

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D66/89

Profits tax – whether taxpayer acting on behalf of herself or as a nominee.

Panel: Anthony F Neoh QC (chairman), Geoffrey Hui and Robert G Kotewall.

Dates of hearing: 5, 6 and 7 September 1989.

Date of decision: 27 October 1989.

The taxpayer was assessed to profits tax in respect of two property transactions which had been carried out by her in her own name. The taxpayer claimed that she had not received the profits arising from the property transactions but had been acting as a nominee for a third party who had in fact received the profits. The taxpayer gave evidence.

Held:

The taxpayer had satisfied the Board that she was acting as a nominee and had not received any profits. Accordingly she should not be assessable to profits tax in relation to the transactions in question.

Appeal allowed.

[Editor's note: The Board had not considered the effect of the taxpayer being a trustee.]

Case referred to:

Cuckmere Brick Co Ltd v Mutual Finance Ltd [1971] Ch 949

Jennifer Chan for the Commissioner of Inland Revenue.

Taxpayer represented by her husband.

Decision:

The Taxpayer has objected to the profits tax assessments raised on her for the years of assessment 1982/83 and 1983/84. These assessments had been raised on her in connection with two property transactions in which the Taxpayer acted as confirmor.

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2. The relevant particulars of the two property transactions are as follows:

<u>Property</u>	<u>Date of Assignment</u>	<u>Stated Consideration</u> \$	<u>Stated Confirmor's Fee</u> \$
A	April 1982	200,000	70,000
B	August 1983	720,000	220,000

3. The Taxpayer did not furnish any tax return. In exercise of his powers under section 59(3) of the Inland Revenue Ordinance, the assessor raised on the Taxpayer the following tax assessments:

(a) Year of assessment 1982/83

Estimated assessable profits	\$70,000 =====
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Tax payable thereon	\$10,500 =====
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(b) Year of assessment 1983/84

Estimated assessable profits	\$220,000 =====
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Tax payable thereon	\$33,000 =====
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4. Subsequently, the assessor allowed the Taxpayer incidental expenses at an arbitrary 10% of the estimated assessable profits and this served to reduce the tax payable for the year of assessment 1982/83 to \$9,400 and for the year of assessment 1983/84 to \$29,000.

5. Upon objection made to the assessments, the Commissioner issued his determination on 21 December 1988 upholding the assessor's revised assessments.

6. Against the Commissioner's determination, the Taxpayer now appeals. In her letter dated 5 January 1989 the Taxpayer stated her grounds of appeal as follows:

(a) That assessments arose out of her signing sale and purchase documents in respect of properties A and B on behalf of Mr X, the proprietor of Company A.

(b) That the Taxpayer's husband was working for Company A.

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- (c) That she was only a 'puppet' owner and Mr X was the real owner.
- (d) That she had to accept that the properties 'were under [her] name'.
- (e) That nevertheless, decoration expenses incurred in the decoration of the two properties, should be deducted from the profits tax assessments (impliedly, she accepted that she was liable to profits tax subject only to the deduction sought).
- (f) That Mr X had arranged for the decoration of the said properties and converted them into nice looking and practical properties to boost their sale price.
- (g) That the decoration expenses had in fact been paid by Mr X and should therefore be deductible expenses.

7. These grounds of appeal should be read in conjunction with the earlier letters sent by the Taxpayer to the Commissioner, in the first of which, dated 6 July 1987, the Taxpayer stated that it was Mr X, her husband's employer, who had requested her to sign the documents relating to the properties in question and that Mr X had promised to take care of all the taxes and outgoings. She considered that since her husband was working for Company A, it was difficult for her to refuse. She further stated that she never gained any benefit from signing the documents in question and at that time, the livelihood of her family depended upon the monthly wages of \$2,000 earned by her husband from working with Company A. In two subsequent letters, one dated 22 February 1988 and another dated 6 April 1988, the Taxpayer gave further particulars of the decoration work undertaken at the two properties and repeated that all cheques in respect of the two property transactions were received by Mr X and that she, the Taxpayer, had only signed on the title deeds on Mr X's behalf.

8. At the hearing, the Taxpayer was represented by her husband, Mr Y. In his opening address, Mr Y stated that since his wife had signed the assignments in question, it was his understanding of Hong Kong Law that she would have to pay profits tax. However, he submitted that decoration expenses had been incurred in connection with the business of buying and selling of the two properties in question, and these expenses should be taken into account and deducted from the assessed profits. Outlining his case, he stated:

- (a) that he started working for Company A in about 1979;
- (b) that although Company A was called a finance company, it had no capacity to accept deposits or make loans. It was in fact engaged in the business of the buying and selling of property;
- (c) that Company A had four staff members including a driver;
- (d) that it was the practice of Mr X, the proprietor of Company A, to ask his staff to sign documents on his behalf for the sale and purchase of landed property in

