INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D122/02

Property tax – exemption to property tax – meaning of 'corporation' and 'business' – whether business registration certificate proves the carrying on of business – sections 2, 2(1), 5(1), 5(2), 5(2)(a), 25 and 68(4) of the Inland Revenue Ordinance ('IRO') – sections 2(1A) and 6(6) of the Business Registration Ordinance ('BRO') – costs – frivolous and vexatious and abuse of the process – section 68(9) of the IRO.

Panel: Kenneth Kwok Hing Wai SC (chairman), Sammy Chan Yin Nin and Jason Yuen King Yuk.

Date of hearing: 24 January 2003.
Date of decision: 25 February 2003.

The appellants, the husband and the wife, are partners and they appeal against the determination of the Commissioner of Inland Revenue whereby property tax assessments for the years of assessment 1998/99 to 2000/01 in respect of certain rents derived by them from the letting of two properties were raised on them. The appellants claimed that they should be subject to profits tax instead of property tax.

The appellants as joint owners acquired the two properties which were let out at the material times. In respect of the first property, rental income derived therefrom was assessed to property tax up to and including the year of assessment 1997/98 without any objection from the appellants.

In June 1999 the appellants applied for a business registration certificate in respect of the alleged business of properties investment.

The appellants contended that they were 'carrying on a business as defined under s.2 of the Inland Revenue Ordinance. Business includes the letting or sub-letting of premises by corporation. Corporation includes any company registered under any enactment. Since the Company is registered under the Business Registration Ordinance, it is a corporation. Therefore, it should be assessed under Profits Tax'.

Held:

1. Property tax is charged under section 5(1) of the IRO. As the appellants were the owners of the properties, property tax shall be charged for each year of assessment

on them computed at the standard rate on the net assessable value of the properties. Section 68(4) of the IRO provides that the onus of proving that the assessments appealed against are excessive or incorrect lies on the appellants. Unless they make out a case of exemption under some provisions of the IRO, their appeal must fail.

2. The only exemption which the Board is aware of is under section 5(2)(a) of the IRO which is restricted to corporations. There is no exemption for persons other than corporations. For taxpayers who are not corporations, although they may deduct property tax from profits tax under section 25 of the IRO, the charge on property tax is perfectly valid and is neither excessive nor incorrect.

3. 'Corporation' is defined in section 2(1) of the IRO. The definition focuses on how corporate personality can be acquired under the English law, that is, by acquiring a Royal Charter, promoting a special Act of Parliament (or special Ordinance in Hong Kong), or by registration under the Companies Acts or the Companies Ordinance ('CO'). As the appellants were not incorporated by any charter, not incorporated by any enactment, not a company, and not a company incorporated by registration under any enactment, the appellants were not a 'corporation' within the meaning of section 2(1) or 5(2) of the IRO.

4. The absurdity of the contention that since the appellants were registered under the BRO, they were a corporation within the meaning of the IRO can be demonstrated by drawing attention to the fact that the appellants applied for registration under the BRO as a 'partnership or other body unincorporate for registration of business carried on by such body in Hong Kong'. The contention that, as an unincorporated body, the appellants registered their business under the BRO, and, by reason of such registration, the appellants were a corporation within the meaning of the IRO has only to be stated to be rejected.

5. The BRO contains no provision that the business registration certificate is evidence of carrying on business. On the contrary, section 2(1A) provides that a company incorporated under the CO or to which Part XI of the CO applies 'shall be deemed to be a person carrying on business' notwithstanding the cessation of business or not having commenced business, and it is clear that the business registration certificate is not evidence of the factual carrying on of business by such company. Secondly, the prominent notice printed in Chinese on the business registration certificates drawing attention to section 6(6) of the BRO, the English version of which being printed on the back of the certificates, was completely ignored. Thirdly, even if the business registration certificate were evidence of the carrying on of a business for the purpose of the BRO, it is not evidence of the carrying on of a business for the purpose of the IRO. Lastly, even if the business registration certificate were evidence of the carrying on of *some* business for the purpose of the IRO, it is not evidence of the

carrying on of the *relevant* business for the purpose of section 5(2)(a) or section 25 of the IRO.

