

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D125/99

**Profits Tax** – additional tax – sale of taxi and taxi licence – whether trade of buying and selling taxi and taxi licence – trade or capital assets – sections 14, 68(4) and 2(1) of the Inland Revenue Ordinance (‘IRO’), Chapter 112.

Panel: Andrew Halkyard (chairman), Sydney Leong Siu Wing and Ma Ching Yuk.

Date of hearing: 2 December 1999.

Date of decision: 23 February 2000.

The taxpayer claims that profits derived by it from the sale of taxis and taxi licences are not liable to profits tax as they were purchased as fixed assets and most of them were used for hiring. Further, it was contended that the taxpayer’s history of taxis and taxi licence transactions did not disclose any pattern of trading.

The Commissioner maintained that the taxpayer had no evidence to show any compelling reason for it to sell the taxis and the taxi licences and concluded that the taxpayer was only waiting for an opportune time to sell.

#### **Held :**

1. To determine whether property is a capital asset or a trading asset, the purchaser’s intention at the time of acquisition is crucial (Simmons v IRC (1980) 53 TC 461 at 491 per Lord Wilberforce considered and applied).
2. An intention to hold property as a capital investment must be definite and not simply a wish incapable of fulfilment. Moreover, the stated intention of a person is not decisive. Actual intention can only be determined objectively (Marson v Morton [1986] 1 WLR 1343 at 1348-1349 and All Best Wishes v CIR (1992) 3 HKTC 750 at 771 per Mortimer J considered and applied).
3. The onus of proving the assessment appealed against is excessive or incorrect is on the taxpayer (section 68(4) of the IRO).
4. On the evidence, the Board found that the taxpayer failed to discharge the burden and that the taxis and taxi licences were not of a capital nature but were trading stocks.

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### **Appeal dismissed.**

Cases referred to:

Chinachem Investment Co Ltd v CIR (1987) 2 HKTC 261

Simmons v IRC (1980) 53 TC 461

Marson v Morton [1986] 1 WLR 1343

All Best Wishes Ltd v CIR (1992) 3 HKTC 750

D63/92, IRBRD, vol 8, 88

Fung Ka Leung for the Commissioner of Inland Revenue.  
Tai Sheung Yan of Messrs P L Au & Co for the taxpayer.

### **Decision:**

1. This is an appeal by the Taxpayer against an additional profits tax assessment raised on it for the year of assessment 1992/93. The Taxpayer claims that profits derived by it from the sale of taxis and taxi licences are not liable to profits tax.

2. Subject to the following clarifications, the agreed facts, which we so find, are set out in the determination of the Commissioner dated 31 May 1999:

1. The directors' report referred to at fact 3 should cover the period from the year of assessment 1989/90 to the year of assessment 1992/93 and not just for the year ended 31 March 1993 (that is, the year of assessment 1992/93). Fact 3 should also refer to the fact that for the period ended 31 March 1989 the directors' report described the Taxpayer's principal activities as: 'general trading of taxis and investment in taxis by receiving rental income from hire of taxis'.
2. The last sentence of fact 11(b) should read: 'No documentary evidence is available relating to any feasibility study or report for acquiring the taxis and taxi licences.'
3. The first time period referred to at fact 15 should read: 'From the date of commencement of business to 31 March 1989'.

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### **Proceedings before the Board**

3. Mr Tai Sheung-yan of Messrs P L Au & Co, certified public accountants, represented the Taxpayer. Messrs Fung Ka-leung and Wong Kuen-fai represented the Commissioner.

4. No oral evidence was adduced on behalf of the Taxpayer. We must, therefore, decide this case on the basis of the facts found (see above), supplemented by the documents produced to us by the Commissioner (Bundle R1) and by the Taxpayer (Bundle A1).

5. Turning first to Bundle R1, with one exception we find that it contained documents upon which the Commissioner relied in reaching her determination. The remaining document was a memorandum from the Licensing Division (VIR Section) of the Transport Department to the Commissioner dated 25 November 1999. The memorandum set out the dates of purchase and sale of certain taxis by the Taxpayer during the period 3 March 1988 to 30 January 1989. We refer to this document below.