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order to facilitate his borrowing from banks. Mr Y explained that Mr X already had a large number of properties in his name, at one time he had about ten under mortgage to his bank and therefore, in order to obtain further financing, he had to ask other persons to acquire property on his behalf and mortgage the same to his bank;

- (e) that Mr X had undertaken to each of his staff who had agreed to sign sale and purchase documents on his behalf to pay all taxes on the profits and all outgoings arising from these dealings;
- (f) that he had asked his wife, the Taxpayer, to sign the documents in question in view of Mr X's request and that he could not afford to displease his employer;
- (g) that the Taxpayer had not got a penny from the two transactions in question;
- (h) that the Taxpayer was unaware that she had to pay profits tax until 1987 when she was stopped by the Immigration Authorities on leaving Hong Kong;
- (i) that the two properties in question had been decorated by Mr Z at the behest of Mr X and that Mr X had paid for such decoration. As proof of such payment, Mr Y referred to the two receipts submitted by the Taxpayer to the Commissioner and appended to the Commissioner's determination. These were in fact replacement receipts as the originals had been issued to Company A at the relevant time.

9. Mr Y gave evidence on oath in which he adopted by reference the facts stated in his opening address. In cross-examination, he further stated that from early 1982, he was assigned by Mr X to work in Company B, another business owned by Mr X. He left Mr X's employment in about November 1983 when Company B collapsed. However, notwithstanding his posting to Company B, his duties throughout were to bring clients of Company A to view flats and that therefore he had been principally involved in Mr X's business of buying and selling properties. He admitted that he had obtained the receipts purely for the purpose of his wife's tax appeal. However, he stated that although the receipts were replacements, he believed that they presented the true position and that Mr Z, who issued the receipts, had in fact taken the figures contained in the receipt from a written record which was pinned onto a board hung on the wall in his office which also served as his residence. For reasons which we shall state later, we consider Mr Y to be a credible witness (see paragraph 16(g) below).

10. Having heard Mr Y's opening address and his evidence, the Board was concerned as to whether the Taxpayer had rightly made the concession that she was liable to pay profits tax. From the correspondence and from the opening address as well as Mr Y's evidence, it was clear that the Taxpayer's case (which was apparent from the earliest of her letters to the assessor) was that she had signed the relevant deeds on behalf of Mr X. Therefore, if in fact this was so, the Taxpayer was, as a matter of law, a nominee of Mr X in

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relation to these transactions. The Board was concerned with Mr Y's statement that as the Taxpayer had signed, she was liable, as a matter of law, to pay profits tax. This is not the correct legal interpretation to be placed on the facts if proved. Accordingly, the Board invited Mr Y to apply to amend his grounds of appeal to add an alternative ground, namely, that the Taxpayer was a nominee of Mr X and would not thereby be liable to pay profits tax. The Taxpayer by her representative, Mr Y, accepted this invitation and applied to add an alternative ground in the terms just stated.

11. The Board has power under section 66(3) of the Ordinance to consent to an amendment of the grounds of appeal upon such terms as it deems fit. Before this discretion was exercised, the Board invited representations from the representative of the Revenue. Mrs Chan, for the Revenue, made preliminary representations objecting to the application for amendment, reserving her right to address us further in her final submissions. These preliminary objections, which with subsequently adopted in the Revenue's final written submission, were as follows:

- (a) that although the Board had powers to consent to an amendment of the grounds of appeal, such discretion should not be exercised in this particular instance as the Commissioner had not been able to accept the Taxpayer's explanations in her earlier letters beginning 6 July 1987. There was insufficient information regarding Mr X in the first place;
- (b) that if the Board should find that the Taxpayer did carry on a business in relation to the properties in question on account of Mr X, the Revenue would be estopped from issuing an assessment for the year of assessment 1982/83 in view of the six years' time limit imposed by the Ordinance.

12. As Mrs Chan was reserving her arguments in support of her objection until final submission, the Board decided and indicated to the parties that it would be prepared to receive evidence de bene esse relevant to the proposed alternative ground of appeal. We note here that the Revenue's representative did not apply to conduct further cross-examination of Mr Y on this point following this indication. Whilst we would have allowed such an application, we would mention that since the claim of nomineehip had been so apparent from the beginning, we are not surprised that the Revenue did not seek to further cross-examine on this point and we would not like it to be taken that we are suggesting any failure on the part of the Revenue's representative to take all necessary points. Indeed, we were much assisted by Mrs Chan's submissions and her painstaking exploration of the evidence. We would like to record a debt of gratitude to her.

