of assessment 1996/97	$

Profits per return	2,677,503
Add: Gain on disposal of the Second Lot and the Third Lots	3,527,970
Assessable profits	6,205,473
Less: Loss brought forward set-off	6,205,473
Net assessable profits	Nil

Statement of loss	$
Loss brought forward	7,400,481
Less: Loss set-off	6,205,473
Loss carried forward	1,195,008

(b) Year of assessment 1997/98

	$
Adjusted loss for the year	1,199,851
Add: Loss brought forward	1,195,008
Loss carried forward	2,394,859

(c) Year of assessment 1998/99 (Additional)

	$
Assessable profits for the year	11,901,353
Less: Loss brought forward set-off	2,394,859
Net assessable profits	9,506,494
Less: Profits already assessed	5,978,524
Additional net assessable profits	3,527,970
Additional tax payable thereon	564,476

14. The Appellant, through BKR Lew & Barr Limited, objected against the original and additional assessments for the year of assessment 1998/99 on the ground that the Land Lots were not purchased for resale purpose and hence the gain on disposal of them was capital in nature and not assessable to tax.

15. In a letter dated 31 October 2001, BKR Lew & Barr Iimited lodged on behalf of the Appellant a claim pursuant to section 70A of the IRO ' for a correction of the tax return for the year of assessment 1996/97' on the ground that the resumption of the Third Lots took place in the year ended 31 December 1993 and hence the respective gain derived from the resumption should be taken out from the profits for the year of assessment 1996/97.

16. By the time of the determination, the assessor agreed that the gain of $3,490,917 derived by the Appellant from the resumption of the Third Lots accrued to the Appellant in the year of assessment 1993/94 instead of 1996/97. As the six-year time limit specified in section 60 of the IRO had already expired, the assessor could not raise any assessment for the year of assessment 1993/94. But after taking into account the gain on resumption of the Third Lots, the assessor considered that there should not be any loss brought forward from the year of assessment 1993/94. Accordingly the assessor was prepared to revise the statements of loss for the years of assessment 1993/94 to 1997/98 and the additional profits tax assessment for the year of assessment 1998/99 as follows:

(a) Year of assessment 1993/94

Loss carried forward	Nil

(b)	Year of assessment 1994/95	$
	Adjusted loss for the year and carried forward	5,688,446
(c)	Year of assessment 1995/96	$
	Loss brought forward	5,688,446
	Less: Loss set-off as previously advised	463,728
	Loss carried forward	5,224,718
(d)	Year of assessment 1996/97	$
	Profits per return	2,677,503
	Add: Gain on disposal of the Second Lot	37,053
	Assessable profits	2,714,556
	Less: Loss brought forward set-off	2,714,556
	Net assessable profits	Nil
	Statement of loss	$
	Loss brought forward	5,224,718
	Less: Loss set-off	2,714,556
	Loss carried forward	2,510,162
(e)	Year of assessment 1997/98	$
	Adjusted loss for the year	1,199,851
	Add: Loss brought forward	2,510,162
	Loss carried forward	3,710,013
(f)	Year of assessment 1998/99 (Additional)	$
	Assessable profits for the year	11,901,353
	Less: Loss brought forward set-off	3,710,013
	Net assessable profits	8,191,340
	Less: Profits already assessed	5,978,524
	Additional net assessable profits	2,212,816
	Additional tax payable thereon	354,051

The determination

17. By his determination, the Commissioner:

(a) held that the Land Lots were purchased by the Appellant with the intention of reselling them at a profit;

(b) held that section 70A had no application because the statements of loss could in no way be regarded as assessments and no tax had been charged for the year of assessment 1996/97;

(c) held that there was ' nothing in the IRO which prevents the Assessor from revising the statements of loss previously issued' to the Appellant; and

(d) endorsed the assessor's revised computations of loss for the years of assessment 1993/94 to 1997/98 and the proposed revised additional assessment for the year of assessment 1998/99.

The appeal hearing

18. By letter dated 20 September 2002, BKR Lew & Barr Limited gave notice of appeal on behalf of the Appellant.

19. There were two grounds of appeal. The first ground of appeal as stated in the grounds of appeal and the second ground of appeal, as summarised in the written submission of the Appellant, were that:

(a) 'In January 1998, the Appellant sold a plot of land ... identified as the "Fourth Lots" in Paragraph 8(c) of the Acting Deputy Commissioner's Determination, for the consideration of $27,000,000 and from which the Appellant derived a gain of $15,479,734.