6. Turning now to Bundle A1, the Taxpayer submitted two additional documents. The first was a very useful table showing details of the purchase and sale of all taxis held by the Taxpayer as well as the claimed nature of the profit derived. We attach this document as ' Appendix 1 ' to our decision and incorporate in it [the changes are shown in square brackets] the dates of purchase and sale of the first 4 taxis referred to therein [such information being obtained from the memorandum dated 25 November 1999 referred to in the previous paragraph].

7. The second document showed that the Taxpayer was related to a company called Company A. This company provided the Taxpayer with the funds to purchase its taxis and taxi licences (fact 11(b) refers). Both companies had common directors and shareholders from the same family.

### **Arguments for the Taxpayer**

8. In its notice of appeal, the Taxpayer advanced the following arguments why its disposal of taxis and taxi licences should not be subject to profits tax:

1. Although the Taxpayer only issued two \$1 shares for a paid up capital of \$2, its acquisition of taxis and taxi licences was financed by Company A. The Taxpayer could therefore keep the funds advanced to it as long as it liked. This meant that it could keep the taxis and taxi licences as fixed assets.
2. Before acquiring the taxis and taxi licences the Taxpayer anticipated that it could hire all its taxis and that the return on capital would be very attractive. Unexpectedly, finding drivers for the taxis became very difficult and some of the taxis were not fully hired.

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3. Although the Commissioner claimed that all the taxis and taxi licences were acquired by the Taxpayer in one lot, it is unreasonable to presume that all of them were acquired for the same purpose. In fact they were purchased on different dates (see Appendix 1) and most of them were used for hiring.
4. The taxis sold in the year of assessment 1989/90 had been used for hiring and thus the profits derived from the sales were wrongly assessed to profits tax. As the amount of profits tax levied on those sales was small (\$86,473) it should not be assumed that the Taxpayer accepted this assessment.
5. Some of the remaining taxis had been hired for nearly 5 years and this is a very important factor in determining that they were acquired as fixed assets. If the Taxpayer had been waiting for an opportune moment to sell the taxis for profit, it would have sold Taxis No. 5, 6, 7 and 15 (see Appendix 1) when these taxis had worn out in the year of assessment 1990/91.<sup>1</sup> Instead the Taxpayer purchased other taxis in that year as replacements in order to continue its taxi hiring business.
6. In view of the directors' reports setting out the principal activities of the Taxpayer (see amended fact 3 above), it appears that there was a change in the nature of its business from the year of assessment 1989/90 onwards, namely, the cessation of the taxi trading business and continuation of the taxi hiring business. In this regard, the case of Chinachem Investment Co Ltd v CIR (1987) 2 HKTC 261 supports the proposition that accounting treatment is not an insignificant factor in determining the character of a taxpayer's assets. All the assessors dealing with the Taxpayer's tax returns have granted depreciation allowances for the taxis, as claimed by the Taxpayer, thus accepting that they were fixed assets and not trading stock.

9. During the Board hearing, Mr Tai reiterated the above arguments. In addition, he contended that the Taxpayer's history of taxi and taxi licence transactions did not disclose any pattern of trading. Indeed, according to Mr Tai, it was quite the reverse. Specifically, Mr Tai noted from Appendix 1 that only 15 taxi licences were purchased, 9 in the year of assessment 1987/88 (1 February – 31 March 1988) and 6 in 1988/99 (1 April - 3 October 1988<sup>2</sup>). He contended that these purchases were divided into two lots, one for trading (Taxis No 1 to 4: 'the First Lot') and one for fixed assets used for hire (Taxis No 5 to 15: 'the Second Lot'). Accordingly, the profits on the sale of the First Lot were properly offered for assessment in the year of assessment 1987/88 as

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<sup>1</sup> Taxi No. 8 also was not sold when it wore out in the year of assessment 1992/93. Instead the car body was scrapped and replaced.