6. 'Business' is defined in section 2(1) of the IRO. The significance lies in the exclusion of the letting of any premises or portion thereof by any person other than a corporation as a business.

7. The Board is of the opinion that this appeal is frivolous and vexatious and an abuse of the process. Pursuant to section 68(9) of the IRO, the appellants are ordered to pay the sum of $5,000 as costs of the Board.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

Lam Woo Shang v CIR 1 HKTC 123
Louis Kwan-nang Kwong v CIR 2 HKTC 541
D3/81, IRBRD, vol 1, 394
D86/99, IRBRD, vol 14, 581

Chan Wai Mi for the Commissioner of Inland Revenue.
Simon Y T Tsao of Messrs Y T Tsao & Co, Certified Public Accountants, for the taxpayers.

Decision:

1. The Appellants, the husband and the wife, are partners and they appeal against the determination of the Commissioner of Inland Revenue dated 17 October 2002 whereby:

(a) Property tax assessment for the year of assessment 1998/99, dated 5 November 1999, showing net assessable value of $130,704 was reduced to net assessable value of $128,539.

(b) Property tax assessment for the year of assessment 1998/99, dated 11 August 2000, showing net assessable value of $168,000 was confirmed.

(c) Property tax assessment for the year of assessment 1999/2000, dated 7 February 2001, showing net assessable value of $153,600 was confirmed.

(d) Property tax assessment for the year of assessment 1999/2000, dated 7 February 2001, showing net assessable value of $336,000 was confirmed.

(e) Property tax assessment for the year of assessment 2000/01 under charge number 5-5618299-01-2, dated 31 August 2001, showing net assessable value of $61,422 with tax payable thereon of $9,213 was reduced to net assessable value of $61,228 with tax payable thereon of $9,184.

(f) Property tax assessment for the year of assessment 2000/01 under charge number 5-5618287-01-4, dated 31 August 2001, showing net assessable value of $320,280 with tax payable thereon of $48,042 was reduced to net assessable value of $319,824 with tax payable thereon of $47,973.

The admitted facts

2. The following facts as stated in the 'Facts upon which the determination was arrived at' in the determination are admitted by the Appellants and we find them as facts.

3. The Appellants have objected to the property tax assessments raised on them for the years of assessment 1998/99 to 2000/01. The Appellants claim that they should be subject to profits tax instead of property tax in respect of certain rents derived by them from the letting of two properties.

4. In 1991 the Appellants as joint owners acquired the First Property at a consideration of $2,060,000.

5. In 1996 the Appellants as joint owners acquired the Second Property at a consideration of $6,900,000.

6. The Appellants have let out the First Property since 1 August 1993 and the rental income derived therefrom was assessed to property tax up to and including the year of assessment 1997/98 without any objection from the Appellants.

7. (a) By a tenancy agreement dated 16 April 1997 the Appellants let out the First Property for a term of two years commencing from 16 April 1997 at a monthly rent of $23,000.

(b) The first tenancy was terminated on 15 June 1998.

(c) By a provisional tenancy agreement dated 6 August 1998 the Appellants agreed to let out the First Property for a term of two years commencing from 1 September 1998 at a monthly rent of $16,500.

(d) With effect from 1 January 1999 the monthly rent of the second tenancy was reduced to $16,000 by mutual agreement.

(e) The second tenancy was terminated on 30 June 2000.

(f) By a third tenancy agreement dated 6 January 2001 the Appellants let out the First Property for a term of two years commencing from 15 January 2001 at a monthly rent of $15,000.

8. (a) By a licence agreement dated 1 October 1998 the Appellants let out the Second Property at a monthly fee of $35,000 commencing on 1 October 1998.

(b) By a tenancy agreement dated 1 April 1999 the Appellants let out the Second Property for a period of two years commencing on 1 April 1999 at a monthly rent of $35,000. The tenancy was terminated on 28 February 2001.

(c) By another tenancy agreement dated 28 February 2001 the Appellants let out the Second Property for a period of two years commencing on 16 March 2001 at a monthly rent of $31,000.