In the assessment for 1998/99, this gain was brought to tax as the assessor, and as confirmed by the Acting Deputy Commissioner, considered that the Appellant had carried on a trade in respect of the purchase and sales of the Fourth Lots. The Appellant denies that it had carry (*sic*) on a trade in respect of the Fourth Lots as it had acquired the property for long term investment purposes. In selling the property the Appellant had disposed of a capital asset and the gain therefrom is not subject to tax under the IRO. The Appellant objects to this gain being treated as a taxable profit.'

(b) 'Ground two relates to the summary denial by the IRD of a loss brought forward from the year of assessment 1993/94. As the IRD had previously agreed to the loss, the Appellant objects to the IRD now denying the loss.'

20. At the hearing of the appeal, the Appellant was represented by Mr V Robert Lew, certified public accountant, and the Respondent by Ms Tse Yuk-yip, senior assessor. Mr V Robert Lew called two witnesses. Ms Tse Yuk-yip did not call any. Quite a few cases were cited, but we derived little or no assistance from any of them on the second issue of whether, in the absence of fraud, the Respondent could re-open a loss after more than six years. Ms Tse Yuk-yip made it clear that there was no suggestion of fraud in this case.

Our decision

21. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant.

22. There are two issues for our decision.

23. The first issue is whether the Fourth Lots were capital assets. The second issue is whether, in the absence of fraud, the Respondent can re-open a loss after more than six years.

Issue 1: capital assets?

24. Section 2 defines 'trade' as including '*every trade and manufacture, and every adventure and concern in the nature of trade*'. Section 14(1) excludes profits arising from the sale of capital assets.

25. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

26. We also remind ourselves of what Mortimer J (as he then was) said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771.

27. The intention, according to the evidence given by a former director of the Appellant, was to build holiday resort houses of about 700 square feet each for rental. The Appellant asserted that the total area of the house lots was about 12,000 square feet and the total area of the agricultural land was about 77,000 square feet.

28. Whether the Appellant's intention at the time of the first acquisition was to build holiday resort houses of about 700 square feet each and to hold them for an indefinite period for rental income is a question of fact. We decide against the Appellant on this factual issue and we do so for the following reasons.

29. The area of the house lots varies from 330 square feet to 484 square feet. The land between each of the three rows of the 24 house lots was government land. We have not been told anything about:

(a) the intended location of the 17 holiday resort houses of about 700 square feet each;

(b) what the houses would look like;

(c) the use, if any, of the agricultural land with an area of about 77,000 square feet; or

(d) what facilities, if any, would be built or developed for the use of the tenants of the resort houses.

30. The first acquisition was on 3 January 1990. By letter dated 4 or 6 March 1990 (the date on our copies is illegible), the Appellant applied for certificates of exemption in respect of all the house lots. Within a matter of days, the Appellant requested the District Lands Office by letter dated 12 March 1990 to 'withhold' its application because there were 'certain changes to the intended development'. On 2 May 1990, the Appellant sold the First Lots. These are objective facts and they are objective facts which contradict the stated intention. The sale is important because it took place within four months of the first acquisition (and probably explains the request to the District Lands Office to withhold consideration of the Appellant's application) and because the land sold, that is, the First Lots, lied in the heart of the Appellant's land. The explanation given was that:

> ' Because at that time a friend of mine told me that he needed that piece of land. He liked it. And we have calculated that we have enough land for development. And one of the reasons is to cut down the cost of development.'

We reject the explanation. The Appellant claimed that the whole of the land (or pieces of land) acquired in the first acquisition was to be redeveloped. It is not a question of whether there would be ' enough' land left after selling the heart of the Appellant' s land. It is a question of how much the sale would cut into the original development plan and how the Appellant intended to redevelop the leftovers. We have not been told how the leftovers fitted, if at all, into the original development plan, or how the original plan was modified to accommodate the sale of the First Lots.

31. Having sold the First Lots on 2 May 1990, the Appellant applied by letter dated 15 May 1990 for certificates of exemption in respect of six out of the 24 house lots on the basis of *in situ* redevelopment. This is an objective fact against the stated intention to build 17 houses of about 700 square feet each, bearing in mind that the area of these six house lots varies from 441 square feet to 484 square feet. Moreover, despite the fact that the certificates of exemption were issued on 29 August 1990, the Appellant took no step to build any house. This belied the stated intention or any intention to build.

32. The Appellant' s case is anything but coherent. The next event which the Appellant chose to tell us about was an application more than one year later by letter dated 10 October 1991 to apply for certificates of exemption in respect of 16 more house lots. We have not been told why the Appellant left out two house lots.

