

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D57/04

Profits tax – onus wholly on the appellant to show the assessment excessive or incorrect on appeal – section 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Lam Wing Wo and Adrian Wong Koon Man.

Dates of hearing: 9 and 16 October 2004.

Date of decision: 17 November 2004.

The appellant was a developer of eight small houses ('the Properties') in the New Territories, Hong Kong.

On diver days in October, November 1998 and January 1999, according to the Land Registry, the Properties had been sold at total sales proceeds of \$28,980,000.

On 3 May 1999, tax return for the year of assessment 1998/99 was issued to the appellant.

The appellant did not submit his tax return for 1998/99 until 18 April 2001 in which he did not report any profits on disposal of the Properties.

On 26 May 2003, the assessor raised on the appellant an estimated assessable profits of \$8,694,000 for 1998/99 derived from the disposal of the Properties.

On 25 June 2003, the appellant objected and in support, provided a profit and loss account for the year ended 31 March 1999 showing a gross income of \$18,800,000 and net profit of \$4,833,304.

The appellant, in spite of reminder, did not reply to the assessor's enquiry made by letter dated 10 July 2003 to him as to:

- The apparent discrepancy between the total sales proceeds (of \$28,980,000) on disposal of the Properties as shown in the Land Registry's records and the gross income (of \$18,800,000) shown in the account.
- The provision of documents to substantiate the construction cost (of \$11,760,360) and the commission expense (of \$2,080,000) claimed.

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In the absence of any reply from the appellant, the assessor then proposed to revise the estimated assessable profits to \$17,942,895 which was agreed and confirmed by the Deputy Commissioner in his determination on 28 May 2004.

On 25 June 2004, in his notice of appeal, the appellant contended that the net profit for the year ended 31 March 1999 should be further revised to \$993,664.

Held:

1. Neither the appellant nor his witness was a credible witness and thus their evidence rejected by the Board.
2. The appellant failed to discharge his onus of showing that gross proceeds on the disposal of the Properties were not \$28,980,000 as registered in the Land Registry.
3. The Board was not satisfied that any of the two purportedly 'original' agreement(s) dated 22 December 1996 produced on 9 and 16 October 2004 by the appellant to the Board was an authentic or contemporaneous document. There will come a time when the Board will have to refer the same to the Secretary of Justice.
4. The appellant adduced no evidence whatsoever on the amount of construction cost claimed.
5. Subject only to the concession made on behalf of the Inland Revenue Department which resulted in the Board's reducing the assessment appealed against, the appellant has failed in this appeal.
6. Should there be no concession and reduction the Board would have jurisdiction and ordered costs against the appellant.

Appeal dismissed.

Leung Wing Chi for the Commissioner of Inland Revenue.

Ko Kok Fai of Messrs Ko & Chow, Solicitors, for the taxpayer.

Decision:

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1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 28 May 2004 whereby the profits tax assessment for the year of assessment 1998/99 under charge number 3-2220901-99-2, dated 26 May 2003, showing assessable profits of \$8,694,000 with tax payable of \$1,304,100 was increased to assessable profits of \$17,942,895 with tax payable of \$2,691,434.

The admitted facts

2. The facts in the 'Facts upon which the Determination was arrived at' in the determination were admitted by the appellant and we find them as facts.

3. The appellant objected to the profits tax assessment for the year of assessment 1998/99 raised on him, claiming that the assessable profits were excessive.

4. By an authorisation agreement dated 13 November 1996, the appellant as developer of eight small houses at Lot Nos A, B, C, D, E, F, G and H in DD I, District J, New Territories authorised a Mr K to sign on his behalf all the documents relating to the development. It was explicitly stated in the agreement that all the income derived from the eight small houses should belong to the appellant.

5. The construction of the eight small houses, known as Blocks 1-3, 5-6, and 8-10, Garden L at Address M in District J, New Territories (collectively 'the Properties') was completed. The Certificate of Compliance was issued on 5 March 1998. According to the District J Land Registry, the Properties were sold with particulars as follows:

Lot no	Garden L	Floor	Date of the sale and purchase agreement	Sale proceeds (\$)
A	Block 6	G/F	10-11-1998	1,800,000
		1/F	17-11-1998	1,080,000
		2/F and roof	30-10-1998	1,080,000
B	Block 5	G/F	2-11-1998	1,400,000
		1/F	30-10-1998	1,000,000
		2/F and roof	31-10-1998	1,400,000
C	Block 3	G/F	9-11-1998	1,110,000
		1/F	17-10-1998	990,000
		2/F and roof	27-10-1998	1,520,000
D	Block 8	G/F	20-10-1998	1,080,000
		1/F	21-10-1998	990,000
		2/F and roof	21-10-1998	1,240,000
E	Block 2	G/F	8-1-1999	1,080,000
		1/F	27-10-1998	1,410,000
		2/F and roof	16-10-1998	1,320,000