<sup>2</sup> Actually 7 taxis were purchased in the year ended 31 March 1989. Taxi No. 16 was apparently written off in the year of purchase.

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trading profits while the hire income from hiring the Second Lot were returned as annual investment income in the year of assessment 1987/88 and later years. All this, according to Mr Tai, was evidenced by the accounting treatment shown by the Taxpayer's audited accounts for the relevant periods and the statements attached thereto, such as the directors' reports.

10. Mr Tai then raised various other matters that were essentially an attempt to adduce evidence. At best, they were hearsay; but he did not introduce such hearsay as sworn evidence that could be subjected to cross-examination by the Commissioner's representative. The Board has placed no weight on these unsworn statements. Even if the Board were disposed to accept them, it would have concluded that they would not assist the Taxpayer's case. To provide several examples, Mr Tai first stated that when the Taxpayer purchased the taxis it had a 'plan' to distinguish those sold (the First Lot) from those kept for hire (the Second Lot). He then stated that none of the First Lot was hired, whereas all of the Second Lot was hired. He also stated that Company A had no need for the funds advanced to the Taxpayer and that these were thus long term loans.

11. All the statements in the paragraph above may be true. But the fact remains that, from the perspective of this Board, these statements are pure conjecture. If accepted, they introduce matters that had not previously been advanced by the Taxpayer. Their submission, at this late stage of the dispute, can only cast doubt upon the Taxpayer's case, given that not one single witness from the Taxpayer was prepared to give oral evidence before us.

### **Arguments for the Commissioner**

12. In light of our view of the facts found, it is not necessary for us to set out the arguments of the Commissioner in detail. Suffice to say that Mr Fung for the Commissioner contended that the Taxpayer's submissions as to its intention for purchasing the taxis and taxi licences were simply not supported by sufficiently strong evidence. Moreover, Mr Fung argued that the Taxpayer's history of selling such assets in the year of assessment 1988/89 (where the profits were agreed by the Taxpayer to be taxable) and in the year of assessment 1989/90 (where the Commissioner's determination taxing the profits was not appealed), as well as the year of assessment in dispute, shows that the nature of its business included trading of taxis and taxi licences.

13. Mr Fung also argued that the Taxpayer had no evidence to show any compelling reason for it to sell the taxis and the taxi licences. He concluded that the Taxpayer was only waiting for an opportune time to sell.

14. In so far as the source of the Taxpayer's finance to purchase the taxis and taxi licences was concerned, Mr Fung noted that there was no evidence to show that the associated lender, Company A, was prepared to advance the funds to the Taxpayer on a long term basis. Objectively, the sale proceeds of the taxis and the licences were used by the Taxpayer to repay the lender (fact 14(1) refers).

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### Analysis

15. The law relevant to this appeal is clear and not in dispute. The question for decision is whether the Taxpayer is assessable to profits tax by having entered into a trade of buying and selling taxis and taxi licences during the year of assessment 1992/93 (sections 14 and 2(1) of the Inland Revenue Ordinance, definition of ‘trade’). To determine whether property is a capital asset or a trading asset, the purchaser's intention at the time of acquisition is crucial. In Simmons v IRC (1980) 53 TC 461, Lord Wilberforce stated at 491:

*‘Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’*

16. An intention to hold property as a capital investment must be definite and not simply a wish incapable of fulfilment. Moreover, the stated intention of a person is not decisive. Actual intention can only be determined objectively (usually on the basis of the so-called ‘badges of trade’, see Marson v Morton [1986] 1 WLR 1343 at 1348-1349).

17. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750, Mortimer J stated at 771:

*‘It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words.’*

18. In light of these and other authorities cited to us by the parties, it is also clear that while accounting treatment may be significant in individual cases, it is not determinative and must be weighed against other evidence. Furthermore, mere letting of property is not conclusive that it is held as a fixed asset as distinct from trading stock (compare D63/92, IRBRD, vol 8, 88 where, although taxis were let for hire before sale, this did not preclude a finding that they were nonetheless trading stock of the taxpayer's trade or business).

