Case No. BR 6/76

Board of Review:

L. J. D'Almada Remedios, *Chairman*, J. G. Oliver, V. O. Roberts, & G. E. S. Stevenson, M*embers*.

9th November 1976.

Profits tax – company in liquidation – whether properties on hand were trading assets and if so whether trading ceased when liquidator was appointed or when properties were disposed of – Inland Revenue Ordinance, section 15C.

The company went into voluntary liquidation on 16th December 1968, the properties on hand at that date being subsequently disposed of or distributed in specie. Prior to disposal or distribution the liquidator collected rents from the properties but no new leases were entered into by the liquidator. The Commissioner took the view that the liquidator continued to trade during the period when rents were collected. The company claimed that the properties were not trading assets and that the business ceased on 16th December 1968. On appeal the company failed to adduce evidence to satisfy the Board that the properties were capital assets.

Decision: The claim that the properties were capital assets disallowed; the trade of the company ceased on 16th December 1968; the market value of the assets on that date to be taken as the amount realized on sale.

R. G. Kotewall for the appellant.
Chan Kam-cheong for the Commissioner of Inland Revenue.

Case referred to:-

1. Tai Shun Investment Co. Ltd. v. C.I.R., (1968) H.K.T.C. 370.

Reasons:

The Appellant Company (hereinafter called 'the Company') was incorporated on the 24th June 1954. From properties acquired by the Company it derived rental income; it also collected dividends from shares purchased and obtained interest from loans made on the security of property. In the years ended 31st March, 1963, 1964 and 1965 the Company sold three of its properties for which profits on sale were assessed to tax.

At an extraordinary general meeting of the Company held on the 16th December 1968, a resolution was passed to wind up the Company voluntarily and that Mr. Norman Mar Fan be appointed Liquidator for the purpose of such winding up. For a technical reason which we need not go into his resolution was rescinded at another extraordinary general meeting held on the 28th January 1969, when the Company passed a further resolution to declare the voluntary winding-up of the Company to take effect on the 28th January 1969 and that Mr. Norman Mar Fan be appointed Liquidator. It seems to us that the effect of rescinding the previous resolution, followed immediately by the passing of a similar resolution, was such that, for all practical purposes, the 16th of December 1968 can still be taken as the effective date when the decision was made for the winding-up of the Company and the appointment of a Liquidator.

Two issues arise in this appeal: Firstly, when did the Company cease to carry on business? This issue is tied up with the question of whether the Liquidator, in the course of liquidation, carried on the business of the Company. Secondly, were the house properties held by Company at the date of cessation of the Company's business, which were distributed in specie by the Liquidator or sold to realize the assets for the purpose of liquidation, trading assets?

On the first issue we have come to the view, on the evidence, that the Company ceased business on the 16th of December 1968, and the Liquidator did not, in the course of liquidation and in discharging his duties as Liquidator, carry on the business of the Company. The Liquidator gave evidence before us. We are satisfied on the evidence that he took all reasonable steps to expedite the liquidation of the Company. He had to deal with nine properties owned by the Company. He gave evidence, which we accept, that after his appointment as Liquidator he attempted to realize the assets by sale for the purpose of distribution, but he had problems to grapple with as the shareholders who were directors had different views and were negotiating between themselves on this matter. Finally, as a result of transfer of shares, the matter was resolved with a distribution in specie completed in September 1969 except as regards two properties which were shortly afterwards disposed of in the realization of assets. Until that time, the Liquidator collected rent from the sitting tenants. They were tenants of pre-war controlled premises and protected from eviction. The Liquidator did not enter into any contracts or leases with them, nor indulge in any trading activities or negotiate any agreements either as Liquidator or on behalf of the Company. He further stated that he did not collect rent for a longer period than was necessary.

It is argued by the Commissioner's representative that by collecting rent the Liquidator was carrying on the Company's business as usual. In our view there was no other reasonable course open to the Liquidator than to collect the rents as they fell due. The rents that fell due can be regarded as a continuing liability under such contracts as were concluded prior to the Liquidator's appointment in respect of which neither the Liquidator nor the Company had a right to lawfully terminate those contracts. We are guided by the test propounded by the Full Court in the **Tai Shun Investment Co., Ltd. v. C.I.R.**[1] at 386, where Mr. Justice Huggins delivering the judgement of the Court said:-

[1] (1968) H.K.T.C. 370.