9. On 2 June 1999 the Appellants applied for a business registration certificate in respect of the following alleged business:

(a)	Name under which business was carried on	:	[Name of husband] and [name of wife]
(b)	Address of place of business	:	[A business address]
(c)	Nature of business	:	Properties investment
(d)	Date commenced	:	1 April 1998

10. In the property tax returns for the years of assessment 1998/99 to 2000/01 in respect of the First Property, the Appellants declared the following particulars:

	1998/99	**1999/2000**	**2000/01**
	$	$	$
Rental income	171,500	192,000	85,742
Rates	8,119	-	8,964

11. In the property tax returns for the years of assessment 1998/99 to 2000/01 in respect of the Second Property, the Appellants declared the following particulars:

	1998/99	**1999/2000**	**2000/01**
	$	$	$
Rental income	210,000	420,000	401,000
Rates	-	-	650

12. With regard to the alleged properties investment business, the Appellants submitted accounts and proposed profits tax computations for each of the years of assessment 1998/99 to 2000/01 which showed, among other things, the following:

	1998/99	**1999/2000**	**2000/01**
	$	$	$
Rental income	381,500	612,000	520,500
Sundry income	-	-	2,065
	381,500	612,000	522,565
Less: Accounting fee	2,000	2,000	2,000
Agency fees	-	-	22,500
Business registration fee	2,250	2,250	2,250
Commission paid	8,250	-	-
Depreciation and amortisation	-	-	1,090
Government rent and crown rent	-	-	5,268
Legal and professional fee	498	-	1,385
Loan interest	219,509	354,959	368,769
Management fee	26,076	13,944	13,236
Rates	19,419	8,300	8,964
Repairs and maintenance	-	1,950	76,000
Utilities	-	-	380
	278,001	383,403	501,842
Profit per account	103,499	228,597	20,723
Add: Depreciation	-	-	1,090
	103,499	228,597	21,813
Less: Rebuilding allowances	179,200	66,200	69,906
Replacement of fittings for tenant	2,480	1,950	-
Assessable profits/(Adjusted loss)	(78,181)	160,447	(48,093)

13. On divers dates the assessor raised on the Appellants the following property tax assessments in respect of the rental income derived by them from the letting of the First Property:

1998/99	**1999/2000**	**2000/01**
$	$	$

Rental income	171,500	192,000	85,742
Less: Rates paid	8,119	-	8,964
Assessable value	163,381	192,000	76,778
Less: 20% deduction	32,677	38,400	15,356
Net assessable value	130,704	153,600	61,422
Tax payable thereon	*	*	9,213

* No property tax was demanded at the time of issue of the assessment due to the Appellants' election of personal assessment.

14. On divers dates the assessor raised on the Appellants the following property tax assessments in respect of the rental income derived by them from the letting of the Second Property:

	1998/99	**1999/2000**	**2000/01**
	$	$	$
Rental income	210,000	420,000	401,000
Less: Rates paid	-	-	650
Assessable value	210,000	420,000	400,350
Less: 20% deduction	42,000	84,000	80,070
Net assessable value	168,000	336,000	320,280
Tax payable thereon	*	*	48,042

* No property tax was demanded at the time of issue of the assessment due to the Appellants' election of personal assessment.

15. On behalf of the Appellants, Messrs Simon Y T Tsao & Co objected against the property tax assessments set out in paragraphs 13 and 14 on the ground that the rental income should be assessable to profits tax rather than property tax. The Appellants put forward the following contentions and arguments:

(a) 'there is not only one isolate (*sic*) property but in fact two properties are involved'.

(b) The husband 'is habitually investing in properties to earn rental income'.

(c) '... [The Appellants are] carrying on a business as defined under s.2 of the Inland Revenue Ordinance. Business includes the letting or sub-letting of premises by corporation. Corporation includes any company registered under any enactment. Since the Company is registered under the Business Registration Ordinance, it is a corporation. Therefore, it should be assessed under Profits Tax.'

(d) 'From the wording of the legislation, it is clear that the legislation is construed to include the receipt of rental income as business. The reason why the legislation is so construed is because of the behavior (*sic*) of the old-aged people habitually invested (*sic*) in properties to earn rental income and they did not apply for business registration. These people did not consider themselves as running a business and made the Inland Revenue very difficult to tax the individuals. Therefore, the property tax was introduced to secure the source of revenue and to avoid unnecessary disputes.'

