

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D23/94

Profits tax – sale of Letters B land entitlements – whether Letters B are trading stock or capital assets.

Panel: Robert Wei Wen Nam QC (chairman), Foo Tak Ching and Michael A Olesnicky.

Dates of hearing: 21, 22 and 28 March 1994.

Date of decision: 5 July 1994

The taxpayer was a private company which owned certain Letters B land entitlements. The taxpayer claimed that when it acquired the Letters B it was the intention of the taxpayer to exchange the Letters B with the government for the purpose of obtaining suitable plots of land for development. The taxpayer submitted that in such circumstances the Letters B were a capital asset. The Commissioner submitted that the nature of the Letters B depended upon the intention of the taxpayer when it acquired of the same. If the intention was to exchange the Letters B for land to be developed for resale then the Letters B would be a trading asset. If however the development was for long term investment holding purposes then the acquisition of the Letters B would be as a capital asset. In fact the taxpayer did not exchange the Letters B with the Hong Kong government but sold the same and made substantial profits. The assessor assessed the profits to tax being of the opinion that the taxpayer had acquired the Letters B for the purpose of trading therein and not for the purpose of exchanging the same as a capital asset. The Commissioner submitted that the taxpayer had not discharged the onus of proof placed upon it.

Held:

The onus of proof is upon the taxpayer. The taxpayer did not satisfy the Board that when it acquired the Letters B it did so with the intention of exchanging the same for land to be developed. Furthermore the taxpayer had not produced evidence to satisfy the Board that even if the intention originally was to exchange the Letters B, the exchange would have been for the purpose of redevelopment as a long term capital asset as opposed to redevelopment for trading purposes.

Appeal dismissed.

Cases referred to:

D61/87, IRBRD, vol 3, 21

D25/88, IRBRD, vol 3, 294

Luk Nai Man for the Commissioner of Inland Revenue.

Robert Kotewall instructed by Messrs Fok & Johnson for the taxpayer.

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Decision:

Preliminaries

1. This is an appeal by a private limited company (the Taxpayer) against the additional profits tax assessment raised on it for the year of assessment 1987/88 and the profits tax assessment for the year of assessment 1988/89, both as revised by the Commissioner of Inland Revenue in his determination dated 6 August 1993. The main ground of appeal is that certain land exchange entitlements (Letters B) sold during the years in question were long-term investments with the consequence that the profits on the sales were not assessable to profits tax.

2. X, a shareholder and director of the Taxpayer, and Z, a partner of BB, the Taxpayer's current tax representatives, gave evidence on behalf of the Taxpayer.

Findings of Fact

3. The following facts are agreed or not in dispute:

- (a) The Taxpayer was incorporated as a private company in Hong Kong in November 1979 with an issued share capital at all times of \$20 which was equally divided between X and his wife. They were the only two shareholders and directors of the Taxpayer.
- (b) X's late father had passed away in November 1939 but his estate was not distributed until 1960. Among other things X inherited over 200,000 square feet of land to which he acquired full legal title in 1966. The land was converted into Letters B in 1975.
- (c) X had 3 children, a son born in 1957 and two daughters born in 1959 and 1960 respectively. In 1976 the 3 children went to Country M to pursue their studies. In the same year X and his wife applied for residence status in Country M, and X bought a home in Country M for the family.
- (d) Prior to the incorporation of the Taxpayer, X had sold a parcel of the Letters B in respect of about 50,000 square feet for \$12,700,000 and had exchanged another parcel of the Letters B in respect of about 30,000 square feet for a site in Place N, which was later developed for sale under a joint venture partnership owned as to 27/40 by X and as to 13/40 by a limited company owned by X's wife and her sister in equal shares.
- (e) The remainder of the Letters B in respect of some 126,700 sq ft were sold at market prices to the Taxpayer as follows:

Price per

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Date	Lot No	Area (square feet)	square foot (\$)
3-1-1980	I	49,558.00	500
3-5-1980	II	77,216.75	650

In each case the purchase price was paid by the grant of an interest-free loan by X to the Taxpayer. At all times those Letters B were the Taxpayer's only asset.