33. We have yet another unexplained gap. About 11 months later, the Appellant applied for land exchange by letter dated 4 September 1992. We have not been told why the Appellant applied for land exchange. Nor have we been told why the Appellant did not apply for land exchange until two years and eight months after the first acquisition. On 8 October 1992, the application was rejected on the ground that:

> ' [the] application for land exchange for development of New Territories Exempted Houses cannot be proceeded as no exempt buildings will be allowed in an exchange.'

34. The Appellant then skipped to a letter dated 1 September 1993, leaving us with an unexplained gap of about ten and a half months. By 13 February 1995, the application had not been approved because the District Lands Office required:

> ' Building plans/sketch plans showing the redevelopment proposal containing relevant information such as dimensions, area, height, position of staircase, stairhood, projections, entrance, position of septic tank, etc.'

35. The Appellant agreed that the set of plans said to be drawn up in 1992 fitted the description of the sketch plans called for. The Appellant also agreed that this set of plans had not been submitted to the District Lands Office. The Appellant' s case on why the purported 1992 plans had not been submitted was that:

> ' Because there is no need to submit the plans for application for exemption.'

With such evidence, we are unable to see how the Appellant can succeed on the factual issue.

36. The balance sheet of the Appellant as at 31 December 1989 showed that it had net current liabilities of $7,760,774 and a net asset value of $1,504,110. The first acquisition was on 3 January 1990. The balance sheet of the Appellant as at 31 December 1990 showed that it had net current liabilities of $32,766,829 and a net deficit of $1,194,197.

37. There is no evidence on the cash flow of the Appellant as at the date of the first acquisition.

38. There is no evidence on the personal net worth of the shareholders or directors of the Appellant as at the date of the first acquisition. There is also no evidence on the cash flow of any of them.

39. There is no evidence on the Appellant's financial ability to build and hold the houses for an indefinite period. The reason given for the sale of the First Lots quoted in paragraph 30 above suggests that the Appellant had to 'cut down the cost of development' within four months of the first acquisition.

40. There is no evidence on the actual rental of any or any comparable 'resort' houses.

41. For the reasons we have given, the Appellant has not proved any of the following and its case of the first acquisition as capital assets fails:

(a) that at the time of the first acquisition, the intention of the Appellant was to build holiday resort houses and to hold the houses on a long term basis;

(b) that such intention was genuinely held, realistic or realisable;

(c) its financial ability, with or without its shareholders, to build and retain the houses for an indefinite period.

42. The appeal on the gain from the disposals of land acquired in the first acquisition fails.

43. There is no allegation or evidence that the second acquisition was for long term holding or for redevelopment. There is no evidence on the intended use of the agricultural land. The Commissioner held that the Land Lots (which comprised land acquired in both acquisitions) were purchased by the Appellant with the intention of reselling them at a profit. Any case of the second acquisition as capital assets fails at the outset.

Issue 2: revisiting a loss more than 6 years ago

44. We reiterate that there is no suggestion of fraud in this case.

45. The Respondent accepted that the gain of $3,490,917 derived by the Appellant from the resumption of the Third Lots accrued to the Appellant in the year of assessment 1993/94 instead of 1996/97. The correct net assessable profits for the year of assessment 1993/94 are $1,315,154, after setting off the loss per return of $2,175,763.

46. The Respondent could not assess the profits of $1,315,154 for the year of assessment 1993/94 under section 60 of the IRO because more than six years had elapsed since the year of assessment 1993/94 (see paragraph 54 below).

47. Instead of assessing the Appellant on the correct net assessable profits of $1,315,154, or leaving the reported loss of $2,175,763 undisturbed, the Respondent attributed a nil balance to the 'loss

carried forward' for the year of assessment 1993/94 (see paragraph 16 above). The Respondent approached it on the basis that there was 'nothing in the IRO which prevents the Assessor from revising the statements of loss previously issued' to the Appellant ('the Respondent's approach').

48. To start with, the nil balance was artificial, fictitious, and mathematically wrong. The correct amount is $1,315,154.

49. Further, the Respondent asked the wrong question.

50. The question is not whether there is any provision in the IRO which prevents the assessor from taking a certain course. The correct question is whether there is a provision in the IRO which empowers or requires the assessor to take such a course.

51. The power of the Respondent and her assessors to assess is conferred by statute. Their work is by its nature quite intrusive. They probe into private matters of taxpayers and assess them to tax. We are not aware of any inherent jurisdiction on the part of the Respondent or her assessors and the Respondent has not argued that there is any. The Respondent has not been able to point to any provision in the IRO or any other ordinance empowering or requiring the Respondent or an assessor to revisit a loss more than six years ago. In our decision, the Respondent's approach was neither authorised nor required by statute. It also exceeded the powers under Parts IX and X of the IRO, including section 60(1) and (2) in particular.

