

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D20/03

Profits tax – property – whether trading asset – instruction to sell shortly after purchase.

Panel: Anna Chow Suk Han (chairman), Anthony Francis Martin Conway and Christopher Henry Sherrin.

Date of hearing: 13 November 2002.

Date of decision: 23 May 2003.

The taxpayer purchased and sold four properties and made substantial profits. In respect of one of the properties, the taxpayer objected to the profits tax assessment against her.

The taxpayer contended that she purchased this property for long term letting purposes. However, she could not rent it out. Thus she sold it.

Enquires were made by the Revenue. Two estate agents gave statements that they were instructed by the taxpayer to sell this property soon after it was purchased by her.

Held:

The Board could not find any reasons not to believe the two estate agents. Since there were instructions to sell from the outset, the Board found the taxpayer intended to acquire this property as a trading asset and thus the profit derived from the sale of it was subject to profits tax.

Appeal dismissed.

Case referred to:

Lionel Simmons Properties Ltd v CIR 53 TC 461

Chow Chee Leung for the Commissioner of Inland Revenue.
Vitus Law Po Tin of Messrs Law & Co for the taxpayer.

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Decision:

The appeal

1. This is an appeal by the Taxpayer against the determination dated 26 July 2002 made by the Commissioner of Inland Revenue ('the Determination') in respect of the profits tax assessment raised against the Taxpayer for the year of assessment 1997/98 showing assessable profits of \$11,180,035.

The facts upon which the Determination was arrived at

2. The Taxpayer had purchased and sold the following properties during the years of 1996 and 1997:

Location of property	Purchase	Sale
	(i) Date of provisional agreement	(i) Date of provisional agreement
	(ii) Date of formal agreement	(ii) Date of formal agreement
	(iii) Date of assignment	(iii) Date of assignment
	(iv) Consideration	(iv) Consideration
[Address of Property A in District J]	(ii) 29-1-1996 (iii) 15-4-1996 (iv) \$4,950,000	(ii) 3-10-1996 (iii) 31-10-1996 (iv) \$5,550,000
[Address of Property B in District J]	(ii) 5-2-1996 (iii) 7-3-1996 (iv) \$3,300,000	(ii) 9-8-1996 (iii) 31-8-1996 (iv) \$3,960,000
[Address of Property C in District J]	(ii) 16-2-1996 (iii) 6-5-1996 (iv) \$4,550,000	(ii) 29-5-1996 (iii) 28-6-1996 (iv) \$4,980,000
[Address of Property D in District J]	(i) 25-4-1996 (ii) 25-5-1996 (iii) 9-9-1996 (iv) \$18,250,000	(i) 19-5-1997 (ii) 3-6-1997 (iii) 18-11-1997 (iv) \$32,000,000

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3. In response to a questionnaire issued by the assessor, the Taxpayer on 27 June 1998 alleged that Properties A, B and C were all intended to be used as her residence and that they were sold for the following reasons:

(a) Property A

The Taxpayer intended to combine Property A with the flat on the first floor and converted the two flats into a duplex flat. As she could not purchase the first floor unit, the Taxpayer thus sold Property A.

(b) Property B

Property B was found to be too small. As the offer from the buyer was good, the Taxpayer sold Property B and used the proceeds to purchase Property C.

(c) Property C

The Taxpayer sold Property C in order to make sure that she had enough cash to purchase the first floor unit mentioned in (a) above.

4. The Taxpayer also provided the assessor with the following computation of profit arising from the sale of Properties A, B and C:

	Property A	Property B	Property C
	\$	\$	\$
Sale proceeds	5,550,000	3,960,000	4,980,000
<u>Less: Purchase cost</u>	<u>4,950,000</u>	<u>3,300,000</u>	<u>4,550,000</u>
	600,000	660,000	430,000
<u>Less: Total expenses</u>	<u>467,492</u>	<u>330,925</u>	<u>315,428</u>
Net profits	<u><u>132,508</u></u>	<u><u>329,075</u></u>	<u><u>114,572</u></u>

5. The assessor was of the view that Properties A, B and C were purchased by the Taxpayer with the intention of reselling them at a profit. On 12 October 1998 the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1996/97:

	\$
Assessable profits	576,155
(\$132,508 + \$329,075 + \$114,572 per paragraph 4)	<u><u>576,155</u></u>

The Taxpayer did not object against the assessment.

