

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D44/02

Profits tax – deductions – deduct from gains arising from sale of property – appeal – withdraw appeal – section 68(1A) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Shirley Conway and Stephen Yam Chi Ming.

Dates of hearing: 30 August 2001 and 17 June 2002.

Date of decision: 26 July 2002.

The appellant, a company incorporated in Hong Kong, had only two shareholders who were also the only directors of the appellant company. The two shareholders/directors of the appellant company were also the only directors of Company D. The appellant company purchased and then sold a property and sought to deduct from its gains arising from the sale of the property various items allegedly paid in favour of Company D. The appellant company produced certain documents in support of its claim. The representative of the appellant company was hopelessly unprepared for the hearing. The Board adjourned the hearing to give the appellant company an opportunity to properly discharge its onus. During the adjournment the appellant company indicated its wish to withdraw its appeal. No attempt was made by the appellant company to put the adjourned hearing to constructive use.

Held:

1. The appellant company failed to discharge the onus resting on them to prove to the Board's satisfaction on a balance of probabilities that the sums in question were truly incurred. The documents were not genuine documents. They did not reflect the actual transactions that took place between the appellant company and Company D.
2. By virtue of section 68(1A) of the IRO, the appellant company was not at liberty to terminate its appeal.

Appeal dismissed.

Cheung Mei Fun for the Commissioner of Inland Revenue.

Taxpayer represented by its director.

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Decision:

1. The Appellant ('Company A') is a company incorporated in Hong Kong on 17 June 1993. At all material times, its authorised share capital is \$10,000 divided into 10,000 ordinary shares of \$1 each. Its issued share capital is two shares of \$1 each. They are registered in the names of Madam B and her husband Mr C. Madam B and Mr C were both appointed directors of Company A on 8 July 1993.
2. Company D is another company incorporated in Hong Kong on 3 June 1986. Mr C and Madam B were at all material times the only directors of Company D.
3. By a sale and purchase agreement dated 29 June 1993, Company D agreed to purchase a shop ('Shop E') from Company F for \$5,500,000. Disputes arose between Company F and Company D in relation to this transaction. Company D sought to rescind the 29 June 1993 agreement on the basis of misrepresentation. Company F instituted proceedings in the District Court on 13 January 1994. Company F did not pursue their action with vigour. The action was eventually struck out on 8 January 1996.
4. By a provisional agreement dated 16 July 1993, Company A agreed to purchase a property ('Property G') for \$5,668,000. Company A completed this purchase on 23 August 1993 with the aid of a \$3,960,000 instalment loan extended by Bank H who held a charge over Property G. By a provisional agreement dated 1 February 1994, Company A sold Property G for \$8,800,000. The sale was completed on 5 March 1994 with repayment in favour of Bank H who in turn released their charge.
5. We are concerned with Company A's tax position in the year of assessment 1994/95. Company A sought to deduct from its gains arising from sale of Property G various items of alleged expenditure:
 - (a) Rent and rates: \$531,000.
 - (b) Agency fees on purchase and sale of Property G in the sums of \$100,000 and \$1,320,000 allegedly paid in favour of Company D.
 - (c) Loan interest of \$468,750 also allegedly paid in favour of Company D.
6. Throughout the hearing before us, Madam B appeared on behalf of Company A. At the inception of the hearing on 30 August 2001, she abandoned Company A's claim for deduction of \$531,000 in respect of rent and rates.

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7. In respect of its claim for deduction of agency fees allegedly paid in favour of Company D, Company A supported this claim by the following documents:

- (a) A receipt dated 24 July 1993 issued by Company D in favour of Company A for \$100,000 allegedly for successfully introducing the purchase of Property G.
- (b) A further receipt also signed by Company D dated 6 March 1994 which purported to record the following:
 - (i) Commission: \$1,320,000.
 - (ii) Rate of commission:

Price	Commission
Over \$6,500,000	5%
Over \$7,500,000	10%
Over \$8,500,000	15%
Over \$9,500,000	20%

- (iii) Fees covering arrangement of loan at time of purchase and sole agency in sale of Property G for the period between January and March 1994.