52. Section 51(1) confers on an assessor the power to give notice in writing to any person requiring him to furnish tax returns. Section 51(2) imposes on every person chargeable to tax to inform the Respondent that he is so chargeable.

53. In respect of any year of assessment, where a person has furnished a return in accordance with the provisions of section 51 the assessor may either (a) accept the return and make an assessment accordingly, or (b) if he does not accept the return, estimate the sum in respect of which such person is chargeable to tax and make an assessment accordingly under section 59(2). Where a person has not furnished a return and the assessor is of the opinion that such person is chargeable with tax, he may estimate the sum in respect of which such person is chargeable to tax and make an assessment accordingly under section 59(3). In the case of profits from a trade or business, if accounts of such trade or business have not been kept in a satisfactory form, the assessor may assess the profits or income of such trade or business on the basis of the usual rate of net profit on the turnover of such trade or business under section 59(4).

54. Whether or not a person has furnished a return and whether or not an assessor has assessed under section 59, an assessor may assess, or additionally assess, under section 60(1) which provides that:

> *'Where it appears to an assessor that for any year of assessment any person chargeable with tax has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person at the amount or additional amount at which according to his judgment such person ought to have been assessed, and the provisions of this Ordinance as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to the tax charged thereunder:'*

55. Section 60(1) is subject to the proviso on fraud which provides that:

> *' where the non-assessment or under-assessment of any person for any year of assessment is due to fraud or wilful evasion, such assessment or additional assessment may be made at any time within 10 years after the expiration of that year of assessment.'*

56. The Respondent could not proceed under section 60(1) in this appeal because of the six-year limit and because there is no suggestion of fraud.

57. Section 60(1) is against the Respondent's contention for two reasons.

(a) We test the Respondent's case by assuming (contrary to the facts in this case) that the Appellant had reported a profit (instead of a loss, see paragraph 11 above) of $5,688,446 for the year of assessment 1994/95, and assuming further that more than six years after the expiration of the year of assessment 1994/95 had elapsed by the time of the determination. Adopting the Respondent's approach, the Appellant's loss for the year of assessment was 'nil' and the Appellant should therefore be assessed or further assessed for the year of assessment 1994/95 on re-opening the loss in the year of assessment 1993/94. But the Respondent was out of time under section 60(1) by the time of the determination. If the Respondent had power to re-open a loss at any time, there is no or no valid reason why such power should depend on whether more than six years had since elapsed from the time when profits first exceeded the corrected amount of loss (if any).

(b) Even in a case of fraud, the Respondent's hands are tied after ten years. If the Respondent's contention is correct, there would be no time limit so far as loss is concerned. It is absurd that a taxpayer who fraudulently or wilfully evades tax may get away with tax after ten years but an honest but mistaken taxpayer is forever liable to have his loss re-opened.

58. Where tax has been repaid by mistake, whether of fact or law, the assessor may assess under section 60(2) to claim back the mistaken repayment. The word used in this subsection is 'repaid' whereas the word used in section 63K is 'refund'. We have considered the difference in wording but conclude that there is no material difference between repayment and refund. Where provisional tax paid in the preceding year of assessment is repaid or refunded because of the mistake of fact that the taxpayer had suffered a loss when in truth and in fact the taxpayer had earned a profit, the assessor may assess under section 60(2) which provides that:

> *' Where it appears to an assessor that the whole or part of any tax repaid to a person (otherwise than in consequence of an assessment having been determined on objection or appeal) has been repaid by mistake, whether of fact or law, the assessor may, within the year of assessment to which the repayment relates or within 6 years after the expiration thereof, assess such person in the amount of tax so repaid by mistake, and the provisions of this Ordinance as to notice of assessment, objection, appeal and other proceedings shall apply to such assessment and to the tax charged thereunder.'*

59. Let us say that a taxpayer reported a loss in a year of assessment. Let us also assume that the assessor accepted the return as correct, and the provisional tax paid by the taxpayer during the preceding year of assessment was then refunded under section 63K which provides that:

> *' When any person has paid provisional profits tax in respect of any year of assessment, the Commissioner shall, not later than when he gives notice of assessment of profits tax, apply the amount of provisional profits tax so paid in payment first of –*
>
> *(a) the profits tax payable by that person for that year of assessment; then*
>
> *(b) the provisional profits tax payable in respect of the year of assessment succeeding that year of assessment,*
>
> *and shall refund to the person paying the provisional profits tax the amount thereof not so applied.'*

60. Let us further assume that subsequently, the assessor discovered that the repayment or refund was by mistake. Upon discovering the repayment by mistake, the assessor may assess under section 60(2) to offset the repayment or refund, and, if necessary, assess under section 60(1). However, both subsections are subject to the six-year limit and the Respondent cannot get back any tax repaid or refunded more than six years ago.