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6. In a questionnaire completed by her on 23 November 1998, the Taxpayer alleged the following in respect of Property D:

- (a) Property D was purchased for long term letting purposes.
- (b) As she could not rent out Property D and the selling price was good, she sold Property D and purchased a shop ('Property E') through Company F.

7. The Taxpayer also provided the assessor with the following information:

- (a) To finance the purchase of Property D, she obtained a loan of \$12,700,000 from Bank G. The loan was to be repayable by 240 monthly installments of \$114,265.2 each.
- (b) The profit from the sale of Property D was computed as follows:

	\$	\$
Sale proceeds		32,000,000
<u>Less: Purchase cost</u>		<u>18,250,000</u>
		13,750,000
<u>Less: Legal fees on purchase</u>	58,210	
Stamp duty	501,875	
Commission to agent on purchase	160,000	
Bank interest	1,336,330	
Decoration	160,000	
Legal fees on sale	53,550	
Commission to agent on sale	<u>300,000</u>	<u>2,569,965</u>
Net profit		<u><u>11,180,035</u></u>

- 8. (a) Company F is a private company incorporated in Hong Kong on 15 January 1997.
- (b) At all relevant times, the Taxpayer and Company H have been the only shareholders and directors of Company F.
- (c) By an agreement dated 27 March 1997, Company F purchased Property E, with an existing tenancy, at a consideration of \$51,000,000. The transaction was completed on 11 September 1997 when Property E was assigned to Company F.

9. The assessor was of the view that Property D was the Taxpayer's trading stock and the profit derived by the Taxpayer from the sale of Property D was chargeable to tax. Accordingly,

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the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1997/98:

	\$
Assessable profits	<u>11,180,035</u>

10. The Taxpayer objected to the profits tax assessment for the year of assessment 1997/98 in the following terms:

- (a) '[Property D] was purchased for investment purpose. The keys of [Property D] were given to the estate agents for the purpose of viewing and letting.'
- (b) 'The estimated monthly rental for [Property D] was approximately \$80,000.00. It was put on market for let for more than half a year before I am aware that property of such size and rental was very difficult to let. Most people would purchase it for their own use. I was then forced to change my mind to sell it and hopefully will buy another property that will allow me to get steady income.'
- (c) '[Property D] was sold on 3 June 1997 and its proceeds were used to purchase [Property E] so that I can get steady income and hopefully can keep it for long term investment purpose. [Property E] was purchased with existing lease for HK\$165,000.00 per month. [Property E] was ... under [Company F] 100% owned by myself. To compare the return for the two investments – a house [Property D] that yields \$80,000.00 per month and can sell for \$32,000,000.00 as compare to a shop [Property E] that yields \$165,000.00 per month and will cost me \$51,000,000.00. The value and reason for the exchange of investment properties is obvious.'
- (d) 'Up to today, I am still holding [Property E] that I purchased with the proceeds from [Property D]. As of today, the value of [Property E] now is only 40% of its original price.'
- (e) 'Over the years, I purchased several properties – some were shops and some were residents. All were purchased for investment and rental income purpose.'

11. By a letter dated 24 September 2001 Estate Agent 1 provided the assessor with the following information in respect of Property D:

- (a) The Taxpayer appointed Estate Agent 1 to sell Property D on 16 June 1996 at an initial asking price of \$22,500,000.
- (b) The asking price of Property D was changed from the initial one as follows:

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Date	Asking price
	\$
4-9-1996	23,000,000
6-11-1996	24,500,000
4-12-1996	26,500,000
23-12-1996	28,000,000
1-3-1997	35,000,000

- (c) A Mr I, on behalf of the Taxpayer, appointed Estate Agent 1 to let Property D on 19 May 1997 at an initial asking rent of \$95,000 per month.

