

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D57/88

Appeals – evidence – substantial receipts of money – lack of evidence as to whether taxpayer was carrying on a trade or business – inferences to be drawn.

Profits tax – commission payments – casual receipts – whether taxpayer was carrying on a trade or business – s 14 of the Inland Revenue Ordinance.

Profits tax – trade or business – whether company is more likely to be carrying on trade or business than an individual – s 14 of the Inland Revenue Ordinance.

Panel: Henry Litton QC (chairman), David Ling Dah Wai and Peter G Willoughby.

Dates of hearing: 16 and 17 November 1988.

Date of decision: 1 December 1988.

The taxpayer received substantial commission payments for introducing sellers and purchasers with respect to two separate transactions. The payors were companies which were controlled by a friend of the taxpayer. The taxpayer had not registered under the Business Registration Ordinance.

The IRD assessed the taxpayer to profits tax with respect to these payments on the basis that he was carrying on business as a commission agent. The taxpayer appealed, and argued that he did not carry on any trade, profession or business.

The taxpayer presented no evidence before the Board of Review.

Held:

The commissions were subject to profits tax.

- (a) For a receipt of money to be chargeable to profits tax, there must be some factors to suggest that the recipient was carrying on a business activity.
- (b) Such an inference of business activity can be more readily inferred in the case of a company than in the case of an individual.
- (c) The issue before the Board is whether the taxpayer's activities giving rise to the receipt of money were of the same kind and were carried on in the same

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way as those which are characteristic of ordinary trading in the line of business in which the taxpayer's transactions were made.

- (d) In the absence of evidence, the Board could not infer that the payments to the taxpayer were a result of no effort on his part and that the payors simply gave him large sums of money for little or no effort. It is unlikely that directors of a company, who owe fiduciary duties to shareholders, would simply authorise large payments of money to their friends.
- (e) The Board could only infer, in the absence of evidence and notwithstanding the low number of transactions involved, that the taxpayer must have engaged in activities which were characteristic of a broker or commission agent who uses his contacts and experience in order to generate commissions.

Appeal dismissed.

Cases referred to:

CIR v Livingston (1927) 11 TC 538  
Lam Woo Shang v CIR (1961) 1 HKTC 123  
Ransom v Higgs [1974] 1 WLR 1594  
Smith v Anderson (1880) 15 ChD 247

Jennifer Chan for the Commissioner of Inland Revenue.  
David Flux of Peat Marwick for the taxpayer.

Decision:

### Introduction

1. This is an appeal by the Taxpayer against a profits tax assessment for the year 1979/80, as confirmed by the Commissioner in his determination.
2. The profits tax assessment was made on account of the receipt by the Taxpayer of three sums of money as follows:

	<u>Date of Receipt</u>	<u>Name of Payer</u>	<u>Amount</u> \$
(i)	12 November 1979	A Company	779,281.60
(ii)	12 November 1979	B Company	278,968.40

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(iii) 21 December 1979	C Company	<u>5,113,692.00</u>
	Total	<u>6,171,942.00</u>

### Background facts

3. The Taxpayer was at all material times employed by C Company. This employment was full-time.

4. The receipt of income outside of his salaried employment was disclosed by the Taxpayer to the assessor by letter dated 28 June 1980 in the following terms:

‘I have, during the year ended 31 March 1980, received payments from A Company and C Company and understand that details of these payments have been reported to you by those companies. I wish to report that the payments were made to me as a gift for introducing some business to those companies and as I am neither an employee of the companies in question nor did I receive the payments in the course of any business carried on by me, I am advised that I am not subject to tax thereon’.

5. With regard to the sum of \$5,113,692 from C Company, referred to in paragraph 2(iii) above, this was in the nature of commission paid to the Taxpayer on account of the Taxpayer introducing a purchaser for floors 5 to 23 of a new building called X Building. Each floor was purchased by a separate limited company, but we infer from the evidence that the beneficial ownership of the shares in each of the purchasing companies was the same.

6. The commission fee paid to the Taxpayer in respect of the purchase of X Building was calculated at the rate of 2% of the purchase price and was paid to the Taxpayer by one cheque.