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F	Block 9	G/F	6-11-1998	1,400,000
		1/F	20-10-1998	1,000,000
		2/F and roof	9-11-1998	1,240,000
G	Block 1	G/F	6-11-1998	1,110,000
		1/F	19-10-1998	1,000,000
		2/F and roof	22-10-1998	1,300,000
H	Block 10	G/F	22-10-1998	1,150,000
		1/F	22-10-1998	1,010,000
		2/F and roof	4-11-1998	1,270,000
			Total	28,980,000

6. The appellant did not report the profits on disposal of the Properties in his tax return for the year of assessment 1998/99. The assessor raised on the appellant the following 1998/99 profits tax assessment to assess the profits derived from the disposal of the Properties:

Estimated assessable profits	<u>\$8,694,000</u>
Tax payable	<u>\$1,304,100</u>

7. Company N objected on behalf of the appellant to the above 1998/99 profits tax assessment on the ground that the assessment was excessive. In support of the objection, Company N provided a profit and loss account for the year ended 31 March 1999 in respect of the appellant showing net profits of \$4,833,304. Details of the profit and loss account are shown as follows:

Service charge received	<u>\$18,800,000</u>
<u>Less: Outgoing expenses</u>	
Accountancy charges	3,000
Commission paid	2,080,000
Construction cost	11,760,360
Entertainment expenses	18,625
Legal fee	74,075
Printing and stationery	1,825
Transportation	26,120
Travelling expenses	<u>2,691</u>
	<u>13,966,696</u>
Net Profit for the year	<u>\$4,833,304</u>

In schedule to the account, it was stated that out of \$2,080,000, the total amount of commission paid, \$2,000,000 was paid to Mr O.

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8. By letter dated 10 July 2003, the assessor raised enquiries with the appellant on the account. In particular, the assessor asked for explanation of the apparent discrepancy between the total proceeds on disposal of the Properties [paragraph 5] and the gross income shown in the profit and loss account [paragraph 7]. The assessor also requested the appellant to provide documents to substantiate the construction cost and commission expense claimed. Despite the issue of a reminder, the appellant had not replied to the assessor's queries.

9. According to Mr O, he acquired Lot Nos A-P in DDI, District J, New Territories in June 1992. He intended to build thirteen small houses on the land lots. The applications to build thirteen small houses on the land lots were approved by the Government in 1996. At that time, he had financial problem. Therefore, he sold the interest in the development project to the appellant for a consideration of \$2,000,000.

10. The assessor estimated the construction cost of a small house at \$1,200,000. She therefore proposed to revise the 1998/99 profits tax assessment as follows:

Sale proceeds of the Properties [paragraph 5]	<u>\$28,980,000</u>
<u>Less: Outgoing expenses</u>	
Accountancy charges	3,000
Commission paid [$\$2,000,000 \times 8/13 + \$80,000$]	1,310,769
Construction cost [$\$1,200,000 \times 8$]	9,600,000
Entertainment expenses	18,625
Legal fee	74,075
Printing and stationery	1,825
Transportation	26,120
Travelling expenses	<u>2,691</u>
	<u>11,037,105</u>
Net profit for the year	<u>\$17,942,895</u>
Tax payable	<u>\$2,691,434</u>

The notice of appeal

11. The Deputy Commissioner agreed with the assessor's proposed revision.

12. By letter dated 25 June 2004, Company N filed notice of appeal on behalf of the appellant contending that the net profit should be \$993,664 and enclosed a copy of an agreement dated 8 October 1996 and what purported to be a copy ('the B9 copy') of an alleged agreement dated 22 December 1996 ('the alleged 22 December 1996 agreement') alleged to have been made by the appellant and Mr Q. Company N wrote as follows (written exactly as it stands in the original):

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' We are the authorized representative of the above named client and would like to lodge a formal notice of appeal on his behalf which hereby does against the Determination of Inland Revenue Department relying upon the following grounds:

- (a) By an agreement dated October 8, 1996, our client being the developer of 13 small houses at [Lot Nos A-P] in [DDI]. All development costs were paid by our client including a sum of \$2,000,000 (\$3,000,000 stated in the agreement and later agreed at \$2,000,000) paid to [Mr O]. In return, 8 blocks were allocated to our client. The remaining 5 blocks were allocated to [Mr R] and [Company S] for the right of development.