> "When all this is said it seems to me that it is very much a matter of general impression whether what is being done can fairly be described as carrying on a business and if any form of analysis is to be adopted I think the only test is that which counsel for the appellants asks us to adopt, whether what is being done goes beyond what can reasonably be regarded as necessary for the winding up of the company.".

In the same passage, Mr. Justice Huggins prefaced the test by saying:-

> "With what is he (the liquidator) concerned? He is to dispose of and divide up the assets and this must include whatever profits remain to be collected.".

On the evidence, we are satisfied that the Liquidator, for the purpose of liquidation, did not go beyond what can reasonably be regarded as necessary for the winding up of the Company. Pending distribution of the assets or their realization the Liquidator had no option but to collect the rents as they fell due which, in our view, cannot fairly be described as conduct evidencing a carrying on of a business but only an act in the performance of his duty necessary for the winding up of the Company. It follows from the view we take that the Company ceased business on the 16th December 1968 and is not assessable to Profits Tax in respect of rents received after the cessation of the Company's business.

The remaining issue relates to whether the house properties held by the Company after the date of cessation are trading assets. It is conceded by the Company that, if they are, the provisions of section 15C of the Inland Revenue Ordinance apply. The Company does not dispute the valuations mentioned in paragraph (13) of the Commissioner's statement of facts; but it is to be borne in mind that these valuations relate to the dates of assignments and not to the date on which we have found that the Company ceased business.

One of the most important tests in deciding whether proceeds from the sale of property is of a revenue or capital nature is the intention with which the asset was acquired. If, in the carrying out of a scheme of profit-making, an asset is acquired for the purpose of resale at a profit, the proceeds derived from sale would constitute revenue of an income nature, even if the property had been retained or let for some time before sale. On the other hand, if property is acquired to produce income in the form of rent and not for the purpose of resale at a profit, the proceeds derived from a subsequent disposal would be a receipt of a capital nature.

Since a company is an artificial person its intention must be taken to be the intentions of its directors acting as such. The onus is clearly on the Company to establish that the house properties are not trading assets if section 15C is not to apply. The directors of the Company are in Hong Kong and were available to give evidence and assist us in this connection but, for reasons best known to themselves, none of them have elected to do so. In the circumstances, we are unable to say that the Company has satisfied us that the house properties are not trading assets. We should not be taken to mean from what we have said that, unless a director is called to give evidence, it would not be possible for a company to

establish its intentions as to the character of the asset held by such company. One could envisage a case where the situation is such that a Board of Review could come to a conclusion in regard to the nature of a property held notwithstanding the absence of any evidence from a director; where, for instance, a director who is able to speak as to intentions of a company at the time of purchase is no longer living. This is because the test of whether one is or is not trading or dealing in land is objective and not subjective. However, a Board of Review may find it difficult, as we have in this case, without the benefit of any evidence as to the intentions of the Company at the time properties were purchased, to say that the onus of establishing that the properties were capital assets has been discharged.

Had a director of the Company given satisfactory evidence before us in support of the Company's contention there is a possibility that we may have come to the conclusion that the properties held at the date of cessation of the Company's business were capital assets observing, as we do, that most of these properties were purchased not long after the Company's incorporation in 1954 and out of which the Company derived rental income for upwards of 15 years (and were retained for rental income). These properties were retained by the Company and disposed of or distributed in specie by the Liquidator. The evidence of Miss CHUI is, unfortunately, not of the texture or quality that can be regarded as a satisfactory substitute for the evidence of such director who could have been called. She was the secretary of another company that acted as secretary for the taxpayer company. Although she stated that these properties were held for rental income, she was in no position to speak as to the intentions of the Company. In her secretarial capacity she was only connected with the Company for a few years before its liquidation, wherefore her evidence does not assist us in determining what were the intentions of the Company at the time the properties were purchased. We are reminded by the Commissioner's representative that the Company had sold properties in respect of which profits derived from sale were assessed to profits tax and that the properties that were sold and assessed to tax were not treated differently in the Company's accounts. In the circumstances, we are unable to say, for the reasons we have given, that the Company has discharged the burden of satisfying us that the properties held by the Company at the date of cessation of business were capital assets. This being so section 15C applies, with the result that, unless the parties can come to an agreement in regard to value of the properties, their valuation must be taken at the date of the Company's cessation of business.

This case is, therefore, remitted to the Commissioner to revise the assessments in accordance with our opinion as stated above.