INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D55/88

Assessment – error – power to correct assessment – whether correction could be made to an assessment issued as a result of an agreement or compromise between the taxpayer and the IRD – s 70A of the Inland Revenue Ordinance.

Profits tax – rental income derived by individual – whether profits from a business – whether subject to profits tax – s 14 of the Inland Revenue Ordinance.

Property tax – rental income derived by an individual – whether profits from a business – whether subject to property tax.

Panel: William Turnbull (chairman), Christopher Chan Cheuk and Benjamin Kwok Chi Bun.

Date of hearing: 20 September 1988.
Date of decision: 1 December 1988.

The taxpayer carried on business as a Chinese herbalist in premises which he owned. The whole of the premises were rented to a Chinese medicine company whose business was separate from that of the taxpayer. The taxpayer nevertheless was permitted by the tenant to occupy a portion of the premises rent-free.

The taxpayer had expressly agreed with the IRD that the rental income which he received from the premises should be assessed to profits tax and not to property tax. The IRD issued assessments on this basis. The taxpayer subsequently changed his mind, and requested that the IRD issue a corrected profits tax assessment pursuant to s 70A excising the rental income.

The taxpayer had not claimed depreciation allowances and interest deductions with respect to the premises, and the premises were not shown in the taxpayer's business accounts.

The IRD refused to issue a corrected assessment. The taxpayer appealed against the IRD's refusal.

Held:

No corrected assessment should be issued.

(a) Section 70A cannot apply where the assessment complained about was issued as a result of an agreement or compromise by the taxpayer and the taxpayer subsequently changes his mind. The taxpayer is bound to such an agreement or compromise and the Board of Review cannot interfere with the terms thereof.

(b) The negotiations leading up to such an agreement or compromise are not relevant. The Board will not allow a taxpayer to plead fundamental error on his part or misrepresentation on the IRD's part in the making of any such agreement of compromise. These matters should be raised before a judge [Editor's note: presumably in an action for judicial review].

(c) Were the Board to consider the matter, it would find that the rental income was not derived from the carrying on of the taxpayer's business and should therefore properly have been assessed to property tax.

Appeal dismissed.

Ho Chi Ming for the Commissioner of Inland Revenue.
Stanley So of Stanley So & Co for the taxpayer.

Decision:

This is an appeal by a Taxpayer against a refusal by the Commissioner to correct an alleged mistake under section 70A of the Inland Revenue Ordinance. It relates to additional profits tax assessments for the years 1980/81 through to 1982/83 and profits tax assessments for the years 1983/84 and 1984/85.

The facts were as follows:

1. A Chinese medicine company ('the company') carried on its business in a building in Hong Kong ('the premises'). The company was a partnership business. The Taxpayer was a Chinese herbalist who carried on his business in the same premises as the company. The Taxpayer did not have a financial interest in the company and was not an employee of the company. He was attached to or associated with the company because the company required a 'resident herbalist' to enable it to carry on its business of selling Chinese medicine. Thus, it was convenient for the Taxpayer to carry on his separate business as a herbalist in the same premises as the company and likewise it was convenient for the company to permit the Taxpayer to occupy part of the premises.

2. The company was the tenant of the premises and the Taxpayer was a sub-tenant.

3. In March 1973, the landlord of the premises notified the company that the landlord wished to sell the premises and gave the company six months' notice to quit the premises.

4. The company negotiated successfully with the landlord to purchase the premises. A deposit was paid but the company was unable to complete the purchase because it did not have sufficient funds. The Taxpayer was then approached by the company with a view to the Taxpayer acquiring the premises. The company did not wish to forfeit its deposit and presumably also did not wish to vacant the premises. The Taxpayer held a family meeting and, with the support of his relatives, he purchased the premises.

5. The company continued to occupy the premises and the Taxpayer continued to occupy part of the premises in the same way as they had respectively done prior to the Taxpayer purchasing the same. The only change which had taken place was that the landlord had changed from being a third party to being the Taxpayer.