In view of the above, all development costs of the 13 blocks were incurred in the production of profits for the 8 blocks sold.

- (b) According to another agreement dated December 22, 1996, the income of the 8 blocks were \$2,350,000 per block totally \$18,800,000. The balance of the sale proceeds were received by a property agent, [Mr Q].
- (c) Agreed with Assessor for the construction cost to be \$1,200,000 per block but all 13 blocks should be incurred.
- (d) Our client did not reply to the Assessor's queries because the said agreements were lost. At the time of the Assessor's queries, the agreement was signed more than 7 years and it is difficult for our client to find or obtain from other party. After many requests made to the [Solicitor firm T], copy of the agreement was eventually received on June 24, 2004.

With the foregoing facts and reasons, our client revises his Profit and Loss Account for the year ended March 31, 1999 as follows:

	HK\$
Service charge received (\$2,350,000 x 8)	18,800,000
<u>Less: Outgoing expenses</u>	
Accountancy charges	3,000
Commission paid	2,080,000
Construction cost (\$1,200,000 x 13)	15,600,000
Entertainment expenses	18,625
Legal fee	74,075
Printing and stationery	1,825
Transportation	26,120
Travelling expenses	2,691
	<u>17,806,336</u>

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Net Profit for the year \$993,664

The profit for the property development should be \$993,664 instead of \$17,942,895 as assessed by IRD.

Attached please find copies of the 2 mentioned agreement, the Commissioner's determination and the statement of facts.'

13. The allegations which the appellant made through Company N were that:
- (a) the original (or duplicate) of the alleged 22 December 1996 agreement had been lost;
 - (b) a *copy* of the alleged 22 December 1996 agreement was received on 24 June 2004;
 - (c) the B9 copy was a copy (or a copy of a copy) of the alleged 22 December 1996 agreement.
14. The document from which the B9 copy was a copy contained what purported to be the signatures of the appellant and Mr Q.

The appeal hearing

15. The appeal came up for hearing on 9 October 2004. The appellant was present at this hearing and was represented by Mr Ko Kok-fai of Messrs Ko & Chow, solicitors. The respondent was represented by Ms Leung Wing-chi, assessor.
16. Mr Ko Kok-fai called the appellant, Mr Q, and a conveyancing clerk from Solicitor firm T, to give oral evidence.
17. Both the appellant and Mr Q asserted on oath that:
- (a) by the alleged 22 December 1996 agreement Mr Q guaranteed that the sale price of each house would be \$2,350,000; and
 - (b) at the appellant's entitlement was fixed at \$2,350,000 per house.
18. The conveyancing clerk claimed that Solicitor firm T had nothing to do with the alleged 22 December 1996 agreement.
19. Ms Leung Wing-chi did not adduce any oral evidence.

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20. We requested the appellant through Mr Ko Kok-fai to produce the original of the alleged 22 December 1996 agreement. The purported original which was shown to us on 9 October 2004 purported to have been signed by Mr Q but not the appellant. We noted that the document seemed quite new for a document said to have come into existence more than seven years ago.

21. Mr Ko Kok-fai said that the appellant might have another 'original' and asked for an adjournment for him to make the other 'original' available. We acceded to his request and adjourned the hearing to 16 October 2004.

22. The appellant absented himself from the hearing on 16 October 2004. As with the appellant, the 'original' shown to us on 9 October 2004 also disappeared from our sight.

23. Mr Ko Kok-fai produced what purported to be another original or duplicate of the alleged 22 December 1996 agreement. This document purported to have been signed by both the appellant and Mr Q. This document also seemed quite new for a document said to have come into existence more than seven years ago. Mr Ko Kok-fai did not adduce any evidence to explain the documentation.

24. In her final submission, Ms Leung Wing-chi:

- (a) accepted that 'commission paid' should be \$2,080,000; and
- (b) was prepared to accept deduction of \$1,200,000 for each of eight houses as construction cost and premium and a further deduction of \$700,000 for each of the remaining five houses as construction cost, making a total of \$13,100,000.

25. Thus, there were only two items in dispute. The first was whether the income was \$28,980,000 as contended by the respondent or \$18,800,000 as contended by the appellant. The second was the amount of construction cost and the amount of premium paid by the appellant.

Our decision

26. Section 68(4) of the Inland Revenue Ordinance ('IRO'), Chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

27. The appellant had treated his obligations, including reporting obligations, under the Ordinance with contempt and he could not possibly complain about or rely on lapse of time.

- (a) The return for the 1998/99 year of assessment was issued on 3 May 1999.

