

some force, that since the Taxpayer derived no profit from the 3rd floor the expense referable to it does not achieve the character of a deductible.

- (3) *Whether the Taxpayer is entitled to a deduction for interest charges?*

The relevant provision reads:—

S. 16 “(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including—

- (a) sums payable by such person by way of interest upon any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procurator fees, stamp duties and other expenses in connexion with such borrowing;”

M sought to show that certain interest which the Taxpayer had incurred was referable to the Taxpayer's profits. However his case was confusing and unconvincing since some of the interest appeared to have occurred in consequence of the Taxpayer himself drawing funds out of his account for his own personal use. In short the Taxpayer failed in our view to be able to attribute any or any given element of interest to any of the profit derived from sub-lettings.

Accordingly for the foregoing reasons the appeal is dismissed in its entirety.

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**Case No. D7/85**

*Board of Review:*

H. F. G. Hobson, *Chairman*; Patrick W. C. Chan and Lawrence H. L. Fung, *Members*.

**3 June 1985.**

Profits tax—letting out of the flats in the name of a director of a company—liability to profits tax.

On 7 December 1962, a piece of land was knocked down to the Appellant. In December 1971 a building comprising 4 apartments were built on the land and the flats were let out to tenants, during the years of assessment 1971/2 to 1976/77. The Appellant filed no tax returns. It was argued that the building was not owned by the Appellant but by a director who leased out the flats in his personal capacity and for his own account.

*Held:*

On the evidence before the Board the Appellant was the legal owner of the building. The director was acting as the agent of the Appellant.

Appeal dismissed.

So Chau Chuen for the Commissioner of Inland Revenue.  
Appellant in person.

*Reasons:*

L, a Director and the principal shareholder of the Taxpayer appeared for the Taxpayer, giving evidence on oath on certain factual aspects. Mr. So Chau-chuen, Assessor (Appeals), represented the Inland Revenue Department (IRD).

Briefly the background to this case is that at a Crown Land auction on 7 December 1962 D.D. 224 Lot No. 334 (the "Land") was knocked down to Hong Wah Investment Co. Ltd. (the "Taxpayer") at a premium of \$95,400 for a period of about 34 years.

In 1965 the Inland Revenue Ordinance amended the definition of "business" to the effect that the mere letting or sub-letting by an individual would not automatically per se be treated as a business; something more than mere passive receipt of rent was required, i.e. the circumstances surrounding that activity would need to be examined to decide whether in common parlance he was conducting a business. However this amendment made it clear that corporations by the very act of letting or sub-letting were deemed to carry on a business and therefore potentially liable to profits tax under section 14.

In December 1971 a building comprising four apartments was built on the Land. At that time that part of the New Territories in which the Land was situate, Sai Kung, was exempt from property tax.

In December 1971 therefore had the Land and building been owned by an individual and the flats let out there would have been no property tax, and the individual might conceivably have also been free of liability to profits tax depending on the manner in which

the lettings were conducted—at any rate he would not be *deemed* to be thereby carrying business.

In this case, after completion the four flats were let out to different tenants for various periods during the major part of the 6 years of assessment 1971/72 to 1976/77.

The Taxpayer initially filed no tax returns. When asked to explain this L argued that the Taxpayer had not engaged in any business because it did not own the building; he claimed it was owned by himself and that he leased the flats out in his personal capacity and for his own account. It is that contention which lies at the very core of the Taxpayer's main case.

L made numerous and extensive submissions to the IRD but finally on the 11 January 1978 the IRD issued 6 profits tax assessments, 1 for each of the years of assessment 1971/72 to 1976/77. The Taxpayer objected to these assessments on the 2nd day of February 1978 and gave further grounds for objection on the 19 September 1978. On the 13th day of January 1983 the Deputy CIR upheld the assessments. The Taxpayer gave notice under section 66 of appeal on the 7 February 1983.

