

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D57/94

Profits tax – whether individual taxpayer carrying on a trade or business – deductibility of losses suffered in hang seng index futures, forex and bullion.

Panel: Ronny Wong Fook Hum QC (chairman), Raymond Faulkner and Peter R Griffiths.

Date of hearing: 26 September 1994.

Date of decision: 6 December 1994.

The taxpayer carried on a trading business in landed properties. He embarked on forex, bullion and hang seng index futures dealings. The taxpayer sought to deduct losses which he made in these dealings against his other profits. The assessor refused to allow deduction of the losses on the ground that the taxpayer was not carrying on a trade or business in the dealings which resulted in the losses. The taxpayer appealed to the Board of Review.

Held:

The Board applied case D42/90 and held that the taxpayer had failed to prove to the satisfaction of the Board that he was carrying on a trade or business in the dealings which resulted in the losses.

Appeal dismissed.

Case referred to:

D42/90, IRBRD, vol 5, 316

Wong Kuen Fai for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

I. OUR FINDINGS OF FACT

1. The Taxpayer's employment history:
 - (a) Between June 1976 and May 1979, the Taxpayer was employed by a bank (Company A) as trainee officer/bank officer. He was initially engaged in the

INLAND REVENUE BOARD OF REVIEW DECISIONS

securities & finance department and subsequently transferred to the bills department.

- (b) Between June 1979 and October 1983, the Taxpayer was employed by a securities company (Company B) as manager of a department. He set up various computerised systems and procedures for the purpose of bank operation.
- (c) Between November 1983 and December 1990, the Taxpayer was the general manager and a director of a business equipment company (Company C). He was responsible for the company's overall performance in real estate investments and provision of computer services business.
- (d) On 20 June 1988, the Taxpayer submitted an application for business registration. He there stated that the nature of his business was 'real estate trading' and the business commenced on 15 December 1985.
- (e) Between November 1990 and August 1991, the Taxpayer was employed by another securities company (Company D) as a senior manager.
- (f) The Taxpayer left Hong Kong for Country X in January 1993.

2. The tax returns:

- (a) On 29 September 1987, the Taxpayer declared that for the year of assessment 1986/87, the nature of his trade was that of 'properties investment'.
- (b) On 24 April 1989, the Taxpayer declared that for the year of assessment 1987/88, the nature of his trade was that of 'properties investment and commodities dealing'. \$660,759 was claimed as 'loss for the year' and this included a loss of \$1,686,216 said to be 'loss on commodities dealings'.
- (c) On 5 January 1990, the Taxpayer declared that for the year of assessment 1988/89, the nature of his trade was also 'properties investment & commodities dealing'. In computation of his profit, a sum of \$24,318 was claimed as 'loss on forex dealings'.
- (d) On 23 April 1990, the Taxpayer declared that for the year of assessment 1989/90, the nature of his trade was 'property investment & commodities dealing'. In computation of his profit, a sum of \$309,212 was claimed as 'loss on bullion dealings'.
- (e) On 28 August 1991, the Taxpayer declared that for the year of assessment 1990/91, the nature of his trade was 'properties investment & commodities dealing'. In computation of his profit, a sum of \$12,672 was claimed as 'loss on dealing in forex'.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (f) At all material times, the Taxpayer bought and sold landed properties and returned the rental income and profits derived therefrom for assessment.
3. The Taxpayer's dealings in Hang Seng Index Futures ['HSIF']:
- (a) This relates to the sum of \$1,686,216 referred to in the return for the year of assessment 1987/88 referred to in paragraph 2(b) above.
- (b) The Taxpayer through his tax representatives subsequently claimed that due to oversight, the total loss on trading in HSIF should be \$1,718,056 summarised as follows:

Date	Loss
	\$
12-12-1986	80,720
17-12-1986	55,510
30-6-1987	60,167
19-9-1987 to 30-9-1987	15,920
1-10-1987 to 31-10-1987	<u>1,505,739</u>
Total	<u>\$1,718,056</u>