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- (b) The appellant did not submit it within the 3-month time limit.
- (c) By letter dated 28 September 1999 received by the Inland Revenue Department on 2 October 1999, he applied for an extension until the beginning of December to submit the return. The excuse he put forward was that time was required for audit of limited company or companies.
- (d) He did not submit his return by early December 1999.
- (e) He did not submit his return by 2000.
- (f) On 19 March 2001, he was convicted for failure to submit the 1998/99 return and was ordered to submit his return by 18 April 2001.
- (g) On 18 April 2001, he submitted his return, leaving the section on profits tax **blank**.
- (h) By letter dated 20 September 2002, the assessor made enquiries.
- (i) Not having received any response, the assessor issued estimated assessment on 26 May 2003 [paragraph 6].
- (j) By letter dated 25 June 2003, Company N objected to the estimated assessment and submitted a profit and loss account [paragraph 7].
- (k) By letter dated 10 July 2003, the assessor made enquiries [paragraph 8].
- (l) On 28 May 2004, the Deputy Commissioner determined the objection, not having received any response to the assessor's enquires.
- (m) The appellant's notice of appeal was received by the Clerk to the Board of Review on 26 June 2004.
- (n) By letter dated 30 August 2004, the Clerk gave notice of hearing and requested the appellant to submit his documents and authorities bundles by 22 September 2004.
- (o) There was no response from the appellant until Company N wrote its letter dated 'September 7, 2004' received by the Clerk on 7 October 2004 saying that the appellant 'would like to defer the hearing for one month' on the ground

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of receipt from the respondent of documents 'dated September 30, 2004 and today'.

- (p) By letter dated 8 October 2004, the Clerk replied saying that the Chairman of the panel was not persuaded to reschedule the hearing.

28. The case put forward by the appellant was that his entitlement was fixed at \$2,350,000 by the alleged 22 December 1996 agreement which he entered into with Mr Q. We reject it for the following reasons:

- (a) Mr Q had no experience, expertise or financial resources for small house projects. We are not satisfied on a balance of probabilities that the appellant made the alleged 22 December 1996 agreement with Mr Q. If the appellant was looking for a safety net or a 'sub-contractor', Mr K would have been a more convincing choice.
- (b) The first allegation of the existence of the alleged 22 December 1996 agreement was made by Company N on behalf of the appellant in the notice of appeal dated 25 June 2004.
- (c) The appellant alleged through Company N that the original had been lost. However, the appellant, through Mr Ko Kok-fai, produced two purported originals.
- (d) The allegation that a copy was obtained from Solicitor firm T was contradicted by what one of their conveyancing clerks said on oath.
- (e) In our decision, neither the appellant nor Mr Q was a credible witness and we reject their evidence.
- (f) We are not satisfied on a balance of probabilities that either the 'original' shown to us on 9 October 2004 or the 'original' produced on 16 October 2004 was an authentic or contemporaneous document. The appellant made no attempt to explain the discrepancies in the documentation. We were almost minded to refer the file to the Secretary for Justice. We emphasize, however, that the integrity of the appeal process to the Board of Review must be respected and protected. There will come a time when the Board will have to refer to the Secretary for Justice.

29. The conveyancing documents registered at the Land Office showed that the appellant received in total \$28,980,000 for the eight houses. The appellant has failed to discharge the onus on him to show that the income was not \$28,980,000.

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30. Ms Leung Wing-chi drew our attention to the provisions in some sale and purchase contracts which provided that the 'developer' was only responsible for premium up to \$500,000 per house. Mr Ko Kok-fai submitted that we had not been shown all the sale and purchase contracts. With respect, the onus is on the appellant to show that the assessment appealed against is excessive or incorrect, not on the respondent to show that the assessment is correct. The appellant has failed to satisfy us on a balance of probabilities that the premium for each of the eight houses exceeded \$500,000, the appellant being under no obligation to obtain consent to sell in respect of the remaining five houses.

31. On the amount of construction cost, Ms Leung Wing-chi was prepared to concede \$700,000 for each house. The appellant has not adduced any evidence on the amount of construction cost. The appellant has not begun to discharge the onus on him. He has failed to satisfy us on a balance of probabilities that the construction cost of each of the 13 houses exceeded \$700,000.

32. Subject only to the concession by Ms Leung Wing-chi, the appellant has failed in this appeal. To give effect to the concession, we reduce the assessment appealed against to one showing assessable profits of \$13,673,664 with tax payable of \$2,051,049.

33. Because of this concession and reduction, we have no jurisdiction to order costs against the appellant. If we had jurisdiction, we would have done so.