The grounds of appeal before us, which broadly followed the objections to the assessments, may reasonably be condensed, from the 103 pages to which we were referred, as follows:—

- (1) The Taxpayer did not let out the flats, all of the lettings having been done in the name of Mr. Lam, not in the name of the Taxpayer.
- (2) If that submission fails, then if the Taxpayer's sole activity is the mere passive receipt of rent then it is not liable to profits tax despite the definition of "business" in section 2. L submitted that in order to make sense of proviso (a) to s. 25 the Taxpayer corporation needs to have a distinct and separate business activity.
- (3) The rules regarding losses under Part II—Property Taxes—and those under Part IV—Profits Tax—are different. If a property is not let then it is exempt from property tax for the vacant period but the cost of upkeep, repair and maintenance of the flat during the vacant period cannot be carried forward against income from future lettings whereas if the activity of letting falls within the ambit of Part IV then upkeep losses can be carried forward. This, L contended, must mean that once a landlord has been subjected to property tax it would

be inappropriate, unacceptable and beyond the intention of the legislature, to subsequently subject him to profits tax at least as a matter of principle: in practice the profits tax assessment is in effect reduced by the amount of property tax paid (see sections 25 and 5(1B)(2)(a)).

- (4) The quantum of the assessments were unreasonable.
- (5) The assessments were time-barred.

L explained to the Board that he appeared at the auction in the hopes of purchasing the Land because it was close to another property which he owned. However when he saw the strength of the competition he did not bid. When the property was knocked down to the Taxpayer corporation (then owned by way of 2 subscriber shares by a W and C who were well known to L) L persuaded them to give up their interests in the Land and mentioned the point to the auctioneer. The latter did not object and accordingly not only did C sign the Agreement and Conditions of Sale as agent for the Taxpayer but L, as a "Director (Managing)", and his wife, MW, also signed.

On the following day, the 8 December 1962, C and W signed blank transfers of shares and bought and sold notes with respect to the aforementioned subscriber shares. A Return of Allotments was filed for the Taxpayer on the 15 December 1962 wherein L was shown as owning 1 098 shares, his wife, MW, 100 shares and 2 subscribers shares of W and C were also shown: in all 1 200 shares having a par value of \$100 each making a total paid-up capital of HK\$120,000. The premium for the Land, as mentioned above, being HK\$95,400 there was a gross surplus of \$24,600.

The construction company was paid by instalments by cheques drawn upon L's own personal account, a fact which is not disputed by the Revenue.

Mr. Lam said that when arranging lettings of the flats he represented himself as being the landlord. In the case of one lease in favour of the Colonial Treasurer Inc. the latter did question his position but it was not resolved and L was content to let the matter remain ambiguous. We should mention that none of these leases or tenancy agreements were produced to us nor to the Revenue.

Mr. So drew the Board's attention to the following provisions of the Agreement and Conditions of Sale, the material parts reading as follows:—

### General Condition

“10(a) The Purchaser [the Taxpayer] shall develop the lot by the erection thereon of a building . . .”

### Special Conditions

“1. The Purchaser shall not—

(a) . . . underlet or part with possession . . . unless and until he has . . . complied with those General and Special Conditions . . . Every . . . subletting . . . shall be registered at the District Office.”

L acknowledged that there was no documentary evidence indicating that the Taxpayer had leased the building to him personally, we believe it is therefore reasonable to assume that no formal step was even taken as for instance a letter to District Land Office requesting such a lease. L has argued that “the Company is me, me is the Company”. As a matter of law and fact we reject this suggestion outright. We have no hesitation in holding that the Taxpayer was the *legal* owner of the building because (1) the obligation to develop fell upon it, (2) the occupation permit was applied for by and issued to it and (3) there was no evidence of the Taxpayer leasing the building to L. Nevertheless argued that there was a resulting trust in his favour as beneficiary because he had personally paid for the cost of construction. Even if that were so—and we decline to express an opinion thereon—as Mr. So quite rightly pointed out the Taxpayer corporation would nevertheless be *legal* owner and consequently the party potentially liable for the taxes concerned. The analysis below, liable to profits tax.

What then was L’s position as regards the sub-lettings made in his name?

