

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D9/99

**Profits Tax** – acquisition of property – intention of taxpayer at time of acquisition – burden of proof on purchaser – lack of supporting evidence fatal to the appeal – sections 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO') – discretion to order costs under section 68(9) of the IRO.

Panel: Kenneth Kwok Hing Wai SC (chairman), Melville Thomas Charles Boase and Benny Wong Man Ying.

Date of hearing: 8 July 1998.

Date of decision: 13 May 1999.

The taxpayer was incorporated in Hong Kong on 22 April 1993. It commenced business on 22 June 1993 and declared its nature of business carried on as 'property investment'. On 23 June 1993, the taxpayer provisionally agreed to purchase a residential house in District X for \$18,700,000. The purchase was completed on 3 August 1993, financed partly by a loan repayable in 180 monthly installments. On 23 November 1993, the taxpayer agreed to sell the property for \$21,000,000. The sale was completed on 23 February 1994.

In its profits tax return for the year of assessment 1993/94, the taxpayer claimed deduction of depreciation charged on the property in the amount of \$194,012. Further, the taxpayer did not offer the gain on sale of the property, amounting to \$1,541,830, for assessment.

In respect of the year of assessment 1993/94, the assessor disallowed the depreciation of \$194,012. In respect of the year of assessment 1994/95, the assessor added the gain of \$1,541,830 to assessable profits for that year.

The taxpayer objected on the grounds that the property, inter alia, had been acquired for long term investment. The Commissioner rejected the objections. The taxpayer appealed before the Board but did not adduce any oral or written evidence to support its case.

#### **Held** by the Board:

- (1) There was no evidence to support any contention that the alleged intention to acquire the property and hold it as a capital asset could have been and was genuinely held realistic and realisable. In this respect, the appeal was doomed to fail.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- (2) The purported minutes of meeting relied upon by the taxpayer as a true record of a directors' meeting held on 15 June 1993 held no weight with the Board in that the directors were only appointed on 22 June 1993. It was not a contemporaneous document.
- (3) Even if the purported resolution passed at the said meeting accurately recorded the intention for the taxpayer to acquire a property for long term investment, the proposed loan structure set out therein was not supported by any evidence at all. Hence, the taxpayer failed to discharge its burden of proof.
- (4) Since the appeal was doomed to failure, obviously unsustainable and bound to fail at the outset, it only led to a waste of time and resources of the Board. It was clearly an abuse of process to pursue it. Relying on the purported minutes was a serious aggravating factor. It was necessary to punish the taxpayer with an order for costs which was to be added to the tax charged.

### **Appeal dismissed and a cost of \$5,000 charged.**

Cheung Mei Fan for the Commissioner of Inland Revenue.  
Paul Tang of Messrs Paul Tang & Co for the taxpayer.

### **Decision:**

1. This is an appeal against the determination dated 21 April 1998 by the Commissioner of Inland Revenue, rejecting the Taxpayer's objections against the profits tax assessment for the year of assessment 1993/94 dated 19 August 1996 showing assessable profits of \$32,564 with tax payable thereon of \$5,698 and against the profits tax assessment for the year of assessment 1994/95 dated 19 August 1996 showing assessable profits of \$1,317,525 with tax payable thereon of \$217,391.

### **The facts**

2. Based on the statement of facts in the determination which had been agreed on behalf of the Taxpayer and the documents produced at the hearing of the appeal, we make the following findings of facts.

3. The Taxpayer was incorporated in Hong Kong on 22 April 1993. At all material times, the authorised and issued share capital of the Taxpayer were \$10,000.