- (f) From September 1980 until May 1988 the Taxpayer sold its Letters B in respect of a total of 112,000 square feet. The proceeds of each sale were paid by the Taxpayer to X or his wife upon receipt in partial repayment of their loan to the Taxpayer. The first sale took place on about 20 September 1980 when the Taxpayer sold a parcel of the Letters B in respect of 10,000 square feet of Lot No II at \$760 per square foot, making a profit of \$1,081,000 on the sale. Through AA, the Taxpayer's auditors and tax representatives at that time, the Taxpayer offered the profit for assessment to profits tax by its 1980/81 profits tax return. A 1980/81 profits tax assessment was raised on the Taxpayer in respect of the returned profit. The Taxpayer did not object to the assessment. In its audited accounts for the period ended 31 March 1981, provision was made for taxation on the returned profit. The unsold Letters B were listed under the heading 'land exchange entitlements at cost'. In the 1980/81 profits tax return, 'property investment' was given as 'the nature of business carried on.'
- (g) The first sale had taken place during the period from March 1980 to December 1980 when the market was rising sharply. (That is based on a chart for the prices of Letters B of 1978 vintage for the period from 1980 to 1988. The parties agreed that the market for the Letters B concerned in this appeal followed the same pattern as shown in the chart, which is referred to hereinafter as the agreed chart.)
- (h) No sale took place during 1981/82 – 1984/85. In the balance sheets as at 31 March 1982 and 31 March 1983 respectively, the unsold Letters B were listed under the heading 'fixed assets, at cost'. However, in the balance sheets as at 31 March 1984 and 31 March 1985 respectively, they were listed under the heading 'land exchange entitlements, at cost'.
- (i) As shown in the agreed chart, the market fell steeply from December 1980 until September 1981; the fall then continued at a somewhat slower pace until it bottomed out in January 1983; it remained at the bottom until November 1984 when the market began to recover; from then on, except for the period between May 1987 and June 1987 and a period after the October 1987 stockmarket crash, the rise continued at an increasing pace until October 1988.
- (j) During the year ended 31 March 1986, the Taxpayer sold two parcels of the Letters B as follows:

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Date	Lot No	Area (square feet)	Price per square foot (\$)
27-12-1985	I	10,000	500.00
9-1-1986	II	10,000	514.80

The Taxpayer made a loss of \$1,350,000 on the sales. On 27 December 1986 the Taxpayer submitted through AA its profits tax return for the year of assessment 1985/86, claiming it as a trading loss and giving 'sales of land exchange entitlements' as 'the nature of business carried on.'

- (k) During the year ended 31 March 1987 the Taxpayer sold 6 parcels of the Letters B as follows:

Date	Lot No	Area (square feet)	Price per square foot (\$)
18-4-1986	II	10,000	544.50
17-6-1986	II	5,000	590.00
11-7-1986	I	10,000	610.00
22-7-1986	II	10,000	628.65
28-10-1986	II	10,000	710.00
19-2-1987	II	5,000	930.00

The Taxpayer made a profit on the third, fifth and sixth sales while losing on the first, second and fourth sales, making, on balance, a profit of \$1,160,000. Its profits tax return for the year of assessment 1986/87 was not submitted until 31 March 1988 (see sub-paragraph (p) below).

- (l) During the year ended 31 March 1988 the Taxpayer sold 4 parcels of the Letters B as follows:

Date	Lot No	Area (square feet)	Price per square foot (\$)
28-5-1987	II	5,000.00	746.00 (average)
25-7-1987	II	5,000.00	756.00 (average)

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24-8-1987	II	7,216.75	746.00 (average)
24-8-1987	I	2,783.25	2,468.50 (average)
8-9-1987	I	7,000.00	2.468.50 (average)

The Taxpayer made a total profit of \$17,500,000 on the sales. Its profits tax return for the year of assessment 1987/88 was submitted on 16 August 1989 (see sub-paragraph (t) below).