12. By a letter dated 11 December 2001 Estate Agent 2 provided the assessor with the following information in respect of Property D:

- (a) The Taxpayer appointed Estate Agent 2 to sell Property D on 17 August 1996 at an initial asking price of \$23,000,000.
- (b) Estate Agent 2 was instructed to contact the Taxpayer in case there was a potential offer.
- (c) The asking price of Property D was changed from the initial one as follows:

Date	Asking price
	\$
19-9-1996	23,500,000
5-10-1996	23,000,000
15-11-1996	25,000,000

- (d) There was no record showing that the Taxpayer had appointed Estate Agent 2 to let out Property D.

The Revenue's case

13. The Revenue submitted that the Taxpayer did not have a genuine intention to purchase Property D as a long term investment. The transaction was but an adventure in the nature of trade.

14. In support of its case, the Revenue emphasized the following points.

- (a) Frequency of transaction

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During the period from January to April 1996, the Taxpayer purchased four properties which were all sold by May 1997. During the period of ownership of those properties, the Taxpayer had not put them to any beneficial use.

(b) Intention

There were no evidence or objective facts to support the Taxpayer's stated intention that Property D was purchased for letting. The Taxpayer had neither let nor taken steps to let Property D. The receipts of keys by the two estate agents produced by the Taxpayer did not confirm that the keys were released to the estate agents for letting purpose. They only confirmed that the keys were released for flat-viewing purpose. Both estate agents, Estate Agents 1 and 2 stated in their letters that they were respectively appointed by the Taxpayer to sell Property D although Estate Agent 1 was later on also appointed to let out Property D. The monthly mortgage repayment of Property D was \$114,265. Property D was purportedly put up for letting at a monthly rent of \$80,000. Thus its rate of return did not support it being a viable investment.

(c) Reasons for sale

The Taxpayer claimed that Property D was sold because she experienced difficulties in letting it out in view of its size and rent. This alleged reason for sale could not be genuine since the Taxpayer, a seasoned property owner, holding four properties in the same district, District J, must be well versed with the property market conditions there. Had she been honest about her intention of acquiring a property for letting, she would have carried out a rental market research beforehand. Besides, there was no evidence to support her claim that it was difficult to let out Property D.

(d) Application of sale proceeds

The application of the sale proceeds of Property D towards the acquisition of a capital asset by the Taxpayer could not reflect her stated intention under appeal.

15. Finally, it was also submitted that the Taxpayer had failed to discharge the onus of proving that Property D was purchased as a long term investment.

The Taxpayer's case

16. The Taxpayer's tax representative submitted on behalf of the Taxpayer as below.

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17. Save and except the contents as referred to in paragraphs 8, 11 and 12 above, the Taxpayer agreed to all the facts upon which the Determination was arrived at. In relation of the contents of paragraph 8 above, the Taxpayer disagreed that she was a shareholder of Company F at all relevant times because she only became a shareholder on 26 March 1997. Furthermore, she denied that Estate Agents 1 and 2 were appointed to sell Property D. The statements of Estate Agents 1 and 2 in their letters to the Revenue referred to in paragraphs 11 and 12 above were bare assertions and were not supported by documentary evidence.

18. In assessing the Taxpayer's intention, the Taxpayer's previous property dealings should not be taken into account, but weight should be given to the Taxpayer's financial ability to hold Property D as a long term investment.

19. The Taxpayer appointed estate agent to let Property D at the monthly rent of \$80,000 and on reasonable terms, which was supported by the two key receipts produced but the Taxpayer's intention to let was frustrated by the lack of interested tenants. The Taxpayer subsequently found that Property D was not suitable for letting because properties in District J were favoured by owner-occupiers and not tenants.

20. The Taxpayer sold Property D when she found Property E which was a better investment property. Property D was replaced by Property E which was still being held by the Taxpayer as an investment property. The act of applying the sale proceeds of Property D towards the acquisition of Property E was consistent with the Taxpayer's stated intention of holding Property D as an investment property. The Commissioner had ignored the legal principle that 'a permanent investment may be sold in order to acquire another investment thought to be more satisfactory'.

21. In respect of the Taxpayer's four properties, Property A, Property B, Property C and Property D, there were differences in their respective lengths of ownership, gross profit ratios, and values. Notwithstanding the fact that Property D was most valuable, its marketability ranked lowest. Since the Taxpayer was 'an experienced property investor', she could not possibly choose Property D as a trading stock.