13. It would be convenient to state at this juncture that in the event, the Board, having heard all the evidence and having heard final submissions from both parties, decided to consent to the addition of the alternative ground of appeal. In effect, this means that the Taxpayer is allowed to withdraw her concession (based on the Board's opinion on a mistaken view of the law) that as she had signed the deeds in question, she was liable to pay profits tax arising from those transactions. In deciding to consent to the addition of the

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alternative ground of appeal, the Board had in mind the fact that at all times, it was the Taxpayer's contention that she was a nominee. If in fact that was proven, then it would be a miscarriage of justice to allow her to proceed on a mistaken view of the law. In its review of the Revenue's arguments in support of their objection the Board noted that the Taxpayer had at an early stage supplied the residential address and telephone number of Mr X. The Board is unaware of the full extent of the enquiries made by the Revenue but the Board takes the view that the Taxpayer had displayed a co-operative attitude and had apparently done all that was in her power to assist the Revenue. The fact that the Revenue was not convinced could not be taken against her.

14. On the second day of the hearing, the decorator, Mr Z, gave evidence on behalf of the Taxpayer. He stated that he had been engaged in the decoration business on and off for the past ten odd years. Until about late 1984, he had worked mainly for Mr X. He recalled having done decoration work for the properties in question and confirmed that he wrote a letter which was annexed to the Commissioner's determination. The two receipts (refer paragraphs 8(i) and 9 above) had been given by him to Mr Y as replacement receipts at the request of Mr Y. The originals had already been issued to Company A at the relevant time. However, he had kept a record in relation to the two sums in question on a piece of paper which he had pinned onto a board which hung on the wall to his office which doubled up as his residence. He had kept no records of other jobs for Mr X. However, in relation to these two sums, he had had an argument with Mr X and therefore he had written the figures onto a piece of paper which he had then stuck onto his board, presumably for future reference. He kept a running account with Mr X for decoration work undertaken for Company A, this account was still in debit as a number of cheques (which were produced to the Board) had been dishonoured. He was unable to ascertain whether the sums appearing in his two receipt had been appropriated to that part of the running account which had been settled. The only thing that he could say to the Board was that Mr X still owed him several tens of thousands of dollars. We found Mr Z, who was cross-examined at some length, to be straight-forward and honest and therefore, we have no hesitation in accepting his evidence.

15. On the third day of hearing the Taxpayer gave evidence. In evidence, the Taxpayer produced her bank book which, she stated, represented evidence of her only bank account. This bank account was opened on 15 January 1983. The opening balance of \$2,594.20 was, according to her, the balance of her father's account which was transferred to her. Her father is now in Brazil. In the year 1983, the largest deposit in this account was the sum represented by the opening balance. Clearly, none of the cheques said to have been issued to her by the solicitors who handed the two transactions in question had been paid into this account. Indeed, the largest deposit ever made into this account was that of \$3,000, on 19 July 1985, two years after the last property transaction in question. In the latter part of 1983, there were small deposits of between \$600 to \$700 paid at approximately fortnightly intervals into this account. These sums, according to her, represented wages for working in a factory in the New Territories. During this time, she had to work in the factory to supplement her family's income. She confirmed that she had signed the two deeds of assignment in the offices of solicitors. She said that she had been brought to the solicitors' offices by Mr X who then indicated to her the appropriate places in the documents for

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signature. She said she felt she had to sign since, if she did not do so, she might jeopardise her husband's job. Considering the fact that in 1983 she had to work for what must have been comparatively low wages to supplement the family's earnings, she clearly could not afford to jeopardise her husband's job. She confirmed that she never got a penny from the transactions and that any cheques which were handed to her, she immediately handed over to Mr X. The Board considered the Taxpayer, who was also cross-examined at some length, to be straight forward and honest and we have no hesitation in finding her a truthful witness. We therefore accept her evidence.

16. The Board finally proceeded to examine the two deeds of assignment, the relevant extracts from the Land Office Register in the light of the other documentary and oral evidence given and the final submissions made by the representatives of the Revenue and of the Taxpayer. From this examination, it was apparent to the Board that:

- (a) there was no sale and purchase agreement registered in respect of both properties;
- (b) property A was mortgaged on the same day to a finance company for 70% of the purchase price stated in the assignment;
- (c) property A was sold in November 1985 for \$115,000 in exercise of the powers of sale under the mortgage. It is interesting to note that three and a half years after the transaction in question, the property was sold in the market (and the mortgagee has the duty to fetch a proper price: see Cuckmere Brick Co Ltd v Mutual Finance Ltd [1971] Ch 949, and the Board must presume that the bank had acted lawfully) at \$115,000, which was \$85,000 less than the stated purchase price of \$200,000 in 1982. Although the property in question was old, it is well known that land prices in Hong Kong do generally increase over time. It is difficult to believe that the price of property A would actually have lowered, three and half years later, by as much as 42.5% particularly when the same property was sold in December 1985, a month later, for \$140,000, an increase of 21%. This leads one to doubt whether the real consideration paid for property A might have been considerably less than the consideration of \$200,000 stated in the assignment and whether the confirmor's fee stated on the deed was ever in fact paid. We note that in reply to an enquiry from the assessor, the solicitors handling the transaction indicated that in fact only one cheque of \$10,000 made payable to the Taxpayer had been issued and that the remaining sum of \$60,000 being the remainder of the stated confirmor's fee, was said to have been settled between Company A and the Taxpayer directly;
- (d) property B was also mortgaged on the same day to the same bank for 70% of the stated consideration;
- (e) property B was sold subject to tenancy and it was remarked upon by the Revenue's representative in the final submission that in view of this, it was