- (m) By a letter dated 29 December 1987 and addressed to the assessor, profits tax, AA, the Taxpayer's then tax representatives, stated, inter alia:

'the original intention for the acquisition of the land exchange entitlements was that, as per copy of director's minute attached, the directors offered a proposal to the company to acquire the said entitlements to exchange proper lands from the Government for the purpose of developing, such as to construct buildings or houses for long term investment...'

The 'copy of director's minute' attached to the letter was in the following terms:

'Minutes of a meeting of directors of the company held at its registered office on 20 December 1979 at 11 a.m.

Present W(X's wife)
 X

Present W was elected chairman of the meeting.

Suggestion X had a suggestion to offer certain land exchange entitlements to the company and also had the following proposal: the company may acquire the land exchange entitlements in order to exchange proper lands from the Government to construct buildings or houses etc for long term investments and for such costs of construction X promised to advance the funds to the company and such funds will bear no interest.

Resolution It was resolved that the company do acquire from X the land exchange entitlements Letters B of Lot No I (portion area = 49,588 square feet) in the consideration of \$24,779,000 and X & W be authorized to execute the assignment of the above mentioned Letters B entitlement and the common seal of the company to be affixed thereon.

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There being no further business, the meeting was terminated.

W (signed)
Chairman

- (n) By a letter dated 22 February 1988 and addressed to AA, the assessor, profits tax, replied as follows:

‘...’

Land Exchange Entitlements

In the profits tax return for the year of assessment 1985/86 and provisional payment of the year of assessment 1986/87, it is noted that your client carried on business of sales of land exchange entitlements. However, I was informed that the land exchange entitlements were purchased for long term investment in your letter dated 29 December 1987. Please explain for the apparent contradiction.’

- (o) By a letter dated 29 March 1988 and addressed to the assessor, profits tax, AA stated:

‘We are instructed by our abovenamed client to reply to your letter dated 22 February 1988. It appeared that there was an error in the preparation of the profits tax return for the year of assessment 1985/86 and the correct nature of our client’s business is long term investment.’

- (p) On 31 March 1988, the Taxpayer through AA submitted its profits tax return for the year of assessment 1986/87 showing a profit of \$3,292. The ‘nature of business carried on’ was stated to be ‘no trading, realization of capital investment’. In the audited accounts for that year, the \$1,160,000 profit on the sales of the Letters B (see sub-paragraph (k) above) was treated as an extraordinary item while the unsold Letters B were listed under the heading ‘land exchange entitlement, at cost’.
- (q) On 9 May 1988 the Taxpayer sold 2 parcels of the Letters B in respect of a total area of 5,000 square feet of Lot No I at the market price of \$1,950 per square feet, making a profit of \$6,650,000. The profits tax return for the year of assessment 1988/89 was not submitted until 20 December 1989 (see sub-paragraph (y) below).
- (r) On 8 September 1988 the assessor, profits tax, issued to the Taxpayer loss computations for the years of assessment 1985/86 and 1986/87. The loss in the year of assessment 1985/86, amounting to \$1,360,000, was based on the

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trading loss of \$1,350,000 claimed in its profits tax return for the year of assessment 1985/86 (see sub-paragraph (j) above). On the same day the assessor, profits tax, raised on the Taxpayer a profits tax assessment for the year of assessment 1986/87 treating the profit of \$1,160,000 (see sub-paragraph (p) above) as a trading profit with, however, nil assessable profits after setting off the trading loss of \$1,360,000 from the year of assessment 1985/86. The balance of trading loss to be carried forward was \$189,000. The Taxpayer was requested to notify the assessor, profits tax, of its reasons for any disagreement with the loss computations. The Taxpayer never notified any disagreement.