(e) 'There are income and expenses derived from the process (in the present case) such as maintenance, management fees etc. Efforts are put in by the partners to locate and to maintain the properties in good condition in order to earn rental income. They habitually seek quality investments and add on new properties to their portfolio. Please note that [the First Property] was purchased in 1991 and [the Second Property] was purchased in 1996. They had recently invested in new properties but now used limited companies for the purchase to avoid uncertainty.'

(f) 'In the case of [the Appellants], it is only a reduction of the total tax payable to the Inland Revenue and not an avoidance of tax. Again, we should look at the case of Westminster, which states that it is the right of the taxpayer to minimize his total tax bill.'

16. In response to the assessor's enquiries, Messrs Simon Y T Tsao & Co supplied the following information:

(a) The Appellants solicited the tenants through estate agents.

(b) The rents were received through the personal bank accounts of the Appellants by direct pay-in.

(c) No separate bank accounts were maintained for the alleged business since the transactions were too few to warrant doing so.

(d) No ledgers were kept for the alleged business but a separate file was kept for each of the two properties in question.

(e) The repairs and maintenance expenses of $76,000 charged in the accounts for year ended 31 March 2001 (see paragraph 12) included an amount of $72,000 being the renovation fund paid to the property management company of the Second Property.

(f) The correct amounts of rental income received by the Appellants from the First Property and the Second Property for the year of assessment 2000/01 should be $85,500 and $401,000. A copy of the revised profit and loss account with a revised proposed tax computation for the year of assessment 2000/01 in respect of the alleged business was furnished.

(g) The correct amounts of rates paid by the Appellants in respect of the two properties for the years of assessment 1998/99 and 2000/01 should be as follows:

	1998/99	**2000/01**
	$	$
First Property	10,826	8,964
Second Property	-	1,219
Total	10,826	10,183

17. To take into account the correct amounts of rental income received by the Appellants and the rates paid by them, the assessor considered that the property tax assessments for the years of assessment 1998/99 and 2000/01 in respect of the First Property should be revised as follows:

	1998/99	**2000/01**
	$	$
Rental income	171,500	85,500
Less: Rates paid	10,826	8,964
Assessable value	160,674	76,536
Less: 20% deduction	32,135	15,308
Net assessable value	128,539	61,228
Tax payable thereon	N/A	9,184

18. To take into account the correct amounts of rental income received by the Appellants and the rates paid by them, the assessor considered that the property tax assessment for the year of assessment 2000/01 in respect of the Second Property should be revised as follows:

	2000/01
	$
Rental income	401,000
Less: Rates paid	1,219
Assessable value	399,781
Less: 20% deduction	79,957
Net assessable value	319,824
Tax payable thereon	47,973

The appeal

19. The Appellants failed in their objection. By letter dated 24 October 2002, signed by the Appellants themselves, the Appellants gave notice of appeal 'on behalf of the taxpayers' on the ground that:

> ' ... in making his Determination, the Commissioner
>
> a) disregard (*sic*) the definition proposed (*sic*) by the taxpayer (*sic*) as defined within the Inland Revenue Ordinance without reasonable cause;
>
> b) wrongly conclude (*sic*) that the passive receipt of rental are (*sic*) not business; and
>
> c) wrongfully refused the right of the taxpayers to choose the legal form of tax which was laid down by the Duke of Westminister's case.'

20. The husband attended the hearing of the appeal but the wife did not. The Appellants were represented by Mr Simon Y T Tsao and the Respondent was represented by Ms Chan Wai-mi.

21. The only authority furnished by Mr Simon Y T Tsao is page 5 of issue 8 of the loose-leaf edition of the IRO. Issue 8 is an outdated issue, so outdated that there was no Chinese version. The current issue is issue 25.