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improbable that the premises could have been decorated and decoration fees incurred. This point was not however put in cross-examination but in his final submission, Mr Y explained that indeed there had been an electroplating factory when Company A bought the premises but Company A then proceeded to convert the factory to a roast pig factory but as Mr X did not have money to pay the purchase price he had to sell the premises and the profits of \$200,000 was in fact used to pay for the decoration expenses. The Board gave leave to Mr Y to incorporate his explanation into his evidence and invited Mrs Chan for the Revenue to cross-examine on this point if she wished. In the event, she decided not to exercise her right to cross-examine;

- (f) the stated confirmor's fee for property B was \$220,000. However, from the information provided by the solicitors handling the transaction to the Commissioner, it was paid by five cheques totalling \$186,640.95 which fall short of the stated confirmor's fee. As we believe the Taxpayer's evidence that she did not receive any part of the confirmor's fee, we believe that we need not explore the reasons for the shortfall;
- (g) Mr Y's evidence that Mr X wished to use third parties to obtain further finance from his bank is supported by the fact that in both cases the properties were mortgaged to the same bank at 70% of the stated consideration. In the case of property A, we entertained grave doubts as to whether the confirmor's fee was in fact paid: the circumstantial evidence certainly strongly indicates that the purchase price was artificially inflated. We have no such evidence for property B though as we believed the Taxpayer, her evidence would tend to corroborate Mr Y's assertions. We therefore also accept Mr Y's evidence.

17. Upon the evidence, this Board makes the following findings of fact:

- (a) that although the Taxpayer did sign the deeds of assignment in relation to the two properties in question as confirmor and had acknowledged receipt in the two deeds of the stated confirmor's fee in each case, she did not in fact receive the stated fees or any part thereof;
- (b) that the Taxpayer had signed the two deeds in question at her husband's behest and at the request of Mr X;
- (c) that she was in fact a nominee of Mr X and that Mr X was the person who took the benefit of the 'confirmor's fees' whether they be represented in money terms or otherwise;
- (d) that decoration work had in fact been undertaken on the properties A and B by Mr Z;

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- (e) that the decoration work done on the properties A and B had been done for Company A which came under the liability to pay Mr Z. As to whether that liability had in fact been satisfied we are unable to determine as it was up to Mr X himself to decide whether or not to appropriate these two sums to that part of the running account which had been settled or to that part which remains outstanding.

18. Section 14 of the Inland Revenue Ordinance states:

‘ Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his [our underlining] assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profit arising from the sale of capital assets) as ascertained in accordance with this part’.

19. In view of the fact that we had found that the Taxpayer had been a nominee of Mr X in respect of the two properties in question and that it was Mr X who took the profits, namely the benefit of the confirmor’s fees, we must hold that the tax arising from such profits should be borne by Mr X and not the Taxpayer. Accordingly, the Taxpayer should not be assessable to profits tax in relation to the transactions in question.

20. In view of our conclusion that the Taxpayer is not assessable to profits tax, it will strictly not be necessary for us to consider whether or not the decoration expenses are deductible from the assessment. However, we would indicate that had we found that the Taxpayer was assessable to profits tax, we would have been unable to find that the decoration expenses should be deductible in view of the provisions of section 16(1) which states that ‘there should be deducted all outgoings and expenses to the extent which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which is chargeable to the tax under this part of any period’.

21. If the Taxpayer had in truth been the recipient of the profits arising from these transactions, the expenses paid by Mr X could not have been incurred by the Taxpayer in the production of such profits unless the Taxpayer could prove that the expenses had been paid on her behalf and she thereby came under a liability to reimburse Mr X. However, that was not how the case was put nor was that the effect of the evidence before us. Indeed, all evidence pointed to the fact that it was Mr X who was behind these transactions and that he was the only person benefiting therefrom. The fact he had paid or purported to have paid for these decoration expenses pointed to the conclusion that he must have been himself be the true beneficiary of these transactions. We cannot see how in the hard business world of Hong Kong someone would pay a large sum of money for the decoration of premises in which he derived no benefit.

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22. Accordingly, we must allow the appeal upon the alternative ground, namely, that the Taxpayer was a nominee of Mr X in the two transactions in question and was not therefore liable to profits tax.