22. The asking price of Property D at \$22,500,000 on 16 June 1996 as quoted by Estate Agent 1 in its letter to the Commissioner was a far cry from reality since the asking price would provide an unattainable gross profit of 23% after only 52 days of acquisition while Property C only yielded a gross profit of 9% after 53 days of acquisition. Furthermore, had Estate Agent 1 really been appointed to sell Property D on 16 June 1996, it did not stand to reason that Estate Agent 1 was only given the keys to Property D on 18 October 1996, which was already 40 days after completion of Property D on 9 September 1996. Further, a trader would not hold its trading stock for as long as 435 days as the Taxpayer did with Property D. Also, it would be absurd to appoint Estate Agent 1 to let Property D on 19 May 1997 which was the date when the Taxpayer entered into a provisional agreement for sale of Property D. The Commissioner ought to verify those

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statements made by Estate Agent 1. Estate Agent 2 alleged that it was appointed as the Taxpayer's agent to sell Property D on 17 August 1996, such appointment was made 84 days after the alleged appointment of Estate Agent 1 to sell Property D. Such an appointment was unrealistic since an eager trader would have appointed two or more agents simultaneously to achieve maximum exposure of the property. Furthermore, the asking prices quoted by Estate Agents 1 and 2 for Property D were not the same. There was always a difference of \$500,000 in those prices. The Taxpayer had no idea as to why the two agents, Estate Agents 1 and 2, made those untruthful statements.

23. A newspaper cutting on a prosecution against an estate agent for 'fraudulent bank transactions' and 'forged documents' was produced. It was submitted that some estate agents could be deceitful for personal gains.

24. While it was true that her failure to find a tenant for Property D induced her to look for a replacement property, the reason which prompted the sale of Property D was that the Taxpayer found a more satisfactory replacement property.

25. The Taxpayer claimed deduction of expenses totalling \$109,495.23 incurred by her during the period of ownership of Property D.

Our findings

26. The Taxpayer attended the hearing and decided not to give evidence after her tax representative read out to us his prepared written statement in relation to this appeal. She told us that since the written statement had fully and clearly stated her case, she had nothing further to add to it. However, we would place on record that a few questions were put to the Taxpayer for clarification by this Board and the answers to those questions were not given under oath. The Taxpayer was thus not cross-examined on them.

27. It is a well-established legal principle from Lionel Simmons Properties Ltd v CIR 53 TC 461 that in determining whether a property is a capital asset or a trading asset, one has to ascertain the intention of the purchaser of the property at the time of acquisition. If the property was purchased with the intention of disposing of it at a profit, it was a trading asset and if the property was acquired as a permanent investment, it was a capital asset.

28. It is the Taxpayer's case that Property D was acquired by her as a capital asset which she intended to let out, but having experienced difficulties in letting it out, she intended to change her investment and upon finding a better investment property, Property E, she sold Property D and replaced it by Property E.

29. In support of her claim that Property D was acquired for letting, the Taxpayer's tax representative submitted that the Taxpayer did appoint estate agents in October 1996 to let

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Property D at a monthly rent of \$80,000 and on reasonable terms and the Taxpayer's instructions to let Property D were borne out by the two key receipts produced by the Taxpayer during the investigation stage.

30. During investigation, upon the request by the assessor for proof of her act of renting out Property D, the Taxpayer produced two receipts of keys to Property D, one from Estate Agent 3 dated 11 September 1996 and the other from Estate Agent 1 dated 18 October 1996. Both receipts stated that the keys were given to the estate agents for flat-viewing purposes but they did not mention whether those flat viewings were for sale or letting purpose. On both of the receipts, the Taxpayer was given the choice to be described as the 'vendor' or the 'landlord' of Property D. On the receipt of Estate Agent 3, the description 'vendor' was crossed out while on the receipt of Estate Agent 1, the description 'landlord' was crossed out. At the hearing, a member of this Board sought clarification from the Taxpayer on the signature of the 'vendor' as appeared on the receipt of Estate Agent 1. The Taxpayer told us that the signature of the 'vendor' on that receipt was not her signature but that of her estate agent friend, Mr I, who was acting on her behalf. It was pointed out to her that on that receipt the description 'landlord' was crossed out which seemed consistent with Estate Agent 1's letter to the Revenue that it was instructed to sell Property D. The Taxpayer replied that she had no explanation as to this because she did not sign the receipt. For the aforesaid observations, it is unsafe for us to accept that the two key receipts were proof of instructions to the estate agents to let Property D, and least of all, to let it out on those terms as submitted by the Taxpayer's tax representative.