- (s) On 19 December 1988 the assessor, profits tax, raised on the Taxpayer an estimated profits tax assessment for the year of assessment 1987/88 in the sum of \$1,389,000 with assessable profits at \$1,200,000 after setting off trading loss of \$189,000 from the year of assessment 1986/87 (see sub-paragraph (r) above) with tax payable thereon of \$216,000. On 18 February 1989 the Taxpayer duly paid the sum of \$393,000 being the first instalment of the total tax payable in respect of the profits tax of \$216,000 for the year of assessment 1987/88 and provisional tax of \$236,256 for the year of assessment 1988/89.
- (t) On 16 August 1989 the Taxpayer submitted through AA its profits tax return for the year of assessment 1987/88 showing a loss of \$6,256. 'The nature of business carried on' was stated to be 'investment'. In the audited accounts for that year the \$17,500,000 profit on the sales of the Letters B (see sub-paragraph (1) above) was treated as an extraordinary item while the unsold Letters B were listed under the heading 'land exchange entitlements, at cost'.
- (u) Together with the profits tax return and audited accounts for the year of assessment 1987/88 mentioned in sub-paragraph (t) above, a note (hereinafter called AA's note) was also filed by AA on behalf of the Taxpayer, setting out the reasons why 'the surplus on the disposition of the land exchange entitlements should be of a capital nature and not chargeable to profits tax'. In particular, it stated:

'Original motive of acquisition

The company did not go out to acquire the land exchange entitlements as in any profit making companies. The land exchange entitlements were owned by a director [X] for many years, in fact, most of them were not purchased by him either, it was inherited by [X] from his late father. The transfer of the entitlements by [X] to the company did not change the nature of the entitlements that he had held for many years, that of long term investment. In fact, there was a valid reason for [X] to transfer the entitlements to the company because he has applied to immigrate to Country M and that holding the entitlements directly under his name may result in immediate tax liability in Country M in the event that should be decided to realise a portion of the investment.'

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As was pointed out to us, the phrase 'most of them' in the above quoted passage should read 'all of them'.

- (v) On 24 October 1989 the assessor, profits tax, raised on the Taxpayer an additional profits tax assessment for the year of assessment 1987/88 in the sum of \$18,000,000 (with tax payable thereon of \$3,250,000) after adding back the extraordinary item of \$17,500,000 (see sub-paragraph (t) above).
- (w) On 22 November 1989 the assessor, profits tax, raised on the Taxpayer an estimated profits tax assessment for the year of assessment 1988/89 in the sum of \$21,450,000 with tax payable thereon of \$3,640,000.
- (x) On 23 November 1989, BB, the Taxpayer's new tax representatives in place of AA, lodged an objection against the additional profits tax assessment for the year of assessment 1987/88.
- (y) On 20 December 1989 the Taxpayer through BB lodged an objection against the estimated profits tax assessment for the year of assessment 1988/89 and submitted its profits tax return stating a loss of \$4,546. 'The nature of business carried on' was stated to be 'investment'. AA, however, remained the Taxpayer's auditors. In the audited accounts for the year of assessment 1988/89 the \$6,650,000 profit on the sales of the Letters B (see sub-paragraph (q) above) was treated as an extraordinary item while the unsold Letters B were listed under the heading 'land exchange entitlements, at cost'.
- (z) The assessor, profits tax, has since revised the additional assessable profits of the year of assessment 1987/88 to \$16,150,000 with tax payable thereon of \$2,900,000 and the assessable profits for the year of assessment 1988/89 to \$6,650,000 with tax payable thereon of \$1,130,000.

The Law

4(1). The Letters B is a marketable asset and, as such, may be held as trading stock or as a long-term investment, its status depending on what the purchaser's intention was at the time of the acquisition. On the other hand, if the Letters B is inherited property, it is generally a capital asset in the hands of the beneficiary; the proceeds of a sale by him will not be subject to profits tax, unless the holding of the Letters B or the subsequent sale amounts to an embarking on a trade. In the present case the Letters B were inherited property in the hands of X until they were sold to the Taxpayer in two parcels in January and May 1980 respectively (see paragraph 3(e) above); their status in the hands of the Taxpayer must be determined according to the Taxpayer's intention towards them at the time of their acquisition. If the intention was to hold them for resale, the Letters B would be trading stock. On the other hand, if the intention was to hold them for long-term investment, such as for capital growth, the Letters B would be capital assets. So far the parties appeared to be in agreement.