7. As regards the sums referred to in paragraphs 2(i) and (ii) above, received on 12 November 1979, these were paid to the Taxpayer by way of commission for introducing purchasers for shares in a company called E Company which indirectly held a parcel of land in the New Territories. From the statements made by the Taxpayer’s representatives in a letter to the assessor dated 11 July 1985, we infer that there were a number of intermediaries involved in the sale of shares in E Company and the commission paid to the Taxpayer was arrived at by some sharing arrangement between the persons who introduced the purchasers, including the Taxpayer.

8. We have not been given much information concerning the management of the companies which paid the three sums to the Taxpayer, but it appears that in each case the chief executive of the company concerned was Mr Y, a prominent businessman and a friend of the Taxpayer. The terms of engagement and payment were arranged, orally, between the Taxpayer and Mr Y.

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9. The Taxpayer had not registered any business as a broker or commission agent under the Business Registration Ordinance, and there was nothing before us which suggested that the Taxpayer had ever held himself out as carrying on such a trade or business. As mentioned in paragraph 4 above, the Taxpayer regarded the payments from A Company and C Company as 'gifts for introducing some business to those companies': he accordingly lodged no profits tax returns.

10. When the assessor made his estimated assessment for profits tax, only the sums received from A Company and C Company had come to light. The receipt from B Company was discovered only after objection had been raised to the assessment and in the course of correspondence with the assessor, prior to the Commissioner's determination. Accordingly, the Commissioner, in confirming the assessment made by the assessor, increased the amount of assessable profits by including the sum received by the Taxpayer from B Company in respect of the sale of shares in E Company.

### The hearing

11. At the hearing before us, Mr David Flux, the Taxpayer's representative, adduced no evidence beyond agreeing with the statement of facts set out in the Commissioner's determination; but, as much of the statements of fact in the determination consisted of quotations from letters written by the Taxpayer's representative to the assessor, there was little by way of primary facts put before us. We heard no evidence from either the Taxpayer or Mr Y regarding the oral arrangements for paying these substantial sums by way of commission to the Taxpayer. We have heard no evidence regarding the scope of the Taxpayer's employment; the terms of that employment were never put before us.

### 'Carrying on trade or business'

12. The case for the Commissioner broadly speaking is that, in relation to the transactions giving rise to the substantial receipts of commission by the Taxpayer, he was carrying on a trade or business of a commission agent and was therefore, as such, chargeable to profits tax under section 14 of the Inland Revenue Ordinance. By way of reinforcement of her case, the Commissioner's representative, Mrs Jennifer Chan, put in evidence before us a letter from the Taxpayer dated 13 September 1977 relating to employment income received by him for the year ending 31 March 1977 which included a sum of \$120,000 shown in the notice of assessment as 'other income'. In relation to this sum of \$120,000 (or, perhaps more accurately, \$120,900), the Taxpayer described it in his letter of 13 September 1977 as 'only a one-shot deal commission'. Mrs Chan relied upon this as reinforcing her point that the receipt of income by way of commission by the Taxpayer was by no means casual and showed that the Taxpayer had, in the year under review, carried on a trade or business of a commission agent or broker.

13. Turning to the case as put on behalf of the Taxpayer, we accept the broad submission made by Mr Flux that, where an individual is concerned, there must be some

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factors in the case which suggest that the individual was carrying on a 'business activity' before he could be charged to profits tax under section 14 for 'carrying on a trade or business'. The charge to profits tax under section 14 is not a general charge on income; it is narrower in scope than the 'sweeping-up' provision under Case VI of the United Kingdom Income Tax Acts which imposes a charge 'in respect of any annual profits or gains not falling under any other Case of Schedule D ...'