- (c) These dealings were conducted through an account opened by the Taxpayer on 5 November 1986 with Company E. Save for these dealings, the only other HSIF dealing of the Taxpayer took place in the year of assessment 1990/91 which resulted in a profit of \$1,014 on 16 August 1990.
4. The Taxpayer's forex/bullion dealings:
- (a) The loss of \$24,317.89 in the year of assessment 1988/89 arose as a result of dealings between 29 June 1988 and 22 September 1988. These were 21 sales matched by an equivalent number of purchases. These were all effected through a margin account of the Taxpayer with an international exchange company (Company F).
- (b) The loss of \$309,212.4 in the year of assessment 1989/90 arose as a result of dealings between 23 August 1989 to 10 October 1989. There were 22 purchases matched by an equivalent amount of sales. These were effected through margin accounts of the Taxpayer with a bullion company (Company G) and an investment company (Company H).
- (c) The loss of \$12,672.33 in the year of assessment 1990/91 arose as a result of a single bought/sold transaction that took place on 24 June 1990 through Company H.

INLAND REVENUE BOARD OF REVIEW DECISIONS

5. All dealings of HSIF, forex and bullion were conducted on margin basis and only the margin deposits of the dealing funds were financed by past savings of the Taxpayer and his wife.

II. THE ISSUE

1. The Taxpayer seeks to set off the losses he incurred as a result of his dealings in HSIF, forex/gold bullions against his profits in the years of assessment outlined above. The Taxpayer maintains that all such dealings are within the definition of the word 'trade' in section 2 of the Inland Revenue Ordinance (the IRO) because:

- (a) Those dealings 'are for speculation purposes that is intended to make a high profit return in a short time'.
- (b) All the dealings were carried out on a margin basis.
- (c) There were numerous repetitive transactions.
- (d) The rapid disposals by him are inconsistent with an intention to engage in long term investment.
- (e) His dealings were closely akin to the work undertaken by him with various employers. The jobs that he held facilitated the making of these deals.

2. The Revenue took the view that the Taxpayer failed to demonstrate that these losses arose from a trade or business carried on by him of dealing in HSIF and Forex. The Revenue relies on the following:

- (a) The Taxpayer failed to inform the Revenue that he was carrying on such a trade whilst he was embarking on the transactions in question;
- (b) These transactions were not in any way connected with the Taxpayer's usual line of business;
- (c) The Taxpayer admitted that he entered into these transactions for 'speculation purpose' and
- (d) In view of the chaotic state of the stock market on 19 October 1987, what the Taxpayer did was merely gambling.

III. THE LAW

1. Our attention has been drawn to D42/90, IRBRD, vol 5, 316 of this Board which reviewed in depth the relevant authorities in this field. It supports the following propositions:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) The issue is whether or not the Taxpayer was 'carrying on' a trade or business. 'This must be a matter of degree and must be a matter which depends on the circumstances of each case'.
- (b) Though it is not essential that a person who is 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.
- (c) In the context of shares and securities, a person can sell and buy shares and securities on the stock market on many occasions without starting the business of share or securities trading. Private individuals would rarely be considered as carrying on a business of trading in shares and securities unless there were other associated activities.

IV. OUR DECISION

- (a) As in D42/90, whilst we appreciate that some weight should be given to the lack of reference in the business registration of 20 June 1988 to any business or trade in HSIF, we are of the view that this factor is not of great materiality. In all his tax returns since the year of assessment 1987/88, the Taxpayer had been claiming that his trade or business was in 'properties investment & commodities dealing'. The crucial issue is whether the Taxpayer was, as a matter of fact, carrying on business within the meaning of section 14 of the IRO.
- (b) We have taken into account the employment history of the Taxpayer. His various positions, in the circumstances of this case, pointed to his having an advantage over other investors in the market.
- (c) The Taxpayer however did not give any evidence before us as to the manner whereby he carried on his twin trade or business of 'properties investment & commodities dealing'. No explanation was given to us as to the system, if any, that he adopted in relation to the 2 branches of his activities. The pattern of his dealings is not habitual or systematic. There is little from the evidence before us which would clothe the Taxpayer with the appearance of carrying on a trade or business in HSIF or Forex. In these circumstances, the admission of the Taxpayer that these dealings 'are for speculation purposes that is intended to make a high profit return in a short time' assumes significance. That admission places the Taxpayer in a position no different from other private investors who seek quick fortune in those markets.
- (d) In conclusion, we are of the view that the onus of proof on the Taxpayer as imposed by section 68(4) of the IRO has not been discharged. We confirm the assessment and dismiss the appeal.