4(2). What the parties could not agree on was the question of what would be the status of the Letters B if they were acquired for the purpose of exchanging them for suitable

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plots of land (if and when they became available) for development. Mr Kotewall, QC, leading counsel for the Taxpayer, submitted that the Letters B were a capital asset, and that it did not matter whether the envisaged development was for resale or for long-term investment, such as for rental income – either way the Letters B were a capital asset; and he relied on D61/87, IRBRD, vol 3, 31. On the other hand, the Commissioner's representative cited D25/88, IRBRD, vol 3, 294 for the following propositions:

- '(a) Letters B are trading stock if they are acquired ... for the purpose of exchanging them for land to be developed for resale. On the other hand, they are investment assets if they are acquired for the purpose of exchanging them for land to be developed and held as a long-term investment.
- (b) The Taxpayer's intention to acquire Letters B for the purpose of acquiring land was a neutral factor, because such expansion could take the form of either trading or investment.

It was thus common ground that if the Letters B were acquired for the purpose of exchanging them for suitable plots of land (if and when they became available) to be developed and held as a long-term investment, they were a capital asset.

The Onus of Proof

5. In his written statement which was treated by consent as his evidence in chief, X stated at the outset that at the time he incorporated the Taxpayer, that is, in November 1979, he intended to hold the Letters B until the Taxpayer could find suitable plots of land for exchange and development. X did not state the purpose or object of such development. However, in re-examination X clarified his position by stating that the Letters B held by the Taxpayer were intended for exchange for suitable lands to be developed for long-term investment. The onus was on the Taxpayer to prove that intention.

The Reasons

6(1). As for his reasons for incorporating the Taxpayer, X stated:

'First, I considered that a limited company would be more appropriate for any future developments involving the exchange of Letters B, and would appear more formal than myself as proprietor. Secondly, it would allow proper management and control to be exercised, while avoiding the risk of unlimited personal liability ... Neither I nor the company intended to buy and sell Letters B at a profit, nor merely to hold them for a year or two. Indeed I have not bought any Letters B, and all the Letters B I held and those subsequently injected into the company, had been derived from properties inherited from my late father. If I had intended to buy and sell Letters B, there would have been no need to set up and maintain the company, or incur the administrative cost and expenses in doing so.'

The last sentence in the above quotation contrasts sharply with the last sentence in AA's note set out in paragraph 3(u) above. In the full context of the evidence, particularly in

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relation to the family's plans for emigration to Country M (see paragraph 3(c) above) and the sales of the Letters B to be mentioned later, the last sentence in AA's note rings true. No reference was made to the issue of tax in Country M in the course of evidence.

6(2). The Letters B were sold to the Taxpayer in two parcels in January 1980 and May 1980 respectively (see paragraph 3(e) above). Five months later, in September 1980, the Taxpayer made its first sale of its Letters B, made a profit and offered the profit for assessment to profits tax (see paragraph 3(f) above). X's evidence was that the purpose of the sale was to raise funds to finance a development project at the site in Place N mentioned in paragraph 3(d) above, and that the funds thus raised were paid by the Taxpayer to X who then paid them to Mrs X who then used them to enable the joint venture partner (the limited company mentioned in paragraph 3(d) above) to pay the construction cost. Proceeds of the sale amounting to \$7,600,000 were paid by the Taxpayer to X on 23 September 1980. As the joint venture was not formed until October 1981, it is difficult to see why it was necessary to raise funds in September 1980. Further, there was no documentary proof of the funding. Furthermore, we note that the first sale, like all the subsequent sales, had taken place on a rising market (see paragraph 3(g) above). For those reasons, we are unable to find that the 'first sale arose from the need to raise funds to finance the project.' The sale reflected a desire to take a profit on the rising market.

6(3). The Taxpayer never applied for exchange of its Letters B for land. X's explanation was as follows:

'Between 1980 and 1984, I considered a few tenders for Government land on behalf of the company to be exchanged for Letters B. I refer, for instance, to explanatory notes in relation to land auctions for Shatin Town Lots Nos III and IV. The Company was unable to exchange any of its Letters B for suitable land for several reasons. First, I was already fully involved in a redevelopment at the site in Place N. Secondly, the user of the lands subject to tender was often not suitable for the company for development purposes. We were looking for plots which allowed commercial and residential user. Thirdly, the economics of such development were usually extremely competitive, and resulted in the company being unable to justify the necessary exchange. At that time, the company's Letters B were not of sufficient age to tender for the more valuable sites. During 1980 and 1984, the company was approached from time to time by estate agents and interested parties to sell the Letters B. These approaches were verbal, and either in person at any office, or on the telephone. However, the company was not interested in selling the Letters B at a profit and rejected these offers, as the company intended to hold them for land exchange purposes for development.'