4. In its profits tax return for the year of assessment 1993/94, the Taxpayer declared that it commenced business on 22 June 1993 and the nature of business carried on was 'property investment'.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

5. By a provisional agreement dated 23 June 1993, the Taxpayer agreed to purchase a residential house at District X ('the House') at consideration of \$18,700,000.
6. The acquisition of the House was subject to an existing tenancy from 1 May 1991 to 30 April 1994 at the monthly rental of \$71,000.
7. The acquisition of the House was completed on 3 August 1993, financed partly by a loan of \$7,000,000 from a bank ('the Bank'). The loan was repayable by 180 monthly instalments of \$67,909.9.
8. By a provisional agreement dated 23 November 1993, the Taxpayer agreed to sell the House for a consideration of \$21,000,000, subject to existing tenancy.
9. The sale was completed on 23 February 1994.
10. In its profits tax return for the year of assessment 1993/94, the Taxpayer claimed deduction of depreciation charged on the House in the amount of \$194,012. In its profits tax return for the year of assessment 1994/95, the Taxpayer did not offer the gain on sale of the House in the amount of \$1,541,830 for assessment.
11. On 19 August 1996, the assessor raised profits tax assessments for the years of assessment 1993/94 and 1994/95. In respect of the former, the assessor disallowed the depreciation of \$194,012 charged. The assessable profits were \$32,564, with tax payable thereon of \$5,698. In respect of the latter, the assessor added the gain of \$1,541,830 on sale of the House. The assessable profits were \$1,317,525, with tax payable thereon of \$217,319.
12. By letter dated 31 August 1996, the representatives of the Taxpayer objected on the ground that in respect of the year of assessment 1993/94, the House was acquired with existing tenancy for long term investment purpose producing rental income and that rebuilding allowance should therefore be allowed; and that in respect of the year of assessment 1994/95, profit on sale of long term investment should not be liable to profits tax.
13. In support of the objections, the representatives submitted what purported to be minutes of a directors' meeting alleged to have been held on 15 June 1993 ('the Purported Minutes').
14. The Commissioner rejected the objections.
15. By letter dated 15 May 1998, the representatives gave notice of appeal on behalf of the Taxpayer.

### **The Taxpayer's case**

## INLAND REVENUE BOARD OF REVIEW DECISIONS

16. Mr Paul Tang, the certified public accountant who represented the Taxpayer at the hearing of the appeal, did not adduce any evidence, oral or written. Mr Tang produced a written submission and argued along the lines of the written submission.

### **Relevant provisions**

17. Section 68(4) of the Inland Revenue Ordinance ('the IRO') provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Taxpayer. Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

### **Our decision**

18. On the question of financing, Mr Tang relied on the bank loan, the monthly repayment of which was less than the monthly rental, and on the 'loan & advance from shareholders ... interest free and has no fixed term of repayment'.

19. In the absence of any evidence on the financial ability of the shareholders to fund the loans from them to the Taxpayer in the region of \$11,700,000 on a long-term basis, this appeal is doomed to failure. There is simply no evidence to support any contention that the alleged intention to acquire and hold the House as a capital asset could have been and was genuinely held, realistic or realisable.

20. In the application for property instalment loan dated 9 July 1993 submitted by the Taxpayer to the Bank, the 'loan amount required' by the Taxpayer was \$11,220,000. The Bank proceeded on the basis of an appraised value of \$14,200,000 and on 26 July 1993, approved a loan of \$7,000,000. There was thus a shortfall of \$4,220,000 from the amount of loan asked for by the Taxpayer. In the absence of any evidence on how the Taxpayer intended to and was financially capable of funding this shortfall of \$4,220,000 on a long term basis, this appeal is obviously unsustainable.

21. Had the Bank approved the loan of \$11,220,000 'required' by the Taxpayer, the monthly loan instalment would have been \$108,849.71, assuming the same repayment terms. The monthly loan repayment of \$108,849.71 would have exceeded the monthly rental of \$71,000. As the Taxpayer has made no attempt to show how it intended to and was financially capable of funding the instalment loan repayments on a long term basis had the Bank advanced the loan of \$11,220,000 'required' by the Taxpayer, this appeal is bound to fail.

