

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D63/92

Profits tax – whether motor vehicle licences capital assets – onus of proof – section 68(4) of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum QC (chairman), Tse Tak Yin and Edwin Wong.

Dates of hearing: 15 and 16 March 1993.

Date of decision: 25 March 1993.

The taxpayer was a limited company which carried on the business of hiring motor vehicles. The taxpayer purchased and sold a number of motor vehicles at a profit. In respect of some motor vehicles the car bodies and the licences were sold separately with resulting profits or losses as the case might be. In the accounts of the taxpayer the motor vehicle bodies were classified as fixed assets but the licences were classified as current assets. The taxpayer submitted that an error had been made.

Held:

The onus of proof is upon the taxpayer by virtue of section 68(4) of the Inland Revenue Ordinance. No evidence was called from the company's accountants and auditors with regard to the alleged mistake. The taxpayer had not discharged the onus of proof.

Appeal dismissed.

Iris Ng Yuk Chun for the Commissioner of Inland Revenue.
Director of taxpayer for the taxpayer.

Decision:

The Taxpayer is a company incorporated in mid-1975. The nature of its business as described in its profits tax return was 'Introducing to Hire Purchase'.

For the year ended 31 March 1989, the Taxpayer conducted the following trading transactions:

VEHICLE

VEHICLE

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| <u>AND TAX LICENCE (NEW)</u> | <u>AND TAX LICENCE (OLD)</u> | <u>SALE PRICE</u> \$ | <u>PURCHASE PRICE</u> \$ | <u>PROFIT</u> \$ |
|--------------------------------------|--------------------------------------|-------------------------|---------------------------------|---------------------|
| (| (| 620,000 | 605,300 | 14,700 |
| (| (| 755,000 | 650,880 | 104,120 |
| (| (| 636,000 | 633,000 | 3,000 |
| (licence | (licence | 680,000 | 638,500 | 41,500 |
| (numbers | (numbers | 670,000 | 496,200 | 173,800 |
| (specified | (specified | 712,000 | 712,000 | - |
| (| (| 848,000 | 843,000 | 5,000 |
| (| (| <u>900,000</u> | <u>800,030</u> | <u>99,970</u> |
| TOTAL | | <u>5,821,000</u> | <u>5,378,910</u> | <u>442,090</u> |

In respect of the cars listed above, the car bodies of cars X, Y and Z were included in the accounts as fixed assets. Those car bodies were sold at a loss and the loss was shown separately from the profit figure derived from the above listed transactions. The loss was added back by the Taxpayer in the tax computation for the year of assessment 1988/89 and not claimed for deduction.

As at 31 March 1989, the Taxpayer owned 5 others cars which were all sold during the year of assessment 1989/90.

| <u>VEHICLE</u> | <u>DATE OF PURCHASE</u> | <u>DATE OF SALE</u> |
|----------------|-------------------------|---------------------|
| (| mid-1987 | mid-1989 |
| (licence | mid-1987 | mid-1989 |
| (numbers | mid-1988 | mid-1989 |
| (specified | late 1986 | late 1989 |
| (| late 1986 | late 1989 |

The Taxpayer accepted that the profits on the sale of cars A and B were assessable to profits tax. However the Taxpayer claimed that the licences in respect of the other 3 cars, that is cars C, D and E were capital assets and the profits on the sale of such assets in the amounts of \$210,500, \$215,000 and \$135,000 respectively should not attract tax. All 5 cars were hired out for rental income before sale. The licences of cars C, D and E, like the licences of all other licences, were grouped in the accounts as current assets. The costs of the related car bodies were, however, grouped as fixed asset. It is the Taxpayer's case that such classification was erroneous. The Taxpayer pointed out that the cars in question could not be used for hiring without the licences. Consequently the licences should have received the same treatment as the car bodies, which had all along been classified as fixed assets in the accounts.

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Mr X, director of the Taxpayer, gave evidence. He emphasized that the licences should be considered in the same light as the car bodies. He told us that the 3 licences in question were specifically purchased for long-term rental income to support staff of the Taxpayer whilst its directors immigrated to a foreign country. He told us that the disposal of the licences arose as a result of 4 June 1989 incident when the directors resolved to wind up the Taxpayer. He explained that the Taxpayer had not taken step to rectify the error of classification in the year of assessment 1988/89 because the Taxpayer had a final tax loss for that year. The company therefore did not insist on a reclassification as the error did not have any practical impact.

In support of the Taxpayer's case, he produced two minutes of directors' meeting dated October 1986 and June 1988. Both minutes were signed by Mr X as chairman. The October 1986 minutes recorded attendance of Mr X and his wife whereby they resolved that 'two car premiums of cars A and B be purchased by the company for trading purposes at a consideration of not more than \$450,000'. The June 1988 minutes recorded the attendance of Mr X, his wife and their daughter Miss Y whereby they resolved that the Taxpayer 'will purchase one car premium of car E for hiring out to produce income'. No minutes was submitted to us in respect of the other two car licences in question, namely, cars C and D.

The Commissioner's representative submitted to us the following:

- (a) Whether an asset is a trading asset or long-term investment asset turns on the intention which existed at the time of acquisition.
- (b) The minutes tendered should be considered with great care as the original minute book has not been produced and the auditor's reports in the relevant years made it clear that the minutes and the statutory books had not been furnished to them for review.
- (c) Cogent evidence is required to explain how the Taxpayer's book-keeper and professional accountant had permitted adoption of the erroneous classification in the accounts.
- (d) Car bodies and licences in respect of other cars had received separate treatment in the accounts. Consequently, in relation to the 3 cars in question, cogent evidence is required to establish the existence of the error.
- (e) The Commissioner's representative further reminded us of the heavy onus on the Taxpayer under section 68(4) of the Inland Revenue Ordinance.

We are of the firm view that the Commissioner's contentions are well founded. An accountant firm assisted the Taxpayer throughout the hearing before us. They audited the accounts of the Taxpayer. No attempt was made by the Taxpayer to adduce evidence from that firm to confirm the error. We are not satisfied with the contemporaneous nature of the minutes produced before us. Even if the minutes of June 1988 be accurate in respect of

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car E, those minutes do not support a clear intention to acquire the licence for the purpose as deposed to by Mr X before us. There is no evidence to indicate that receipts from the 3 cars in question were segregated and ear-marked for specific purpose. In these circumstances, we find that the Taxpayer has not discharged the heavy onus imposed upon them under section 68(4) of the Inland Revenue Ordinance.

Profits tax assessment for the year of assessment 1989/90, dated 1 November 1990, showing net assessable profits of \$418,859 with tax payable thereon of \$69,111 is hereby confirmed.