22. Ms Chan Wai-mi furnished us with a bundle of the following authorities:

(a) IRO, sections 2, 5, 5B, 14 and 68;

(b) CO, sections 2 to 5A, 15, 16, 332 and 333 and Part XI;

(c) BRO, sections 1 to 6;

(d) Lam Woo Shang v CIR 1 HKTC 123;

(e) Louis Kwan-nang Kwong v CIR 2 HKTC 541;

(f) Board of Review decision D3/81, IRBRD, vol 1, 394;

(g) Board of Review decision D86/99, IRBRD, vol 14, 581;

(h) Inland Revenue (Amendment) Bill, No 29 of 1965;

(i) Halsbury's Laws of Hong Kong, volume 6, paragraphs 95.007 to 95.013.

23. Mr Simon Y T Tsao called the husband to give oral evidence.

24. Ms Chan Wai-mi did not call any witness.

Our decision

Property tax

25. Property tax is charged under section 5(1) of the IRO which provides that:

> *'Property tax shall, subject to the provisions of this Ordinance, be charged for each year of assessment on every person being the owner of any land or buildings or land and buildings wherever situate in Hong Kong and shall be computed at the standard rate on the net assessable value of such land or buildings or land and buildings for each such year ...'*

26. As the Appellants are the owners of the First Property and the Second Property, property tax shall be charged for each year of assessment on them computed at the standard rate on the net assessable value of the First Property and the net assessable value of the Second Property.

27. Section 68(4) of the IRO provides that the onus of proving that the assessments appealed against are excessive or incorrect lies on the Appellants. Unless they make out a case of exemption under some provisions of the IRO, their appeal must fail.

28. Mr Simon Y T Tsao has made no attempt to make out any case of exemption under the IRO.

Exemption under section 5(2)(a) and deduction under section 25

29. The only exemption which we are aware of is under section 5(2)(a) of the IRO which provides that:

> *'Notwithstanding subsection (1), any corporation carrying on a trade, profession or business in Hong Kong shall, on application made in writing to the Commissioner and on proof of the facts to the satisfaction of the Commissioner, be entitled to exemption from the property tax for any year of assessment in respect of any land or buildings or land and buildings owned by*

the corporation where the corporation would be entitled under section 25 to a set-off of the property tax which, if exemption were not granted under this subsection, would be paid by the corporation; and the property shall be and remain exempted from property tax for each year of assessment in which the circumstances are such as to qualify the property for such exemption for that year.'

30. The first point is that exemption under section 5(2)(a) is restricted to corporations. There is no exemption for persons other than corporations. For taxpayers who are not corporations, although they may deduct property tax from profits tax under section 25 of the IRO, the charge on property tax is perfectly valid and is neither excessive nor incorrect. Section 25 provides that:

'*Where property tax is payable for any year of assessment under Part II in respect of any land or buildings owned by a person carrying on a trade, profession or business, any profits tax payable by such person in respect of that year of assessment shall be reduced by a sum not exceeding the amount of such property tax paid by him:*

Provided that –

(a) no reduction shall be allowed unless either the profits derived from such property are part of the profits of the trade, profession or business carried on by such person or the property is occupied or used by him for the purposes of producing profits in respect of which he is chargeable to tax under this Part;

(b) if the amount of property tax paid for a year of assessment exceeds the profits tax payable, the amount so paid in excess shall be refunded in accordance with the provisions of section 79'.

Mr Simon Y T Tsao's contention

31. Mr Simon Y T Tsao contended that since the Appellants were registered under the BRO, they were a corporation within the meaning of the IRO.

32. We reject Mr Simon Y T Tsao's contention. We do so for a number of reasons.

Meaning of 'corporation'

33. 'Corporation' is defined in section 2(1) of the IRO to mean:

> *'any company which is either incorporated or registered under any enactment or charter in force in Hong Kong or elsewhere but does not include a co-operative society or a trade union'.*

34. In our decision, the definition focuses on how corporate personality can be acquired under English law, that is, by acquiring a Royal Charter, promoting a special Act of Parliament (or special Ordinance in Hong Kong), or by registration under the Companies Acts or the CO. A company is incorporated by a charter or an enactment (Act or Ordinance) conferring corporate personality or incorporated by registration under the Companies Acts or the CO. Thus a 'corporation' is defined in section 2(1) of the IRO to mean:

(a) any company which is incorporated by any charter;

(b) any company which is incorporated by any enactment; or

(c) any company which is incorporated by registration (and referred to simply as 'registered') under any enactment.