No specific instance where X considered any land exchange proposal was given to illustrate the reasons, particularly the reason that the economics were such that the exchange could not be justified. Furthermore, we note that none of the reasons was mentioned in AA's note (see paragraph 3(u) above); in fact AA made no attempt to explain why the Taxpayer never applied for land exchange. We are therefore unable to accept X's generalities. As for the assertion that the Taxpayer was not interested in selling its Letters B at a profit and rejected the offers, we can only say that on the evidence of the agreed chart, the market declined

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from December 1980 and remained at the bottom until November 1984 when the recovery began (see paragraph 3(i) above). The second sale in December 1985 and the third sale in January 1986 took place when the market was already on the way up, although the Taxpayer still made a loss (see paragraph 3(j) above). In our view the fact that the Taxpayer did not sell its Letters B in the 4 intervening years is consistent with an unwillingness to sell on a market which was falling or bottoming out.

6(4). From December 1985 until May 1988 the Taxpayer executed 13 sales spread out over the period (see paragraphs 3(j), (k), (l) and (q) above). X's evidence in this regard was as follows:

'However, after the political and economic crises in Hong Kong from late 1982 to 1985, with substantial falls in the Hong Kong property and stock markets, and the Hong Kong dollar. I became disheartened and lost confidence in Hong Kong's future. I therefore decided in 1985 not to pursue my original plan for the company to retain the Letters B for exchange purposes. Instead, I decided to realise the loans made to the company, and to buy properties and assets abroad.'

From the agreed chart (see paragraph 3(i) above), and the records of the sales (see paragraphs 3(j), (k), (l) and (q) above), we note that the sales were all made on a rising market. It seems to us that the spreading out of the sales reflected a desire to maximise the benefit to be gained from what promised to be a sustained rising market, while providing a measure of cushion against the impact of any unexpected downturn along the way. That is consistent with the fact that there were no sales during the 4 years of assessment 1981/82 - 1984/85 during which the market plunged and bottomed out, and the fact that the Taxpayer was willing to sell a few parcels at below the cost price during the period from December 1985 to July 1986 when the upward trend was becoming ever more pronounced.

6(5). X stated that W, his wife, had not taken any active role in the Taxpayer and that X controlled and managed the Taxpayer. We are not convinced that that was so. W was a 50% shareholder; decisions to sell the Letters B were taken by X and W jointly; proceeds of sales of the Letters B were deposited in the name of 'X and/or W', the expression 'and/or' presumably meaning joint and several control. W was involved in a separate property development (see paragraph 3(d) above). She was named as chairman of the directors' meetings supposedly held on 20 December 1979 (see paragraph 3(m) above) and 3 January 1980 (see paragraph 6(6)(b)(ii) below). We are inclined to the view that W was, jointly with X, in control of the Taxpayer. No explanation was offered as to why she was not called as a witness.

6(6)(a). Y and his father had handled accounting matters for X and limited companies controlled by X. Y took over his father's accounting business in the early 1970s. AA, of which Y was the principal, had been the Taxpayer's auditors and tax representatives since its incorporation.

6(6)(b). X's evidence was that in December 1987, Y informed him that 'AA may have made an error in the past and that the disposal of the Letters B should not be subject to profits tax.' Y further advised, according to X, that the Taxpayer 'should prepare proper

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minutes to be backdated, since the company's minutes did not expressly state the company's true intentions.' X further stated that two board minutes backdated 20 December 1979 and 30 April 1980 respectively were prepared by Y and signed by W as chairman to replace two earlier minutes dated 3 January 1980 and 3 May 1980 respectively. The earlier minutes had been drafted and signed by X and were contemporaneous minutes to record the sales of the Letters B by X to the Taxpayer. They were formal 'conveyancing' minutes without any indication as to the intention of the Taxpayer in purchasing the Letters B. The backdated minutes were in similar terms to the contemporaneous ones except that each had a paragraph headed 'Suggestion' added before the paragraph headed 'Resolution':

- (i) Minute backdated 20 December 1979

Same as the 'copy of director's minute' quoted in full in paragraph 3(m) above.