31. Whilst there is no evidence that Property D had been put on the market for letting by the Taxpayer, there was, on the other hand, evidence adduced by the Revenue showing that Property D was put on the market for sale by the Taxpayer soon after the formal agreement to purchase Property D was entered into by her.

32. The evidence adduced was the two letters referred to in paragraphs 11 and 12 above. Those letters were annexed to the Determination. They were letters written by Estate Agents 1 and 2 respectively in response to the enquiries made by the Revenue. Estate Agent 1 informed the Revenue that it was instructed by the Taxpayer to sell Property D on 16 June 1996 and the initial asking price was \$22,500,000 and it was also instructed by Mr I on behalf of the Taxpayer on 19 May 1997 to let Property D at the monthly rent of \$95,000. Estate Agent 2 informed the Revenue that it was instructed by the Taxpayer to sell Property D on 17 August 1996 with an initial asking price of \$23,000,000 but no instructions to let were given to it. Both estate agents also informed the Revenue that the asking prices were adjusted upward at various intervals. The tax representative submitted that the statements in those letters were untrue because the Taxpayer neither gave Estate Agents 1 and 2 the instructions to sell nor Estate Agent 1 the instructions to let on 19 May 1997. It was contended that those statements could not be true because it would not make sense if instructions to let Property D were given to Estate Agent 1 on 19 May 1997 when the provisional agreement to sell Property D was entered into by the Taxpayer on that same day. However, the tax representative submitted that the Taxpayer could not think of

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any reasons for Estate Agents 1 and 2 to make those false statements against her, but he asserted that some estate agents could be deceitful for personal gains and referred us to a recent court case against an estate agent for fraud and forgery. We find that the court case has no bearing on this appeal and should be ignored. The Taxpayer could not offer us any explanations as to why those statements, if were untrue, should be made against her by the estate agents. In our view, it does not stand to reason that both estate agents should make similar false statements of instructions to sell against the Taxpayer and that Estate Agent 1 should be untruthful about the instructions to let given by Mr I on 19 May 1997. Nor can we think of any possible benefits which the estate agents could gain out of giving those statements. Since neither the Taxpayer nor Mr I was called to rebut the evidence, it is difficult for us not to accept those statements as true. Further and importantly, when this Board asked the Taxpayer whether she contacted the estate agents for clarification after she had seen those letters, we were told that the Taxpayer did not take any follow-up actions on them. The Taxpayer explained that since she had difficulties in obtaining from Estate Agent 1 a copy of its letter to the Revenue, she believed that it would be hopeless for her to expect a reply from Estate Agent 1 if she did write. This reason for no follow-up actions on those letters is not credible, especially when the Taxpayer's tax representative submitted that Estate Agent 2 was very helpful and it was only Estate Agent 1 which refused to help. The natural course of action expected of the Taxpayer in the circumstances would be her writing to the estate agents for clarification of the contents of those letters. It seems extraordinary that the Taxpayer should have taken such passive attitude towards the matter. The burden of proof is on the Taxpayer, as opposed to the submission of the tax representative that the Commissioner ought to verify the estate agents' statements. Had the Taxpayer been genuine about her claim that instructions to sell had not been given to the estate agents, she ought to have taken steps to rectify the matter for the purpose of this appeal. She should appreciate that evidence cannot be rebutted by mere denial.