19. Finally, the onus of proving the assessment appealed against is excessive or incorrect is on the Taxpayer (section 68(4) of the Inland Revenue Ordinance).

20. Applying the law to the facts before us, we conclude that there is little evidence to support the claimed intention argued by Mr Tai that although Taxis No. 1 to 4 were trading stock, the remainder were not. The Board nonetheless appreciates the weight of Mr Tai's submissions that the Taxpayer has kept several taxis for nearly 5 years, that it financed the purchase of the taxis and taxi licences from a related company, that it did not sell certain taxi licences when the car bodies

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were replaced and that its audited accounts and other supporting (but self-serving) documents showed the taxis as fixed assets. These factors do not fit the classic mould of a taxi speculator. However, they do not necessarily preclude the conclusion that the Taxpayer's intention in purchasing the taxis and taxi licences was for resale at a profit.

21. Mr Tai alleged that the taxis comprised in the First and Second Lots were not purchased at the same time and that the Taxpayer acted according to some unspecified 'plan'. Apart from Mr Tai's mere assertions at the Board hearing, there was no evidence before us – in any particular – of any 'plan'. Nor had such a plan previously even been hinted at by the Taxpayer in its correspondence with the Commissioner that has been produced to us.

22. Furthermore, it is simply not true that the taxis were purchased at different times. As can be seen from Appendix 1, Taxi No. 1, acknowledged as trading stock, was purchased on the same date as Taxi No. 6, claimed to be a fixed asset. Similarly, Taxi No. 2, acknowledged as trading stock, was purchased on the same date as Taxis No. 5 and 8, claimed to be fixed assets. Further, Taxi No. 3, acknowledged as trading stock, was purchased just 2 days before Taxi No. 9, which was also claimed to be a fixed asset – notwithstanding that it was sold in the year of assessment 1989/90. What 'plan' could give rise to these results is still unclear to us. Rather, it is much more likely that these results are explicable by a subsequent rationalisation for the events that unfolded.

23. These and other matters that troubled the Board, such as a total absence of independent evidence supporting Mr Tai's contention that the taxi transactions in dispute were of a capital nature, could have been dispelled by oral testimony from the Taxpayer's controllers. Evidence showing the feasibility of the Taxpayer's actions in distinguishing between the two lots of taxis could have been helpful. Similarly, documentary evidence showing that none of the First Lot of taxis was hired but that all of the Second Lot of taxis was hired could also have been helpful. To take another, but by no means final, example, evidence concerning the so-called 'forced' sale of taxis in the year of assessment 1989/90 due to the claimed difficulties in finding taxi drivers could have been an important part of the Taxpayer's case. But, in the event, neither oral nor documentary evidence was forthcoming to explain any of these matters.

24. In the result, on the basis of the facts found and documents before us, we are unable to conclude that the Taxpayer's contentions as to its reasons for purchasing the taxis and taxi licences in dispute have been substantiated.

25. In these circumstances, the Taxpayer could only succeed in its appeal by showing demonstrably that the Commissioner was wrong in reaching the conclusion that it had carried out a trade of buying and selling taxis and taxi licences during the period under review. Given the short period between purchase and the commencement of sales, the absence of proof of the Taxpayer's intention at the time of purchasing the relevant taxis and licences and the evidential factors referred to above which, while remaining unexplained, must cast doubt upon the Taxpayer's claims, it was

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clearly open to the Commissioner to decide that in purchasing and selling the relevant property the Taxpayer had engaged in a trade of dealing in taxis and taxi licences. We therefore have no hesitation in concluding that the Taxpayer has not discharged the onus of proving that the assessment was incorrect.