- (ii) Minute backdated 3 January 1980

'Minutes of a meeting of directors of the company held at its registered office on 30 April 1980 at 11:00 a.m.

Present W
 X

Chairman W was elected chairman of the meeting.

Suggestion X suggested to offer more land exchange entitlements to the company hence the company will have sufficient entitlements to deal with any big amount of lands granted by the Government for exchange.

Resolution It was resolved that the company do acquire from X the land exchange entitlements Letters "B" of Lot No II (portion area = 77,216.75 square feet) in consideration of \$50,190,887.50 and X & W be authorized to execute the assignment of the above mentioned Letters B entitlement and the common seal of the company to be affixed thereon.

There being no further business, the meeting was terminated.

W (signed)
Chairman

Further, X stated that in 1987 in similar circumstances two more backdated minutes were prepared by AA and on AA's advice to replace the contemporaneous minutes relating to the two sales in December 1985 and January 1986 (see paragraph 3(j) above) in order to expressly state that the Letters B were sold pursuant to X's 'Suggestion' in order to settle the loans due to X.

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6(6)(c). In the absence of Y's testimony which could have been crucial, we are unable to accept X's evidence as to the precise roles played by X and Y respectively in, or the motivation behind, the creation of those backdated minutes, except that we accept that they were prepared in 1987 and that they were signed by W or X as shown. Each of the 4 backdated minutes contained a representation that X made the 'Suggestion' as recorded therein. There is no factual foundation for the representations; consequently the evidential value of the backdated minutes is nil.

6(6)(d). By the letter dated 29 March 1987 (see paragraph 3(m) above), AA sent the minute backdated 20 December 1979 to the assessor, profits tax, as proof that in acquiring the Letters B from X, the Taxpayer intended to hold the Letters B for exchange for suitable plots of land (if and when they became available) to be developed for long-term investment (that intention is hereinafter referred to as the long-term-investment intention). By the letter dated 29 March 1988 (see paragraph 3(o) above), AA made the consequential admission to the assessor, profits tax, that there was an error in the preparation of the 1985/86 profits tax return which claimed a trading loss and stated that the nature of the Taxpayer's business was 'sales of land exchange entitlements'. The backdated minute may be of no evidential value. But the question that remains to be answered is whether, on the totality of the evidence, we can accept that the long-term-investment intention was the true intention of the Taxpayer in acquiring the Letters B and that the 1985/86 profits tax return was erroneous as asserted.

6(6)(e). We now consider Y's and AA's acts as the auditors and tax representatives of the Taxpayer. Up to and including the year of assessment 1985/86, the status of the Letters B received no definitive treatment in the Taxpayer's accounts: they were listed as an independent item under the heading 'land exchange entitlements, at cost', except for the accounts for the years of assessment 1981/82 and 1982/83 where they were listed under the heading 'fixed assets, at cost' (see paragraph 3(h) above); there was no such heading as 'fixed assets' in any other year's accounts. By contrast sales of the Letters B in the years of assessment 1980/81 and 1985/86 were treated as trading items in the accounts; the profit made on the sale in the year of assessment 1980/81 was offered for profits tax assessment (see paragraph 3(f) above); the loss made on the sale in the year of assessment 1985/86 was claimed as a trading loss (see paragraph 3(j) above); the first instalment of the total tax payable under the profits tax assessment for the year of assessment 1987/88 was paid on 18 February 1989 (see paragraph 3(s) above) despite the fact that by that time AA on behalf of the Taxpayer had already claimed that the Letters B were long-term investments and that profits made on sales of the Letters B were not subject to profits tax (see paragraphs 3(m)-(o) above). The listing of the Letters B as an independent item separate from 'current assets' was arguably an indication that they were treated as a capital asset or long-term investment. However, the treating of the sales as trading items, the offering of the profits for assessment to profits tax, the paying of that tax and the claiming of a trading loss were all indications that the Letters B were stock-in-trade; they were consistent, deliberate acts extending over a period of years and can hardly be regarded as inadvertent mistakes made in a distracted moment. X stated that Y was embarrassed and was unwilling to give evidence. Be that as it may, without satisfactory explanatory testimony from Y, we are not prepared to accept that all those acts were mistakes and that the Letters B were treated as capital assets in the accounts; nor can we accept that there was an error in the preparation of the year of assessment 1985/86 profits tax return as asserted by AA in their letter dated 29 March 1988 and addressed to the assessor, profits tax (see paragraph 3(o) above).

