

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. BR 12/74

Board of Review:

L. J. D'Almada Remedios, *Chairman*, B. A. Bernacchi, N. J. Gillanders, Lau Chan-kwok, *Members*.

15th June 1976.

Profits tax – redevelopment of inherited properties – identity of properties changed – sale – whether profits chargeable to tax.

The appellant inherited certain properties consisting mainly of dilapidated buildings which were subject to rent control. With borrowed funds, the appellant who was connected with companies dealing in landed properties, carried out an extensive redevelopment scheme of his inherited properties. He then sold all of those properties, some in the course of and others after completion of their redevelopment.

Taking the view that the actions of the appellant in respect of his inherited properties were compatible with the acts of a person carrying out a scheme of profit-making the Revenue charged the profits derived from the sale to profits tax. On appeal the appellant contended, *inter alia*, that the gain obtained by the sale of inherited property upon which expenditure had been incurred for its improvement or development was not chargeable to tax as profits of a trade.

Decision: Appeal disallowed, assessment confirmed.

Henry Litton Q.C. & Rex Bretten instructed by Peter Mark & Co. for the appellant.
Benjamin Shih for the Commissioner of Inland Revenue.

Case referred to:-

1. Pilkington v. Randall, 42 T.C. 662.

Reasons:

The issue before us is whether the profits derived from the sale of certain properties are chargeable to profits tax.

It is submitted by counsel for the Appellant that those considerations that bear on the question of whether a person was trading in land must be approached with caution. We are reminded that these properties were not acquired for the purpose of resale at a profit but are

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inherited properties. In the circumstances, it is submitted that principles or decisions drawn from reported cases that do not concern inherited property should be viewed with circumspection.

It will be convenient if we state what appears to us to be fundamental. *Prima facie*, an asset which has come into the hands of a donee by gift or inheritance is in the nature of a capital asset. It makes no difference if the recipient is a dealer in the type of asset he receives by gift or inheritance. To turn the inheritance or gift into money by realization does not attract tax. It is simply a realization of a capital asset. It is a capital asset at the time of its receipt, but whether it retains that characteristic thereafter depends on whether the donee has so acted in relation to it that would justify the conclusion that he has so dealt with the asset as to make it form part of his stock-in-trade either in a business he is currently carrying on or in the launching of a business to which such asset relates by dealing with it in such manner that one can say that such asset was absorbed, converted or dealt with as his stock-in-trade, in such business, trade or adventure in the nature of trade. As Cross J. said in **Pilkington v. Randall**¹, at p. 669:

“To my mind, the question whether what has been done in any particular case is simply the realization of an inheritance or amounts to an embarking upon a trade is a question of degree. I do not think that one can lay down hard and fast rules, such as that the construction of roads and sewers and the installation of services can never be enough to make the case one of embarking upon trade. One has to look at the whole picture and say whether the amount of money spent on the development before sale and the objects for which and the circumstances in which the money was spent are such as to make it reasonable to say that what was inherited has changed its character and become part of the raw material or stock-in-trade of a business.”.

In April, 1956, the deceased died. About a year later, the Appellant's father also died. The Appellant was then in America but he gave up his career there and returned to the Colony to sort out the difficulties associated with the inheritance of a large estate. He describes his inherited properties as being all in crowded districts; dilapidated, having small tenancies, rent controlled and some of them with Crown leases having only a short term to run. In June 1958 he had to grapple with the problem of double estate duty which absorbed a great deal of his liquid assets. He was landed with dilapidated properties without liquid capital to bring about improvements.

In evidence the Appellant stated that in 1960 when some of the Crown leases fell to be reviewed his liquid assets were practically nil and that unless he did something about it he would lose his inheritance as regards those properties.

In relation to most of the properties, it would appear that the Crown leases would not expire until 1974. If his objective was to improve and preserve the properties to which this appeal relates by development and retention for rental yield, which is the main theme of his

¹ 42 T.C. 662.

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case, it has not been explained to us why this could not have been brought about by the disposition of other properties to implement such intention.

The Appellant is the Chairman of a Group of Companies. The business carried on by this group included, *inter alia*, dealing in landed properties. He is also the Chairman of C.P. Ltd., of which his equity holding is 68 %. Prior to January 1972, H.K.D. Ltd. was virtually his company. The Appellant had previously traded in property for which he was charged to tax for profits. In a statement contained in the prospectus of the H.K.D. Ltd. (the accuracy of which is admitted by the Appellant) it is said that he has been. ... 'associated in the past decade with the Group of Companies, during which time he has been a pioneer in the construction and sale of housing for the middle income group together with the provision of mortgage financing for such sales.'

As to the properties concerned in this appeal, we have come to the view that the Appellant dealt with these properties in a manner that clearly evinced a conversion of these properties into trading stock in furtherance of a profit-making scheme in the business of property dealing. The characteristics that point to such a conclusion are all present. The old buildings have all lost their identities. In each of the sites the buildings have been pulled down and replaced by multi-storeyed structures. The construction of the new buildings was financed by extensive loans.