61. The Appellant's tax computation for the year of assessment 1992/93 reported net assessable profits of $7,606,599 and tax thereon of $1,331,154 and provisional tax of $2,463,027 for the year of assessment 1993/94. We do not know whether the Appellant had paid provisional tax for the year of assessment 1993/94. Nor do we know whether any provisional tax for the year of assessment 1993/94 had been refunded under section 63K in view of the loss reported for the year of assessment 1993/94 and the issue of the statement of loss by the assessor (see paragraph 11 above). If tax had in fact been repaid, the assessor could not proceed under section 60(2) because of the six-year limit. Since the assessor could not get back the tax repaid and could not assess the Appellant for the year of assessment 1993/94, there is no reason why the Appellant could assign an artificial nil figure for the year of assessment 1993/94.

62. Irrespective of whether there was a tax refund in this case and irrespective of whether section 60(2) covers a refund of provisional tax because of a mistaken acceptance of a loss, the six-year limit appears in both subsections (1) and (2) of section 60. This takes us to the point that not only is there no provision in the IRO empowering or requiring the Respondent to re-open a statement of loss issued by an assessor in respect of a year of assessment more than six years ago, the Respondent's approach is contrary to the statutory scheme that, in the absence of fraud, there is finality in tax matters after six years.

63. Section 29(6) provides that any revocation of a claim for married person's allowance for a couple living apart must be made within six years after the expiration of the year of assessment.

64. Section 60 (see paragraph 54 above) is the second provision with a six-year limit.

65. An application under section 70A to correct errors must be made within six years after the end of a year of assessment or within six months after the date on which the relative notice of assessment was served. While on this section, we note that it must be established to the satisfaction of the assessor that ' the tax charged for that year of assessment is excessive' . As there was no tax charged for the year of assessment 1996/97, the application referred to in paragraph 15 above was clearly misconceived.

66. Any application under section 79 for refund of tax in excess of the amount with which a taxpayer was properly chargeable for a year of assessment must be made within six years of the end of

a year of assessment or within six months after the date on which the relevant notice of assessment was served, whichever is the later.

67. Section 80(3) provides that no person shall be liable to any penalty under section 80 unless the complaint concerning such offence was made in the year of assessment in respect of or during which the offence was committed or within six years after the expiration thereof.

68. The time limit of six years from the end of a year of assessment runs through the provisions referred to above. Consistent with this is the duty to keep records for seven years.

69. The duty of every person carrying on a trade, profession or business in Hong Kong to keep and retain sufficient records under section 51C is limited to not less than seven years after the completion of the transactions, acts or operations to which they relate.

70. Likewise, the duty of every person who is the owner of land or buildings or land and buildings situated in Hong Kong to keep and retain sufficient records under section 51D is limited to not less than seven years after the completion of the transactions, acts or operations to which they relate.

71. The power under section 51D to require a taxpayer to furnish an assets betterment statement cannot go beyond seven years before the commencement of the year of assessment in which the notice is given.

72. Last but not least, although lapse of time affects both the Appellant and the Respondent, it is more likely that long lapse of time will prejudice the Appellant rather than the Respondent because of onus of proof under section 68(4) which falls on the Appellant. Since the legislature has seen fit to restrict the duty to keep and retain records to seven years, there is no reason why the Respondent and her assessors should be permitted to revisit a loss more than six years ago.

Conclusion

73. For the reasons we have given, the Appellant succeeds only in respect of the gain from the resumption of the Third Lots.

74. We believe that the original profits tax assessment for the year of assessment 1998/99 should be confirmed and that the additional profits tax assessment for the year of assessment 1998/99 as reduced by the Commissioner should be reduced from additional net assessable profits of $2,212,816 (see paragraph 16 above, made up of the 1993/94 loss of $2,175,763 and the gain of $37,053 on disposal of the Second Lot) to additional net assessable profits of $37,053.

75. But as we have not heard the parties on the outcome of the appeal in the event the Appellant succeeds only on the gain from the resumption of the Third Lots, the better course is to remit.

Disposition

76. The appeal succeeds in part, but only to the extent that the Respondent should not have interfered with loss of $2,175,763 for the year of assessment 1993/94. We remit both assessments appealed against to the Respondent to revise to give effect to our decision.