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7. Z was the only other witness apart from X. He was a partner of BB, the Taxpayer's new tax representatives since November 1989, and was called to give evidence for the Taxpayer as an accounting expert. He agreed that the sales of the Letters B were treated as trading items in the profit and loss accounts for the years of assessment 1980/81 and 1985/86, but pointed to a note to the accounts, which is quoted below, as showing that the Letters B were treated as capital assets or investments:

‘The market value of the land exchange entitlements has declined significantly. However, in the opinion of the directors, such decline in value is of a temporary nature which is in line with the general market deterioration and therefore no provision for diminution in value is deemed necessary.’

By contrast, the representative of the Commissioner, contended that the note was consistent with the Letters B being treated as current assets or trading stock. We consider that the note was, in the context of the accounts, ambivalent; hence the opposing arguments. In this regard, it is not without significance that AA's note (see paragraph 3(u) above) made no mention of the note. Z also pointed out that the Letters B were listed as an item separate from the ‘current assets’ and stated that that was consistent with their being treated as a capital asset or investment. That may well be, but the points taken by Z only serve to contrast with the fact that the sales appeared as trading items in the profit and loss accounts and that provision was made for taxation on the profit in the 1980/81 profit and loss account. Z's evidence therefore did not carry the matter any further. Last but not least, in any event we must decline to give any weight to his evidence, and for this reason: Z was not only a partner of BB, the Taxpayer's new tax representatives, but was personally involved in handling the Taxpayer's objection to the assessments now under appeal and has made written representations to the Commissioner in the matter; consequently, he cannot be regarded as an independent expert witness.

8. The burden was on the Taxpayer to prove that the assessments were incorrect, and, for that purpose, to prove its case that its intention was to exchange the Letters B for suitable land to be developed for long-term investment (see paragraph 5 above). There are too many ‘question marks’ in our minds which have given rise to considerable doubts that make it impossible for us to conclude that the Taxpayer has discharged its onus of proof on a balance of probabilities. These doubts concern the issue of tax in Country M which was raised in AA's note but not dealt with at the hearing; the fact that X's wife, whom we cannot readily accept had no role in these transactions, was not called as a witness; the fact that Y, the first tax representative, did not appear as a witness; the fact that minutes had been backdated, which must reflect on the general credibility of the Taxpayer's evidence; the fact that the sales occurred only in rising markets; that the balance sheet treatment of the Letters B was not conclusive; that the profits were treated as trading items and offered for tax, that a loss was claimed for tax purposes; that there was in fact no exchange of the Letters B for land; and that there was no mention of an intention to develop property for long-term investment until the backdated minutes were prepared, and until X revised his evidence. All these factors, when taken together, raised doubts in our minds.

Conclusion

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9. For the reasons set out in paragraph 6 to paragraph 8 above, we conclude that the Taxpayer has failed to discharge its onus to prove that in acquiring them its intention was to hold the Letters B for exchange for suitable plots of land (if and when they became available) to be developed for long-term investment. For the same reasons, had it been necessary for us to decide the question of whether the Taxpayer has proved that in acquiring them it intended to hold the Letters B for exchange for suitable plots of land (if and when they became available) for development, we would have concluded that it has not.

Decision

10. It follows that this appeal is dismissed and that the assessments in question as revised are hereby confirmed.