

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D73/94

Profits tax - purchase and sale of property - whether profit liable to assessment.

Panel: Ronny Wong Fook Hum QC (chairman), Karl Kwok Chi Leung and Benny Wong Man Ying.

Dates of hearing: 4 and 5 January 1995.

Date of decision: 8 March 1995.

The taxpayer was a private limited company which purchased property in Kowloon which comprised an hotel. A feasibility study was conducted regarding the construction of a new hotel. The property was subsequently sold at a profit. The assessor assessed the profit to profits tax and the taxpayer appealed to the Board of Review on the ground that it was a capital gain. No evidence was called on behalf of the taxpayer.

Held:

The onus of proof is upon the taxpayer. Although the taxpayer had indicated an intention to re-develop the property as a hotel. It had attempted to sell the shares in the taxpayer company and subsequently the taxpayer company had sold the property. The taxpayer had failed to discharge the onus of proof.

Appeal dismissed.

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Harry Y T Ho for the taxpayer.

Decision:

I. THE FACTS:

1. The Taxpayer is a company incorporated in January 1988. Its issued share capital was \$2. Its immediate holding company was Company A. Miss P was the beneficial owner of Company A. At the material times, Miss P, Mr Q and Mr R were its directors.
2. According to its profits tax returns for the years of assessment 1988/89 and 1989/90, the Taxpayer's business was 'property investment and development'.

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3. On 23 May 1988, the Taxpayer acquired New Kowloon Inland Lot No XX, ['the Lot'] at a consideration of \$175,000,000. The Lot was hitherto the site of Hotel M. According to the minutes of a board meeting of the Taxpayer dated 21 July 1988, the directors present [Miss P and Mr Q] resolved to purchase the Lot 'for long term investment'. Those directors further approved to borrow from Bank N \$180,000,000 secured by a mortgage of the Lot.
4. The loan from Bank N was granted pursuant to the terms of a letter from that bank addressed to the ultimate holding company of the Taxpayer dated 8 July 1988. The loan was described as a 'one year bridging loan'. The bank agreed that 'no penalty is payable in respect of prepayments out of the sale proceeds of the property or internal resources'.
5. On or about 5 July 1988 a document described as 'Hotel M Projection 1991-2009' was submitted by one Mr S to Mr Q. This document discussed the financial implications of a hotel investment totalling \$340,000,000 and envisaged an initial capital investment of \$34,000,000.
6. A 'redevelopment study' dated 8 July 1988 was produced by the architect firm Company B. This study explored the feasibility of a 430 rooms hotel project costing \$200,000,000.
7. On 15 October 1988, the Taxpayer entered into a demolition contract with Company C. 3 days later an application was submitted to the Building Authority for consent to the commencement of demolition works at the Lot.
8. By a preliminary agreement dated 4 November 1988, Company A agreed to sell to Company D the entire issued share capital of the Taxpayer together with its interest in various shareholders' loans for \$238,000,000. Completion was to take place on 1 February 1989. Company A warranted that on completion the Taxpayer is the beneficial owner of the Lot free from encumbrances. Company D defaulted. Company A forfeited its interest on 27 January 1989.
9. On 3 February 1989, the Taxpayer granted an option to Company E to purchase the Lot. The option was exercisable on or before 15 February 1989. It was duly exercised. By minutes dated 31 March 1989, the directors of the Taxpayer approved the assignment of the Lot in favour of Company E for \$230,000,000.
10. The Taxpayer cancelled its demolition contract with Company C and paid them \$18,680 by way of compensation on 6 March 1989.
11. Company F was hitherto the auditors of the Taxpayer. In the accounts of the Taxpayer for the period between January 1988 (date of incorporation) and 31 March 1989 audited by that firm, the Taxpayer classified the Lot as 'land under development' under current asset. Provision was also made for taxation of the profits on disposal of the Lot.

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Those accounts were approved by the board of directors of the Taxpayer on 7 September 1989.

II. THE ISSUE BEFORE US:

1. The issue is whether the profits of the Taxpayer from the disposal of the Lot amounting to \$28,540,260 was a revenue gain. The Taxpayer contends that the same is capital in nature. The Commissioner determined otherwise by their determination dated 18 July 1994. The Commissioner relied upon the following:

- (a) lack of evidence on a long term source of fund to support the hotel project;
- (b) apart from the documents relating to the preliminary studies and the application for demolition, there is no evidence to show that the alleged redevelopment plan had been carried out;
- (c) the quick disposal of its holdings in the Taxpayer by Company A and the eventual disposal of the Lot by the Taxpayer; and
- (d) the accounting treatment by the Taxpayer and its auditor.

2. The Taxpayer called no evidence before us. In particular, there was no attempt to adduce evidence from any of its directors to depose to the Taxpayer's intention at the date of acquisition of the Lot or from its auditor to depose to its accounting treatment.

III. OUR DECISION:

1. Section 68(4) of the Inland Revenue Ordinance (the IRO) imposes an onus on the Taxpayer to satisfy us that the assessment is incorrect.

2. The Lot was first acquired by the Taxpayer on 23 May 1988. Its intention at that juncture is the crucial consideration.

3. The projection from Mr S and the re-development study from Company B came in July 1988. Both documents indicate that the hotel project was still very much under consideration. Whilst the minutes of 21 July 1988 described the acquisition as 'for long term investment', there was no reference in those minutes to a hotel project. Those minutes further approved the short term loan of 1 year from Bank N. Specific provision was made in the terms of that loan to negative any liability for penalty in the event of prepayment from proceeds of sale of the Lot. When these factors are held against the rapid sales of an indirect and then a direct interest in the Lot and against the accounting treatment sanctioned by the auditors and the directors of the Taxpayer, we are of the firm view that the Taxpayer has failed to discharged its onus.

4. For these reasons, we confirm the assessment by the Revenue.