

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D132/98

Profits Tax – section 14 of the Inland Revenue Ordinance – whether carrying on a trade or business – subject matter of trade or business – whether the transactions are pure speculation – presence or absence of a business registration certificate – whether office and staff and organization exist – whether loss can be set-off.

Panel: Ronny Wong Fook Hum SC (chairman), Daisy Tong Yeung Wai Lan and Roderick Woo Bun.

Dates of hearing: 18 September 1998 and 19 October 1998.

Date of decision: 9 December 1998.

On 4 December 1989, the taxpayer applied for a registration of a business in the name of Company A. The taxpayer stated that the nature of Company A was ‘property agency’ and that Company A commenced business on the same date. On or about 21 July 1992, the taxpayer as ‘client’ entered into an agreement with Company B as ‘dealer’. Pursuant to this agreement, the taxpayer opened accounts with Company B for the sale or purchase of currencies at their spot rates from time to time.

On 30 November 1993, the taxpayer submitted a profits tax return. In that return, the taxpayer stated that he traded in the name of Company A and the nature of his business is property dealing and trading in foreign currencies. The taxpayer submitted that the net profit on sales of properties and commission received were to be set off against the net loss on trading in foreign currencies. The assessor did not agree that the loss in foreign currencies was a trading loss. It was the taxpayer’s case that no distinction can be made between trading in foreign currencies and his property dealing business. The taxpayer also claimed to have devoted the bulk of his time and energy to foreign currency dealings and his foreign currency dealings were organised and systematic.

Held:

- (1) Section 14 of the Inland Revenue Ordinance involves a double test. Only persons who are carrying on a trade or business are taxable and then they are only taxable in respect of profits which arise from such trade or business.
- (2) The issue as to whether a person is carrying on a trade or business is a question of fact. The tribunal must consider the matter as a matter of degree with no hard and fast rule. The tribunal must look at all the facts and reach a considered opinion on the evidence.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (3) One factor to consider is the subject matter of the alleged trade or business. Private individuals would rarely be considered as carrying on a business of trading in shares unless there are other associated activities. In relation to futures, by virtue of its short lifespan, it would be difficult to claim that they are held as long term investment.
- (4) Another factor to consider is whether the transaction are pure speculation. If so, it is a factor which weighs against the finding that the taxpayer is carrying on a trade. Clear evidence is necessary to show that a person who does not habitually carry on a business or trade and who is a pure speculator is carrying on a trade or business.
- (5) The presence or absence of a business registration certificate is not determinative of whether or not carrying on a trade or business but it would have been significant if the taxpayer had taken out a business registration certificate before he embarked upon the activities in question.
- (6) Though it is not essential that a person who is carrying on a trade or business must have an office and staff and organisation, where none of these attributes exists, there must be other clear evidence of carrying on a trade or business.
- (7) The Board found that the taxpayer's foreign exchange activities were not organised and systematic and the Board were not persuaded by the taxpayer's argument as to the amount of time and energy that the taxpayer spent in his foreign exchange activities. The Board lastly concluded that the taxpayer's foreign currency dealings were not considered as carrying on a trade or business.

Appeal dismissed.

Cases referred to:

Cooper v Stubbs 10 TC 29
Salt v Chamberlain 53 TC 143
D42/90, IRBRD, vol 5, 316
D57/94, IRBRD, vol 9, 335
D38/96, IRBRD, vol 11, 529
D111/97, IRBRD, vol 13, 20
D42/98, IRBRD, vol 13, 280

Yim Kwok Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Background

1. On 4 December 1989, the Taxpayer applied for registration of a business in the name of Company A. He stated that the nature of Company A was 'property agency' and that Company A commenced business on the same date.
2. On or about 21 July 1992, the Taxpayer as 'client' entered into an agreement with Company B as 'dealer'. Pursuant to this agreement, the Taxpayer opened accounts with Company B for the sale or purchase of currencies at their spot rates from time to time.
3. Two days later, the Taxpayer commenced currency dealings through his accounts with Company B. The number of transactions can be summarised as follows:

| MONTH | GBP | DEM | CHF | JPY | TOTAL |
|----------------|-----|-----|-----|-----|-------|
| July 1992 | 16 | 0 | 0 | 0 | 16 |
| August 1992 | 85 | 0 | 0 | 0 | 85 |
| September 1992 | 144 | 17 | 0 | 0 | 161 |
| October 1992 | 23 | 46 | 2 | 0 | 71 |
| November 1992 | 18 | 20 | 0 | 0 | 38 |
| December 1992 | 10 | 12 | 0 | 0 | 22 |
| January 1993 | 6 | 6 | 4 | 0 | 16 |
| February 1993 | 18 | 2 | 11 | 5 | 36 |
| March 1993 | 12 | 0 | 6 | 0 | 18 |
| | | | | | 463 |

4. On 30 November 1993, the Taxpayer submitted a profits tax return. According to that return:
 - (a) He traded in the name of Company A in a shop at District C.
 - (b) Nature of his business: 'Property dealing and trading in foreign currencies'.
 - (c) 'Net profit on sales of properties' amounting to \$1,154,419 and 'commission received' amounting to \$95,795 were to be set off against \$567,330 being 'net loss on trading in foreign currencies'.
5. The assessor did not agree that the loss of \$567,330 was a trading loss. The issue before us is whether he is right in taking that view.