6. On the evidence before us, it is not clear as to whether or not the company paid a higher or lower rent after the Taxpayer purchased the premises and likewise it is not clear as to whether or not the Taxpayer paid any rent as sub-tenant or licensee of the company either before or after he purchased the premises. Presumably, both before and after the purchase of the premises by the Taxpayer, the company paid the same rent for the entire premises and allowed the Taxpayer to occupy part of the premises free of charge as part of the arrangement between the company and the Taxpayer. At least there is no evidence before us that the Taxpayer paid any rent to the company but there is evidence that the company paid rent for the entirety of the premises both before and after the Taxpayer bought the premises. After the purchase of the premises, the company continued to operate the same business as it had before and the Taxpayer likewise continued to operate the same business as he had before and the relationship between the Taxpayer and the company remained the same except that the company was now a tenant of the Taxpayer and not of the previous owner of the premises.

7. It was stated by the Commissioner in his determination that, after the Taxpayer purchased the premises, he let only part of the premises to the company and retained that part which he occupied himself. With due respect to the Commissioner, we can find no evidence to support this. It was stated on behalf of the Taxpayer that, when he purchased the premises, the tenancy arrangements were left as they were before except that he was now the landlord. For reasons which will appear later we do not consider this to be material but, if

it were necessary for us to make a decision on the facts regarding this, we would find as a fact that, in the absence of documentary proof or other evidence to the contrary, the tenancy arrangements previously in existence had not changed but were carried on with the Taxpayer being the Landlord and the company being the tenant of the whole of the premises.

8. By letter dated 7 November 1984, the accountants for the Taxpayer wrote to the assessor in reply to a letter from the assessor. In that letter, the accountants set out the rental income received by the Taxpayer for the whole of the premises (not part) for the years 1979 to 1984 inclusive and included the following statement:

> ‘ Our client agreed with your proposal that the rental income should be assessable to profits tax instead of property tax.’

Prior to that date the Taxpayer, through his tax representative, had submitted that the premises should be subject to property tax and that the rental income should not be included for assessment to profits tax.

9. The additional profits tax assessments for the years 1980/81 to 1982/83 and the profits tax assessments 1983/84 and 1984/85 which are the subject matter of this appeal were issued and included the rental income received by the Taxpayer for the premises.

10. The Taxpayer has now appealed to this Board against the refusal by the Commissioner to correct the additional profits tax assessments and profits tax assessments under section 70A by removing from the assessable profits of the taxpayer’s business the rental income of the premises. The Taxpayer submitted that the premises should have been assessed for property tax instead of the rental being assessed for profits tax.

There is only one possible decision which we can reach and it is both clear and simple. The accountants for the Taxpayer, in their letter of 7 November 1984, agreed with the assessor that the rental income for the premises should be assessable to profits tax instead of property tax. We do not know and we are not concerned with what negotiations may have taken place between the parties. The Taxpayer originally submitted that the premises should be subject to property tax and that the rental should not be included for assessment to profits tax. Obviously there must have been a change of mind on the part of the Taxpayer. Section 70A of the Inland Revenue Ordinance can have no application in such circumstances. Where the parties have agreed to a compromise, the Board of Review has no jurisdiction to interfere with the terms thereof. A compromise reached between the Commissioner acting through his assessor as his agent and a taxpayer acting through a tax representative as his agent constitutes a legally binding and enforceable agreement between the two parties.

There was no suggestion before us that the agreement had been reached either through fundamental error or misrepresentation. However, even if such claims were to be made, they cannot be made before a Board of Review but must made before a judge. We have no jurisdiction to hear contractual matters.

As we have said, the reasons why a taxpayer may enter into a compromise with the Commissioner are not material. However, we consider it appropriate to make one observation. The Acting Commissioner in the reasons for his Determination has placed great importance on the fact that the Taxpayer had let only a portion of the premises to the company. This is contrary to all of the statements made by the Taxpayer through his various representatives and seems to be an unwarranted assumption or finding of fact. If this appeal were to fall to be decided on a finding on the facts before us as to whether the premises were a business asset, we would have found in favour of the Taxpayer. There are strong indications to support the proposition that the premises were not part of the business assets of the Taxpayer. For example, in the course of the hearing, the Commissioner's representative stated that no depreciation allowance had been granted in respect of the premises, that no interest had been allowed with regard to moneys borrowed in respect of the premises, and that the premises had not been shown as a capital asset in the accounts of the Taxpayer.

However, all of this is irrelevant. On 7 November 1974, the Taxpayer agreed to a proposal that rental income from the premises would be subject to profits tax as forming part of his business income. Section 70A of the Inland Revenue Ordinance can have no application in such circumstances. In this crucial regard we agree with the Acting Commissioner's determination and dismiss the appeal.