35. As the Appellants are not incorporated by any charter, not incorporated by any enactment, not a company, and not a company incorporated by registration under any enactment, the Appellants are not a 'corporation' within the meaning of section 2(1) or 5(2) of the IRO.

Registration under the BRO

36. The absurdity of Mr Simon Y T Tsao's contention that since the Appellants were registered under the BRO, they were a corporation within the meaning of the IRO can be demonstrated by drawing attention to the fact that the Appellants applied for registration under the BRO as a 'partnership or other body unincorporate for registration of business carried on by such body in Hong Kong' (see R1, page 62). The contention that, as an unincorporated body, the Appellants registered their business under the BRO, and, by reason of such registration, the Appellants are a corporation within the meaning of the IRO has only to be stated to be rejected. See also paragraph 15(c) above on the contention and paragraph 15(e) above on the reference to the 'partners'.

Further absurdities

37. The construction of the word 'corporation' contended by Mr Simon Y T Tsao ignores the word 'company' and the phrase 'incorporated or' before the word 'registered'. Essentially what Mr Simon Y T Tsao is saying is that any registration under any enactment turns the subject matter of registration into a corporation. The absurdity of this contention can be illustrated by two samples. Any individual registered under the Registration of Persons Ordinance (Chapter 177) is a corporation under the IRO. Married persons registered under the Marriage Ordinance

(Chapter 181) are a corporation under the IRO. As 'corporations', neither the individual nor the couple can claim personal assessment nor personal allowances.

Business registration certificate as evidence

38. Mr Simon Y T Tsao contended that the business registration certificate proves that the Appellants were carrying on business.

39. We reject his contention. Again, we do so for a number of reasons.

40. To start with, the BRO contains no provision that the business registration certificate is evidence of carrying on business. On the contrary, section 2(1A) provides that a company incorporated under the CO or to which Part XI of the CO applies 'shall be deemed to be a person carrying on business' notwithstanding the cessation of business or not having commenced business, and it is clear that the business registration certificate is not evidence of the factual carrying on of business by such company.

41. Secondly, Mr Simon Y T Tsao completely ignored the prominent notice printed in Chinese on the business registration certificates drawing attention to section 6(6) of the BRO, the English version of which is printed on the back of the certificates as follows:

> '**ATTENTION**
>
> Sec.6(6) Provides that the issue of a business registration certificate shall not be deemed to imply that the requirements of any law in relation to such business or to the persons carrying on the same or employed therein has been complied with.'

42. Thirdly, even if the business registration certificate were evidence of the carrying on of a business for the purpose of the BRO, it is not evidence of the carrying on of a business for the purpose of the IRO.

43. Lastly, even if the business registration certificate were evidence of the carrying on of *some* business for the purpose of the IRO, it is not evidence of the carrying on of the *relevant* business for the purpose of section 5(2)(a) or section 25 of the IRO.

Whether the Appellants carried on a business

44. As we have held that the Appellants were not a 'corporation' within the meaning of section 5(2)(a) of the IRO, it is immaterial whether the Appellants were carrying on a business and the appeal fails.

45. For completeness, we deal with the point briefly as follows.

46. 'Business' is defined in section 2(1) of the IRO to include:

> *' agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government'.*

47. The significance lies in the exclusion of the letting of any premises or portion thereof by any person other than a corporation as a business.

48. The onus is on the Appellants to prove that they have done more than the letting of premises to take their case out of the exclusion under section 2(1) and to make out a case of deduction under section 25. Mr Simon Y T Tsao has made no attempt to discharge the onus. Ground (b) of the grounds of appeal is clearly bad in view of our decision that the Appellants are not a corporation and in view of the exclusion in section 2(1). No attempt has been made to make out a case of carrying on a business beyond the letting out of premises and what is incidental thereto. In our decision, the Appellants have failed on the facts to make out any case of the carrying on of any business beyond the letting out of premises.

Disposition

49. The Appellants have not discharged the onus under section 68(4) of the IRO of proving that any of the assessments appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessments as confirmed or reduced by the Commissioner.

Costs order

50. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process.

51. Pursuant to section 68(9) of the IRO, we order the Appellants to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.