

# INLAND REVENUE BOARD OF REVIEW DECISIONS

## Case No. D38/96

**Profits tax** – whether the taxpayer was carrying on a trade in nickels future such that the loss in the one-off transaction was deductible.

Panel: Audrey Eu Yuet Mee QC (chairman), Peter R Griffiths and William Zao Sing Tsun.

Date of hearing: 1 August 1996.

Date of decision: 22 August 1996.

### **Appeal dismissed.**

Cases referred to:

CIR v Livingston 11 TC 538  
Cooper v Stubbs 10 TC 29  
CIR v Dr Chang Liang-jen HKTC 975  
Salt v Chamberlain 53 TC 143  
Lewis Emanuel & Sons v White 42 TC 369  
D20/90, IRBRD, vol 5, 164  
D42/90, IRBRD, vol 5, 316  
D57/94, IRBRD, vol 9, 335

May Chan for the Commissioner of Inland Revenue.

Taxpayer in person.

### **Decision:**

#### **A. THE APPEAL**

A.1 The Taxpayer appeals against that part of the determination of the Commissioner of Inland Revenue dated 15 February 1996 whereby the Commissioner upheld the assessor's refusal to accept an amount of \$1,225,000 arising from the closing of some futures contracts as a deductible loss of Company A.

A.2 The issue is whether Company A, which carries on business as a transportation company, had carried on a trade or business in the buying and selling of the nickel futures.

#### **B. BACKGROUND**

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- B.1 The Taxpayer is registered as the sole proprietor of Company A. The principal place of business is in District B. The nature of business is said to be transportation. The date of commencement is said to be 23 January 1990.
- B.2 Company C is said to be a related business. Its business registration has the following particulars. The sole proprietor is Mr D. It has the same principal place of business as Company A. The business is said to be trading investment and the commencement date 1 September 1988.
- B.3 Another related company is Company E, an investment limited. It has three directors namely the Taxpayer, Mr D and one Mr F.
- B.4 The subject futures contracts were not traded through any of the aforesaid businesses or company. Instead, they went through an account held by one Mr G with one Company H, an investment limited. On 7 September 1992, two contracts, one for 24 lots and the other for 180 lots were purchased through Mr G's account. On 13 October 1992, contracts for these 24 lots and 180 lots were closed resulting in a loss of US\$164,592 shown in Mr G's account.
- B.5 The above loss was said to have been paid for by Company A whose bank accounts show the following payments:

9-9-92	US\$64,733.30
30-9-92	HK\$200,000
15-10-92	HK\$185,000
15-10-92	HK\$400,000

The payments add up to some \$1,290,000 which is more than the loss of \$1,225,000 claimed.

### **C. THE TAXPAYER'S EVIDENCE**

- C.1 The Taxpayer gave evidence. He said that he had a share in all three businesses set out in B.1 to B.3 above. Despite the business registration, he and Mr D were in fact equal partners in Company A and Company C. Both Company C and Company E traded in metals, that is, the buying and selling of physical metal. Company A delivered the metals for Company C. In support of the above, he produced a number of invoices addressed to or from Company C or Company E during the relevant year of assessment.

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- C.2 He explained that transactions in nickel futures were not done by way of speculation. They served as a hedge against the fluctuating price of the metal and were ancillary to the trading of the physical metal.
- C.3 He also explained why the transaction was done through Mr G's account. Mr G was the proprietor of Company I, one of their biggest suppliers. Mr G was also a trusted friend. For trading in futures, the investment company would not readily accept new customers. There were also margin requirements and new customers would not be given the best price. Since Mr G already had an account, the Taxpayer would not have to pay margin deposit if he traded through Mr G's account. Of course, if the price fell, he would have to pay the margin call.
- C.4 According to the Taxpayer, Company A only ever dealt with nickel futures on that one occasion. He said this in evidence:
- ‘Actually we should use the name of Company C. When we lose money, we pay cheque in Company A's name because Mr G did not want Company H to know that the contract is mine.’
- C.5 The Taxpayer said he or Company C had done transactions in nickel futures on other occasions. But they would similarly use other people's accounts. The other transactions were with Company J in Country K or Company L in Hong Kong.
- C.6 The Taxpayer was shown the return submitted by Company C for the relevant period. It showed a loss. He was asked but could not tell if the transactions in metal futures which Company C had done had been included in the return. As far as he could recollect, Company C had not included such transactions in its tax returns.

### **D. THE LAW**

- D.1 The relevant section is section 14(1) of the Inland Revenue Ordinance (the IRO). The question is whether the Taxpayer had been carrying on a trade or business. ‘Trade’ is defined in section 2 of the IRO to include ‘every trade and manufacture, and every adventure and concern in the nature of trade’.
- D.2 There is no rule which prohibits a transportation company from carrying on a trade in metal futures. It is a matter of fact to be decided on all the circumstances of the case.
- D.3 It is also well established that one single transaction may constitute an adventure in the nature of trade.

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D.4 There are many decisions which set out the applicable principles in this type of case, including:

CIR v Livingston 11 TC 538

Cooper v Stubbs 10 TC 29

CIR v Dr Chang Liang-jen HKTC 975

Salt v Chamberlain 53 TC 143

Lewis Emanuel & Sons v White 42 TC 369

D20/90, IRBRD, vol 5, 164

D42/90, IRBRD, vol 5, 316

D57/94, IRBRD, vol 9, 335

D.5 The above cases establish the following principles:

- (a) It is a question of fact to be decided on all the circumstances of each case.
- (b) An isolated trading transaction outside a man's ordinary business may amount to the carrying on of a trade.
- (c) Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption is that he is not.
- (d) For dealing in securities or futures, there has to be a habitual and systematic course of dealing. It is a question of degree.
- (e) Though it is not essential that a person carrying on a trade or business must have an office and staff and organisation, where none of these attributes exist, there must be other clear evidence of carrying on a trade or business.

## **E. REASONS FOR DECISION**

E.1 The Taxpayer had quite frankly told us that the subject transaction was in fact Company C's. It was not intended for Company A and it was outside Company A's ordinary course of business. It was only booked into Company A's accounts because of Mr G's request. Even if the partners behind Company A and Company C were the same, there were separate businesses for tax

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purposes. On the Taxpayer's own evidence, Company A never carried on any business in nickel futures.

- E.2 It was an one-off transaction. There was no habitual or systematic operation. Indeed no habitual or systematic operation was intended. Company A did not have its own account. There was not even the barest minimum for the carrying on of such trade.
- E.3 Dealing in nickel future might have been a wise hedge in respect of Company C's trade in physical metals but such transactions were not even included in Company C's accounts, a fortiori, we do not see how any such transaction can be a trade carried on by Company A.
- E.4 For the above reason, we have no doubt that the loss of \$1,225,000 was not a deductible loss and the appeal is accordingly dismissed.