All these properties were disposed of by the Appellant after, and in some cases in the course of, redevelopment. The Commissioner gives, *inter alia*, the following reasons in support of his conclusion that the Appellant was dealing in property:

“Firstly, the development was elaborate and extensive and the Taxpayer had financed the projects with borrowed funds.

Secondly, numerous sales of flats took place long before and soon after the occupation permits were issued.

Thirdly, special exertions had been made to find and attract purchasers as evidenced by sales brochures ...

Fourthly, the Taxpayer has long been associated with companies dealing in real properties and therefore possesses a specialized knowledge of property matters. Indeed, all actions taken by the Taxpayer were compatible with the acts of a person carrying out a “scheme of profit making”.”.

The brochures submitted in evidence show that H.E. Ltd. was the vehicle used in advertising the sales of units in 3 of the new buildings.

The publicity and advertising expenses to bring about sales amounted to over \$36,000. This together with the fact that the Appellant had laid out substantial sums to enable him to proceed with his plan for development followed by sales of the properties puts

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this case beyond the pale of mere realization of inherited property into the category of acts done which amount to the carrying on or carrying out of a business.

The frequency and multiplicity of sales, the organized efforts, the supplementary work on the properties to bring them into marketable condition to turn them, by disposal, into profitable account, and the amount of expenditure incurred for such purpose are features which, in our view, give rise to the inference that what was inherited has changed its character and become part of the raw material and stock-in-trade of the Appellant's business.

None of the properties that are the subject matter of this appeal have been retained. One of the new buildings was sold to C.P. Ltd. in exchange for shares and three others were disposed of by the Appellant to H.K.D. Ltd. also in exchange for shares. It appears that the transfer of these properties to these companies were made in anticipation of or at a time when these companies were going public as we are informed that two weeks later share quotations for both these companies were obtainable from the Hong Kong Stock Exchange. The Appellant, therefore, took and obtained shares in exchange of the properties which became marketable securities.

The Appellant's case appears to be this: the acquisition of property by way of inheritance is a mode of acquisition which lacks all commercial character; such acquisition cannot of itself give rise to the property being held as stock-in-trade. It is argued, therefore, that a man may spend money upon improving, developing or otherwise enhancing the value of such property without thereby rendering the gain through development and sale chargeable to tax as profit of a trade. We find this contention to be much too wide and not in line with accepted principles. We do not go so far to say that any improvement of inherited property before sale will transform what is otherwise a capital asset into trading stock. It could perhaps be forcibly argued that where the identity of the building remains substantially unchanged it would be most difficult to draw the inference of trading. It is really a matter of degree but in this case the line has been clearly crossed.

The Appellant denies trading and his alternative line of argument is that his objective was to improve and consolidate his inheritance. The Appellant says he went about it in a way that necessitated redevelopment and sale of domestic flats to pay off the loans as he 'wanted to retain as much as he could and keep the corpus of the estate intact and preserve it'. The Appellant's evidence is that he intended to retain the commercial premises on the buildings and he was able to retain part of his inheritance in that he had retained all (or nearly all) the commercial units in all the buildings and 55 domestic flats and that he also retained an entire building.

It is unnecessary for us to decide whether this argument, if accepted, can outweigh the other considerations that so evidently point to his carrying on a trade of property dealing although we were not impressed by the argument. Suffice it to say, however, that this aspect of the Appellant's evidence has not found favour with us. We are unable to say that his evidence has satisfied us on this score. If his intention was to retain all the commercial units

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in all the buildings, it is strange no real attempt was made to explain why the brochures in advertising the sale of all the units in the buildings included the commercial units (ground floors) which also quote the price for such units. Furthermore, if it was the Appellant's intention to retain as much as possible the corpus of his estate and preserve it, one would expect some evidence to show the extent of his loans at the time of the sales and that only a sufficient number of flats were sold to pay off such loans thereby enabling him to retain as much as possible of his inheritance. Again, no such attempt was made. We are not satisfied on the evidence that the Appellant limited his sales to only a sufficient number of flats in keeping with his professed intention to retain as much as possible of his inheritance. Furthermore, we do not agree with the Appellant's statement that he retained all the commercial units in the buildings together with 55 domestic flats and an entire building. All the properties with which we are concerned were eventually disposed of by the Appellant either to individual purchasers or to C.P. Ltd. or to H.K.D. Ltd. In the transfer of the properties to these companies the Appellant received shares in lieu of cash. In our view, it matters not that some sales were for a consideration other than cash. The Appellant is no longer the owner of these properties. The Appellant's entire share holding in H.K.D. Ltd. has been disposed of by him.

We have been spared the task of determining on what date the properties were converted into trading stock as we have been informed that for the purpose of computing assessable profits valuations have been agreed. Based on these valuations quantum of assessments for years under review have also been agreed between the parties.

Finding as we do, for the reasons given above, that in regard to the properties to which this appeal relates the Appellant was carrying on a trade or business of property dealing, the assessments as agreed are hereby confirmed.