33. The tax representative contended that Property D was not a trading asset because a trader would not hold a trading stock for such a lengthy period as the Taxpayer did with Property D. In our view, the length of ownership of an asset is not always indicative or determinative of the status of the asset. Its bearing on the status of an asset depends on the facts and circumstances of each case. In the present case, the Taxpayer entered into an agreement to purchase Property D in April 1996, and completion of the purchase took place in September 1996. She then entered into an agreement to sell it in May 1997. First of all, we do not consider that the said period of ownership of Property D by the Taxpayer was unduly long as to support the intention of it being acquired as a capital asset. Besides, during the period between April 1996 and May 1997, the property market was strong and in a continuous rise. As submitted by the tax representative and not challenged by the Revenue, the Taxpayer had the financial means to hold Property D. That being the case, it stands to reason that the Taxpayer was in no haste to sell Property D, but was waiting to sell it at a desirable price. Thus, the tax representative's contention in this regard is unsustainable. The tax representative also contended that the estate agents' statements to the Revenue could not be true because if the instructions to sell were indeed given in June 1996, the keys should not have been released to the estate agent only in October 1996. Perhaps also for the reason that the Taxpayer was in no haste to sell, and completion only took place in September

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1996, the keys to Property D were thus not released to the estate agents as quickly as they ought to be, as contended by the tax representative.

34. Having carefully considered all the documentary evidence before us and the submissions made on behalf of both parties, we find that the Taxpayer has failed to establish her stated intention of acquiring and holding Property D as a long term investment. Furthermore, since we cannot find any reasons to doubt the truthfulness of the statements made by both Estate Agents 1 and 2 in their letters to the Revenue, we are satisfied that instructions to sell Property D were given by the Taxpayer as early as on 16 June 1996. Since there were instructions to sell from the outset, we are satisfied that the Taxpayer intended to acquire Property D as a trading asset and the profit derived from the sale of it is subject to payment of profits tax.

35. Having found that Property D was acquired by the Taxpayer as a trading asset, we need not go further to consider her alleged reason for the sale of it. Had it been necessary for us to do so, we would hold the alleged reason not genuine. It was alleged that because the Taxpayer experienced difficulties in letting out Property D, she intended to change her investment and when she found Property E, a better investment property, she sold Property D. It was submitted that until she had difficulties in letting it out, the Taxpayer was not aware that properties in District J, such as Property D for its location, size and rental, were favoured only by owner-occupiers and not tenants. We are not convinced by this claim. Firstly, we have no evidence before us that properties like Property D in District J were unpopular among tenants. Secondly, even if it was true, we do not believe that the Taxpayer was unaware of it when she acquired Property D. Given that the Taxpayer, as submitted by her tax representative, was an experienced property investor and prior to her acquisition of Property D she also had other properties in District J, she ought to be familiar with the market conditions there. Besides, we would expect the Taxpayer to have carried out a property market research prior to her embarking on an enterprise. Thus, we would find this reason which allegedly led to the sale of Property D not genuine. Also, since we hold that Property D was a trading asset, how its sale proceeds were applied is irrelevant to the issue under appeal.

36. The Taxpayer has made a claim of deduction of expenses in the amount of \$109,495.23. After the Revenue had an opportunity to peruse the receipts and debit notes of the expenses claimed, which were only produced by the Taxpayer's tax representative at the hearing, the parties agreed that the Taxpayer was entitled to a deduction of expenses in the amount of \$114,495 instead of \$109,495.23.

37. For the aforesaid reasons, we dismiss the appeal and confirm the assessment less the deduction of \$114,495 agreed.

38. Finally, we would express our disquiet on the disregard of directions which the Taxpayer and the tax representative had shown the Board in this appeal. The tax representative on behalf of the Taxpayer served on the Board a notice of appeal. By a letter of 30 September 2002 from the Clerk of the Board to the Taxpayer and a copy to the tax representative, the Taxpayer

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was requested to submit to the office of the Board, on or before 28 October 2002, copies of the written evidence and authorities which the Taxpayer would adduce in support of her appeal. By a letter of 4 November 2002 from the Revenue to the Taxpayer and also a copy to the tax representative, the Taxpayer was reminded to provide details of the expenses claimed and also the documents and authorities in support of the appeal prior to the hearing on 13 November 2002. Notwithstanding the said request and reminder, the debit notes and receipts in support of the expenses claimed and the documents and authorities in support of the appeal were not produced by the Taxpayer until the hearing on 13 November 2002. The Taxpayer and the tax representative ought to understand that the lack of co-operation on the part of any party involved in an appeal may not only undermine the efficient and effective running of the appeal system, but it may also prejudice the interests of the parties to the appeal and is therefore disapproved by the Board.