22. Mr Tang relied on the Purported Minutes and contended that it was an authentic document and a true record of a directors' meeting factually held on 15 June 1993. Miss Cheung who appeared for the Respondent (the CIR) submitted that the Purported Minutes was not a contemporaneous document.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

23. The Purported Minutes purported to be ‘minutes of a directors’ meeting held at its registered office on 15 June 1993 at 3 p.m.’ with the following ‘Resolution’ –

‘The chairman informed the board that the estate agent has approached him that a property [the House] is available at a price of \$18,700,000 with existing tenancy of monthly rental of \$71,000. [The Bank] agreed to lend \$7,000,000 repayable monthly at \$67,909.9 for 180 monthly instalments. In view the monthly rental well enough to cover the monthly instalment. The chairman expected monthly rental can be increased to \$100,000 after the expiration of existing tenancy. In view of above, all agreed to acquire the property for long term investment.’

24. The Purported Minutes purported to be minutes of a directors’ meeting held on 15 June 1993. However, according to the Taxpayer’s financial statements for the period ended 30 September 1993, the directors were not appointed until 22 June 1993, that is 7 days after the date of the alleged directors’ meeting. In the Taxpayer’s profits tax return for the year of assessment 1993/94, the Taxpayer declared that it commenced business on 22 June 1993. The purported ‘Resolution’ contained the words the Bank ‘agreed to lend \$7,000,000 repayable monthly at \$67,909.9 for 180 monthly instalments’. The precise amount of monthly repayable was given in the purported ‘Resolution’ allegedly passed on 15 June 1993. The Taxpayer’s application to the Bank for property instalment loan of \$11,220,000 was dated 9 July 1993 and the Bank only approved the loan of \$7,000,000, instead of \$11,220,000 asked for by the Taxpayer, on 26 July 1993, about 40 days after the date of the alleged directors’ meeting.

25. We accept Miss Cheung’s submission that the Purported Minutes was not a contemporaneous document. In any event, we attach no weight to this document which is clearly a self-serving document.

26. Mr Tang’s response was that:

‘Normally in the Hong Kong banks, the banks in Hong Kong they first approach the bank manager or the branch manager to have a so-called verbal agreement, how much they can afford to loan. After they verbally agree between the bank and the purchaser or the client they loan approximately only such a figure, \$7,000,000 or \$8,000,000, and then if verbally agreed the company will go to the bank to have a written application. Of course the purchase price as shown in the page 26 is \$18,000,000 ... They want to borrow more money but actually the bank do not agree. They verbally agreed only allow \$7,000,000, but they want to make a higher ... And beforehand, in June, 15<sup>th</sup> of June they contact the bank manager, the branch manager to have, you know, what is their opinion the money he can borrow. But at the day of having the written application to the bank they say to the bank is \$18,000,000, the purchase price, and the bank’s valuation only \$14,000,000. And at their valuation only agreed to lend \$7,000,000 as verbally agreed between the company and the bank. That is why they have the first idea

## INLAND REVENUE BOARD OF REVIEW DECISIONS

how much they can loan from the bank beforehand. They have idea of \$7,000,000 and the balance of money will be financed from the shareholders, shareholder's loan advance'.

27. The short answer to Mr Tang's arguments is that there is no evidence to support his assertions. Facts are to be proved by evidence, not by assertions in the course of submissions.

28. The Taxpayer has not begun to discharge the burden of proving that the assessments appealed against are excessive or incorrect in that the House was acquired as a capital asset.

29. We dismiss the appeal and confirm the assessments.

### **Order on costs**

30. The discretion of the Board under section 68(9) to order an unsuccessful taxpayer to pay costs is not expressed to be restricted to appeals which are obviously unsustainable. The maximum sum was increased from \$100 to \$1,000 in 1985 and further increased to \$5,000 in 1993. \$5,000 represents only a small fraction of the cost of a Board of Review hearing.

31. For reasons which we have given, this appeal is doomed to failure, obviously unsustainable and bound to fail. Pursuing such a hopeless appeal can only waste the time and resources of the Board of Review and is clearly an abuse for the process. Putting forward and relying on the Purported Minutes is a serious aggravating factor. Pursuant to section 68(9) of the IRO, we order the Taxpayer to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.