L produced property tax receipts. Though they were not for the assessment years in question, he maintained that they were a fair sample. However property tax demands at that time were made upon the person shown in the ratepayers list without regard to the actual relationship of that person with the property, in other words such list and the demands were not conclusively indicative that L was the landlord in his individual capacity as distinct from, for example, that of an agent for the Taxpayer corporation.

In our opinion the only reasonable interpretation is that L was acting as agent for the legal owner of the apartments, namely the Company.

Under the theme “once property tax always property tax”, L advanced many esoteric arguments to undermine the natural inter-

pretation of section 14, the interpretation of “business” in section 2 and the inter-relationship of section 25 and section 5.

Section 14, in material part reads thus:

“14. Subject to the provisions of this Ordinance, profits tax shall be charged . . . on every person carrying on a . . . business in the Colony . . . in respect of his assessable profits arising in or derived from the Colony . . . from such business . . .”

At all material times the present interpretation of business in section 2 was in force. Its material parts are thus:

“‘business’ includes . . . the letting or sub-letting by any corporation . . . of any premises or portion thereof . . .”

L referred to the case of **Lam Woo Shang v CIR** (1961 HKLR 609) in an attempt to show that the 1965 amendment was brought about by a misunderstanding by the legislature of the decision in that case. We do not accept this, however it is immaterial since the interpretation as it now stands is quite without doubt or ambiguity so far as corporations are concerned.

The pertinent portion of section 25 reads:—

“25. Where property tax is payable . . . in respect of any land or buildings owned by a person [which is defined to include a corporation] carrying on a . . . business, any profits tax payable by such person . . . shall be reduced by a sum not exceeding the amount of such property tax . . . provided that (a) no reduction shall be allowed unless . . . the profits derived from such property are part of the profits of the . . . business.”

In the abstract it may be possible to mount, as L has done, an analytical argument that some distinct business with its own income source is needed before the property tax payer can take advantage of s. 25. Nevertheless such an argument would be unhelpful for the Taxpayer in as much as it would—if taken to its conclusion—mean that the Taxpayer would not be entitled to set-off the property tax, consequently it would be liable to both taxes. We think however that the words of proviso (a) quoted above mean that an individual who carries on two distinct activities namely (1) as the holder of a Crown Lease and sublets (and hence is not thereby *deemed* to be carrying on the business under s. 2) (“Activity A”) and another business (“Activity B”), cannot take advantage of the reduction against profits tax on Activity B if in actual fact activity A is being conducted as a business and thereby itself liable to profits tax: it is as though the word “taxable” were inserted so as to read “the profits derived from such property are part of the *taxable* profits of the business”.

Be that as it may in this case the Taxpayer owned 4 flats and we consider that the letting of the first flat was part and parcel of the

business of the subsequent lettings of the remaining three flats and therefore the foregoing rationale just does not arise.

Having concluded that L was merely the agent for the Taxpayer we do not accept that the Taxpayer is not liable to profits tax under section 14. It follows that we look upon the Taxpayer as the principal and consequently entitled to the set-off referred to at the conclusion of the Deputy Commissioner's Determination.

As to the reasonableness of the estimated assessments made by the IRD in consequence of L's inability to produce accounts of his activities as an agent and the fact that he failed to have any accounts drawn up for the Taxpayer (let alone audited statements), the Revenue based its estimates upon L's own figures for lettings between the years 1972 and 1976 and then discounted. L produced no persuasive reasons for finding that the said assessments were unreasonable. Accordingly we reject this ground of objection.

Finally L submitted that the assessments were time-barred or if they were not then any action upon them would be (see s. 4(1) of the Limitation Ordinance). We reject the first contention because all of the assessments were made within the 6 years referred to in section 60 of the Inland Revenue Ordinance and the second argument because no cause of action arises while the assessments are the subject of reference to the CIR or to the Board.

Accordingly this appeal fails.

In closing we should perhaps add that L, a retired solicitor of 82 years of age, in advancing his arguments to the Commissioner and before us exercised a mental agility (occasionally interspersed with wry humour) which belied his years but in essence his case failed for lack of any evidence of a lease by the Taxpayer to himself. We are indebted to Mr. So who dealt skilfully, painstakingly and fairly with the numerous points raised by L.