Evidence of the Taxpayer

6. During the tax year in question, he allegedly carried on 4 heads of business:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) foreign currency dealings;
- (b) broker for foreign currency dealings of others;
- (c) sale and purchase of premises; and
- (d) broker for sale and purchase of premises by others.

No distinction can be made between each of these 4 heads of business activities.

7. When he first started foreign currency trading in July 1992, he did not have any sum earmarked as capital for this business. His available capital was dependant upon the amounts realised through his real estate dealings.

8. He claimed to have devoted the bulk of his time and energy in foreign currency dealings. His foreign currency contracts involved no less that US\$43,000,000. By way of contrast, in the year in question he had only three property deals amounting in total to \$4,138,000. He paid 1.2% margin for each of his foreign currency contract whilst he paid 10% to 15% in respect of the initial instalments for the sale and purchase of the three buildings. He admitted that he did not close out any of his foreign currency contracts.

9. His foreign currency dealings were organised and systematic. He read publications available in the market and he did his own calculations. He also attended sessions in Company B where he discussed with others the market trend.

10. He did not consider engaging any member of staff as he was anxious to protect his own investment personally.

11. No books of account were maintained for his foreign currency dealings. The print-outs by Company B constitute all the records of his foreign currency business.

12. He maintained no distinct bank account for his foreign currency business. He conceded his bank accounts are somewhat messy.

The applicable legal principles

13. Our attention has been drawn to the following authorities:

- (a) Cooper v Stubbs 10 TC 29
- (b) Salt v Chamberlain 53 TC 143
- (c) D42/90, IRBRD, vol 5, 316

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) D57/94, IRBRD, vol 9, 335
- (e) D38/96, IRBRD, vol 11, 529
- (f) D111/97, IRBRD, vol 13, 20
- (g) D42/98, IRBRD, vol 13, 280

The following propositions can be deduced from these authorities cited to us.

14. The issue turns on the proper construction of section 14 of the Inland Revenue Ordinance. That section involves a double test. Only person who are carrying on a trade or business are taxable and then they are only taxable in respect of profits which arise from such trade or business.

15. The issue as to whether a person is carrying on a trade or business is a question of fact. The tribunal must consider the matter as a matter of degree with no hard and fast rule. The tribunal must look at all facts and reach a considered opinion on the evidence.

16. One factor to consider is the subject matter of the alleged trade or business. In relation to shares, the Commissioner had accepted that private individuals would rarely be considered as carrying on a business of trading in shares unless there were other associated activities. In relation to futures, by virtue of its short lifespan, it would be difficult to claim that they are held as long term investment.

17. Another factor the consider is whether the transactions are pure speculation. If so, it is a factor which weighs against finding that the taxpayer is carrying on a trade. Clear evidence is necessary to show that a person who does not habitually carry on a business or trade and who is a pure speculator is carrying on a trade or business.

18. The presence or absence of a business registration certificate is not determinative of the issue but it would have been significant if the taxpayer had taken out a business registration certificate before he embarked upon the activities in question.

19. Though it is not essential that a person who is carrying on a trade or business must have an office and staff and organisation, where none of these attributes exists, there must be other clear evidence of carrying on a trade or business.

Our decision

20. The Taxpayer's foreign currency dealings stand on a wholly different basis from his dealings in real estate. When he first registered Company A in 1989, its business was that of a 'property agency'. Company A carried on such business at an established shop venue in District C. The Taxpayer's real estate business was therefore one with an established track record. The foreign currency dealings were however conducted at home and in the office of Company B.

INLAND REVENUE BOARD OF REVIEW DECISIONS

21. We find it hard to describe the Taxpayer's foreign exchange activities as organised and systematic. There was no separate ledger or bank account. No capital was designated for this venture. Giving every allowance to the reading and research which the Taxpayer alleged he had undertaken for his foreign currency dealings, in the circumstances of this case, they merely pointed to the Taxpayer having, perhaps, an advantage over other investors in the market.

22. We are not persuaded by the Taxpayer's argument as to the amount of time and energy that he spent in his foreign exchange activities. He did not have any capital ear-marked for this venture. He stood to gain or to lose substantially through the volatility of the market. He did not close any of the contracts. He was cautious and most of the positions were liquidated on the same transaction day. Whilst he might be a prudent speculator, these factors do not convert his activities to that of carrying on a trade or business in foreign currency dealings.

23. For these reasons we agree with the assessment and dismiss the appeal.