14. Whilst, as Mr Flux submitted, companies are generally regarded as vehicles for business, the position of an individual is rather different. The Board of Review must therefore be slow to conclude, from the fact of a substantial receipt of money alone, that the individual had carried on a trade or business giving rise to assessable profits. We accept this submission. Indeed, it was not in any way challenged by Mrs Chan in the course of her submissions. But what she, on behalf of the Commissioner, says is this: the expression 'business' in section 14 is very broad, and anything which occupies the time and attention and labour of a man for the purpose of profit can be 'business' (see dictum to this effect by Jessel MR in Smith v Anderson (1880) 15 ChD 247 at 258). Moreover, as Mrs Chan further submits, the expression 'trade' in section 14 is also very wide, and includes 'operations of a commercial character by which the trader provides to customers for reward some kind of goods or services' (see Ransom v Higgs [1974] 1 WLR 1594 at 1600). Also, the Full Court in Lam Woo Shang v CIR (1961) 1 HKTC 123 has equated 'trade' with 'business'.

### Was the Taxpayer carrying on trade or business?

15. Accepting as we do the broad submissions of the parties' representatives as summarised in paragraphs 13 and 14 above, what we have to resolve ultimately is whether the activities of the Taxpayer giving rise to the receipt of income are of the same kind and are carried on in the same way as those which are characteristic of ordinary trading in the line of business in which the Taxpayer's transactions were made (see dictum to this effect in CIR v Livingston (1927) 11 TC 538 at 542).

16. What we are concerned with here is the activity of a person who rendered services characteristic of a broker: someone who, by the use of business contacts and business experience, brought together buyers and sellers in two separate transactions, giving rise to very substantial payments of money to him.

17. The suggestion made by the Taxpayer in his letter to the assessor dated 28 June 1980 (see paragraph 4 above) that the payments from A Company and C Company were 'gifts' was plainly untenable. We have not seen the articles of association of A Company or of C Company, but it would, generally speaking, be extraordinary if Mr Y as the chief executive of those companies were to simply authorise large payments from those companies by way of gift to a friend. We would not so conclude unless the evidence was overwhelming. On the contrary, at the hearing before us, the Taxpayer's representative did not seek to maintain this stance; Mr Flux in opening the case accepted that all the sums received by the Taxpayer came from enforceable contracts between the Taxpayer and the companies making the payments.

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18. No evidence was given as to the steps which the Taxpayer had to undertake to earn the various sums paid by way of commission, the negotiations which might have been conducted or the time, labour and effort which might have been expended by the Taxpayer before the respective buyers and sellers came together in the transactions concerned. The Taxpayer called no oral evidence at the hearing.

19. The burden of showing that the assessment, as confirmed by the Commissioner, is incorrect is on the Taxpayer.

20. It cannot simply be assumed in his favour that no effort was expended on his part in earning the substantial sums by way of commission in this case. As a matter of common sense, the converse is more likely to be true. Experienced business people do not go about giving away large sums of money on behalf of limited companies to casual 'brokers'. Chief executives of companies owe fiduciary duties to their shareholders to safeguard the coffers of the companies.

21. We infer from all the circumstances of this case that the Taxpayer must have engaged in activities which were characteristic of those of brokers and commission agents when he brought the prospective buyers and sellers together. Nothing suggests that he did anything different in nature from what a broker, carrying on business as such, might have done.

22. Frequency of transactions is not the sole test of whether or not a person was conducting the business of a broker. As far as the transactions involving the shares in E Company are concerned, it appears that the Taxpayer was not the only broker involved; and as for the commission paid by C Company, this was at a fairly high rate: 2% on the purchase price. It appears to us to be somewhat far-fetched to submit, in such circumstances, that the transactions could be regarded as simply ones 'between friends'. Nor was there any evidence to support the submissions made on behalf of the Taxpayer that the commissions were 'unsolicited'. We were not told how precisely these transactions came about.

### Conclusion

23. We think that the transactions giving rise to the income were not 'casual'; this view is reinforced to an extent by the Taxpayer's claim in September 1977 that the receipt of \$120,000 was a 'one-shot deal commission'. In all the circumstances of this case, the Taxpayer has not satisfied us that the assessment, as confirmed by the Commissioner, was erroneous. In our judgement, the Taxpayer was at the relevant time carrying on a trade or business of a broker. The income arose in the course of that trade or business. The assessment, as varied by the Commissioner's determination, is accordingly confirmed. The appeal is dismissed.