

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. BR 23/74

*Board of Review :*

L. J. D'Almada Remedios, *Chairman*, B. S. McElney, R. S. Sheldon, & Seaward Woo,  
*Members.*

#### **4th July 1975.**

Profits tax—development company—profits on sale of shops on short leases—whether shops were trading or capital assets of company.

The taxpayer, a public company carrying on business as a land developer, acquired a site and developed it into a large estate comprising 936 domestic flats in four towers and a ground floor of 18 shops. The flats were contracted for sale prior to the completion of the building all the domestic flats were sold. The shops were let out on short leases. Subsequently the company sold the ground floor. The Commissioner, being of the view that the ground floor was not a capital asset, disallowed the company's claim for re-building allowances and assessed the profit made on the sale of the ground floor to tax. On appeal.

**Decision:** Appeal dismissed. Assessment confirmed.

H. R. Ireland for the appellant.

Benjamin Shih for the Commissioner of Inland Revenue.

*Reasons :*

The assessments appealed against by the Company arise by reason of the Commissioner's determination that the ground floor of a building known as U. Building was a trading asset held by the Company.

The Company was incorporated as a private company on the 23rd of December 1969. One of its two shareholders was the Holding Company. On the 20th of November 1973, the Company was converted into a public company. The business of the Company is that of land development. In a letter to the shareholders of the Holding Company, the Company stated that its principal business at the time was the development of the land resources surplus to the requirements of the Holding Company. The site on which U. Building stands was acquired by the Company from the Holding Company and developed into a large estate. The building comprises 936 domestic flats in four towers and a ground floor of 18 shops (hereinafter called "the ground floor").

It is not disputed that all the domestic flats in that building were constructed for sale. Prior to the completion of the building in October 1972 all of the domestic flats were sold.

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But the ground floor was let to various tenants under a total of 13 leases; some for duration ranging between 3 to 5 years. About a year after the building was completion the Company disposed of the ground floor to a company owned by the shareholders of the Company in exactly the same proportions as they stood prior to the public issue for \$12,000,000 determined by an independent valuation.

The Commissioner being of the view that the ground floor was not a capital asset, disallowed the Company's claim for Rebuilding Allowances for the year of assessment 1973/74. The profit made on sale of the ground floor was also included for tax purposes for the year of assessment 1974/75.

The issue in this appeal, therefore, turns on our finding on whether the ground floor is a trading or capital asset.

The Company's case is that the ground floor was all along not intended for sale but was to be retained for rental income; that in 1973, the Company decided to go public and for the purpose of floating the Company and offering shares to the public it was necessary to have an increasing trend of profit and to show profits for the purpose of paying a dividend after conversion into a public company which would not have been possible in the normal course of events as the Company was not making sufficient profits for that year. The Company, therefore, had no other recourse but to sell the ground floor and thus create sufficient profits available for dividend.

The secretary of the Company gave evidence which was related mainly to the reason for the sale of ground floor. Although he did say that it was the Company's intention to retain the ground floor for rental income, it is to some extent hearsay since the intention of the Company is reflected by the intention of its directors and there is no evidence before us that he is or was a director of the Company. Furthermore, he joined the Company in July 1971. The property was developed in 1970. He is, therefore, hardly in a position to say what were the intentions of the Company at the time of purchase and development. It may well be that during the time he was secretary he believed the Company did not intend to dispose of the ground floor which was producing rental income. The aspect of the matter does not take us very far as a company may nurse its property by letting it out pending sale at a convenient time.

A director of the Company also gave evidence. Although he did say that there was no question that the Company intended to retain the ground floor for income earning purposes, he appeared unable to give us any information as to when this matter was discussed or between which of the directors or when such a decision was arrived at. When pressed for clarification he stated that he was in a position to say what the Company's intention was because it is the Company's policy to retain the commercial units of all their buildings to provide income revenue for the Company. This statement does not appear to be in keeping with what is contained in the Prospectus of the Company. The Prospectus, in dealing with another project under planning (also involving commercial blocks) stated that "the decision to retain or sell will be made according to prevailing market conditions as the development

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progresses". When asked whether the contents in the Prospectus are true and accurate, his answer was in the affirmative. If so, no explanation was given for the statement in the Prospectus and this does not appear to be in harmony with the evidence given as to the policy of the Company.

Apart from the oral evidence given there are some features in this case to support the contention that the Company was not minded to dispose of the ground floor on completion of the building. The published price list and brochure did not advertise the sale of the ground floor but related to the domestic flats only; there is a board minute stating that the ground floor is to be retained by the company; there is also a letter from the Company to shareholders that all 936 flats in the building have been sold but the ground floor areas have been leased to restaurants, shops, super markets, banking offices, etc. to provide continuing revenue for the Company.

We agree with the Company's submission that although it may be a dealer in property, yet it may hold land as a capital asset. The character of the asset held is a hard question of fact. In a case of this kind the onus is on the Company to show that the profit made on the sale of the ground floor is accretion to capital. If a dealer in property constructs a building of which part is sold and part is let and subsequently disposes of units that have been let, that factor does not, *per se*, create a presumption that the parts that were let are capital assets nor, on that account, does he discharge the burden resting upon him unless there are other features in the case consistent with the inference that what was sold was not part of the dealer's trading asset.

Having considered all the evidence before us and looking at the broad spectrum of all the circumstances, we are not satisfied that the Company held the ground floor as a capital asset. In the Prospectus of the Company the ground floor was treated under the heading of net tangible assets as a "Current Asset". It was brought into the account not as a capital asset but as a trading asset. The ground floor was referred to as "Land and Building *for sale* at a written down value". These words are, in our view, indicative that the ground floor was part of the stock-in-trade of the Company. At page 12 of the Prospectus the ground floor was included under the caption "Completed Property Agreed to be Sold". At page 28, the Prospectus lists properties "Held for Development", "Held for Investment" and "Property Agreed to be Sold". The ground floor of the building with which we are concerned was put under the heading "Property Agreed to be Sold". To anyone reading the Prospectus it is difficult to escape the conclusion that the Company represented to the public that the ground floor was part of its trading asset and held in much the same way as the other domestic flats in the building that were sold before completion.

It goes without saying that a prospectus is an important document and companies are expected to and do take particular care to ensure that statements made in it are accurate and can be relied upon. The first page in the Prospectus of this Company contains a statement that the information contained in it is : —

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“... supplied by the directors of the Company who collectively and individually accept full responsibility for the accuracy of the information given and confirm having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission or inclusion of which would make any statement in this Prospectus misleading”.

The Prospectus, therefore, militates against the Company's contention that the ground floor was held as an investment or capital asset. We have also been supplied with the Company's published Annual Report for 1973. The sale of the ground floor of this building is included in the Profit & Loss Account 1973 as “Profit from Operations”. In our view these words do not suggest that the disposal of the ground floor was a sale of a capital asset. Indeed, the inference suggests the contrary.

If a dealer in land makes a representation that land dealt with is part of its trading asset, it amounts to an admission that the transaction is associated with the trade that is being carried on. When such admission is contained in a prospectus and the Annual Report of the Company in the following year confirms it by referring to the profit made as being from its “operations”, the burden of proving otherwise is correspondingly heavier and, on the evidence, we are not satisfied that the Company has discharged that burden. We have also not been persuaded to accept the Company's alternative argument that at the date of sale the Company converted an investment into trading stock. The assessment, is, therefore, confirmed.