26. For all the above reasons this appeal is dismissed.

Appendix 1

The Taxpayer

Taxi No.	Date of purchase	Cost of car body	Licence premium	Purpose & use	Nature of business	Date of sale	Selling price \$	Profit (\$) & its nature
<u>Year of assessment 1987/88</u>								
1	[10/3/1988]	[30/1/1989]	2,754,030	trading	Note (1)	year ended 31/3/89	3,233,000	trading <u>478,970</u>
2	[3/3/1988]	[17/9/1988]						
3	[29/3/1988]	[23/12/1988]						
4	[15/4/1988]	[21/12/1988]						
5	3/3/1988	134,080	549,000	hire income	Note (1)	} worn out & replaced in 1990/91 in 1992/93		
6	10/3/1988	136,800	553,000	hire income	Note (1)			
7	25/3/1988	139,550	597,000	hire income	Note (1)			
8	3/3/1988	132,580	549,000	hire income	Note (1)			
9	31/3/1988	136,070	597,500	hire income	Note (1)	sold in 1989/90		
<u>Year of assessment 1988/89</u>								
10	2/6/1988	108,000	657,000	hire income	Note (1)	sold in 1989/90		
11	2/6/1988	109,250	657,000	hire income	Note (1)	sold in 1989/90		
12	2/6/1988	109,250	657,000	hire income	Note (1)	sold in 1989/90		
13	8/6/1988	109,250	657,000	hire income	Note (1)	sold in 1989/90		
14	8/6/1988	109,250	657,000	hire income	Note (1)	sold in 1989/90		
15	3/10/1988	115,930	610,000	hire income	Note (1)	replaced in 1990/91		
16	22/3/1989	35,000		hire income	Note (1)	written off		
<u>Year of assessment 1989/90</u>								
9	in 1987/88			hire income	Note (2)	16/2/1990	850,000	Total <u>764,851</u>
10	in 1988/89			hire income	Note (2)	9/8/1989	855,000	(capital
11	in 1988/89			hire income	Note (2)	9/8/1989	855,000	claimed but
12	in 1988/89			hire income	Note (2)	9/8/1989	855,000	assessed
13	in 1988/89			hire income	Note (2)	9/8/1989	855,000	as revenue)
14	in 1988/89			hire income	Note (2)	9/8/1989	855,000	
5 – 8	in 1987/88			hire income	Note (2)	c/f to 1990/91		
15	in 1988/89			hire income	Note (2)	c/f to 1990/91		

Taxi No.	Date of purchase	Cost of car body	Licence premium	Purpose & use	Nature of business	Date of sale	Selling price \$	Profit (\$) & its nature
<u>Year of assessment 1990/91</u>								
5			Replaced for	hire income	Note (2)	c/f to 1991/92		
6			the then Taxi No. 5	hire income	Note (2)	c/f to 1991/92		
7			the then Taxi No. 6	hire income	Note (2)	c/f to 1991/92		
8			the then Taxi No. 7	hire income	Note (2)	c/f to 1991/92		
15			the then Taxi No. 15	hire income	Note (2)	c/f to 1991/92		
<u>Year of assessment 1991/92</u>								
5 – 8	in 1987/88			hire income	Note (2)	c/f to 1992/93		
15	in 1988/89			hire income	Note (2)	c/f to 1992/93		
<u>Year of assessment 1992/93</u>								
5	in 1987/88		Replaced for	hire income	Note (2)	23/2/1993	1,682,000	1,117,075
7	in 1987/88		the then Taxi No. 5	hire income	Note (2)	23/2/1993	1,688,000	1,075,310
8	in 1987/88		the then Taxi No. 7	hire income	Note (2)	23/2/1993	1,663,000	1,097,000
8	in 1987/88		the then Taxi No. 8	hire income	Note (2)	23/2/1993	3,000	3,000
			Scrapped	hire income	Note (2)			
Total								<u>3,292,385</u>
6	in 1987/88		the then Taxi No. 6	hire income	Note (2)	c/f to 1993/94		
15	in 1988/89		the then Taxi No. 15	hire income	Note (2)	c/f to 1993/94		

Note (1) : As stated in the directors' report for the period 1-2-1988 to 31-3-1989, the Taxpayer was engaged in general trading of taxis and investment in taxis by receiving rental income from hire of taxis.

Note (2) : As stated in the directors' reports for the years of assessment 1989/90, 1990/91, 1991/92 and 1992/93, the Taxpayer was engaged in investment in taxis by receiving rental income from hire of taxis.