8. In respect of its claim for deduction of loan interest of \$468,750 allegedly paid in favour of Company D, Company A supported this claim by the following documents:

- (a) A loan agreement dated 15 July 1993 which provided as follows:
 - (i) Borrower: Company D.
 - (ii) Lender: Company A.
 - (iii) Date and amount of loan: \$500,000 on 22 July and \$2,000,000 on 22 August with year unspecified.
 - (iv) Loan period: Not fixed, the lender could ask the borrower to repay at any time by giving 15 days' notice.
 - (v) Interest rate: 15% per annum, calculated on a monthly basis.

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- (vi) Supplementary conditions: Company A to use this sum for the investment of property. Should profit be made during the loan period, Company D could obtain a certain percent of the profit to be decided by both sides at that juncture.
 - (b) A receipt issued by Company D to Company A dated 5 January 1994 acknowledging \$343,750 in respect of the alleged loan of \$2,500,000 for a period between 1993 and 1994.
 - (c) A further receipt issued by Company D to Company A also dated 5 January 1994 acknowledging \$125,000 in respect of an alleged loan of \$2,500,000 for a further period which is not legible on our copy receipt.
9. At the 30 August 2001 hearing, Madam B told us that:
- (a) Company D had accumulated substantial loss in the course of its business. Such loss was available to set off any profit of Company D.
 - (b) Had Company D not been involved in litigation with Company F over Shop E, Company D would have been used to purchase Property G. Company A was used in order to minimise risks arising from the litigation with Company F.
 - (c) She was uncertain whether the alleged commission of \$1,320,000 was actually paid. She said she had to check before she could confirm one way or the other.
 - (d) She could not assist in the method of computing the interest depicted in the various receipts. She said the computation was done by Company A's accountant.
10. Madam B was hopelessly unprepared at the 30 August 2001 hearing. We decided to adjourn that hearing to give Company A an opportunity to properly discharge its onus.
11. By letters dated 17 September 2001 and 4 March 2002, Company A indicated its wish to withdraw its appeal. By letter dated 19 September 2001, this Board informed Company A that by virtue of section 68(1A) of the IRO, Company A is not at liberty to terminate its appeal.
12. We resumed our hearing on 17 June 2002. Madam B made no attempt to tender any documentary evidence to prove any advance from Company D to Company A and any payment by Company A to Company D which formed the subject matter of the receipts dated 5 January 1994 and 6 March 1994. No explanation was given to us as to the basis leading to the alleged

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payments of \$125,000 and \$343,750. No attempt was made by Company A to put the adjourned hearing to constructive use.

13. The primary concern expressed by Madam B at the adjourned hearing was the risk of having to pay tax twice. She said the Revenue had accepted the validity of the subject transactions as depicted in the accounts of Company D. The Revenue had repeatedly pressed Company D for payment. Ms Cheung for the Revenue indicated that Company D's file was handled by a different section in the Inland Revenue Department. She further indicated that the Revenue would make appropriate adjustments in the light of our ruling. With the consent of Madam B for Company D, we asked for sight of the correspondence between the Revenue and Company D.

14. After perusal of the correspondence between Company D and the Revenue, we are of the firm view that any concern of Madam B on behalf of Company A and Company D is illusory. The Revenue took numerous proceedings to enforce the liability of Company D. The tax representative of Company D was told of its outstandings on 20 September 2001. Company D apparently took no step to discharge those outstandings. We are satisfied that the position of both companies is adequately protected by the assurance which we had from Ms Cheung.

15. We are of the firm view that Company A failed to discharge the onus resting on them to prove to our satisfaction on a balance of probabilities that the sums in question were truly incurred. The loan agreement and the various receipts are not genuine documents. They do not reflect actual transactions that took place between Company A and Company D. These documents are no more than belated attempts to transfer the profits to Company D so as to enable Company D to set off its accumulated loss.

16. For these reasons, we reject the claim of Company A and dismiss its appeal.