

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. BR 9/74

*Board of Review :*

L. J. D'Almada Remedios, *Chairman*, Alex S. C. Lam, P. D. D'Almada Remedios & P. B. Tata, *Members*.

**24th March 1975.**

Profits tax—investment company—property acquired for redevelopment—sale of part of redeveloped property to meet demand for discharge of overdraft account—no previous activity of acquisition of property for redevelopment and sale—whether profits derived from sale were accretions to capital.

An investment company acquired building property which it redeveloped by erecting thereon a 14 storey building containing 3 units on each floor. During the course of redevelopment the bank which had granted the company overdraft facilities demanded repayment of the overdraft account. A resolution was then passed by the company to sell a sufficient number of units in the building to enable the bank's demand to be met. Advertisements were issued by the company to the effect that units in its new building were for sale and letting. More units were sold than were required to satisfy the overdraft account and the sale of some of the units was on an instalment basis. On being charged to tax in respect of the profits derived from the sale of the units, the company claimed that the object of acquiring the property for development was to retain it as a long term investment but because of the bank's demand it was forced to sell part of the building. The company also contended that it had not previously dealt in the acquisition of property or resale. On appeal.

**Decision:** Appeal dismissed.

P. A. L. Vine for the appellant.

Benjamin Shih for the Commissioner of Inland Revenue.

**Cases referred to:—**

1. Hillerns & Fowler v. Murray, 17 Tax Cases 77.
2. Turner v. Last, (1965) 42 T.C. 517.
3. Johnston v. Heath, (1970) 3 All E.R. 915.

*Reasons :*

Y. Limited is a family business. In March 1962, the company acquired land in Des Voeux Road, which it developed by the construction of a building known as W. House. Finance for the development was obtained from the Bangkok Bank Limited under a

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mortgage on the security of the property. W. House is unsold and has been retained by the company for rental income.

Later, through transactions which we find unnecessary to relate, the company acquired Nos. X and Y Bonham Strand, which were also re-developed by the construction of a single new building known as W. S. Building.

W. S. Building (hereinafter referred to as “the building”) is a 14 storeyed structure consisting of 3 units on each floor. As units in the building were sold by the company the profits derived from sales were brought into charge to tax by the Revenue, against which the company now appeals on the ground that the building is a capital asset wherefore profits made are not liable to tax.

The Appellant’s case is that : —

- (a) The Company’s business is that of investors and not dealers in property; that it has not previously dealt in property and the only other property it has is W. House which is held as a capital asset.
- (b) Nos. X and Y Bonham Strand were acquired and developed with the object of retaining the new building as an investment in the same way as W. House and not for the purpose of resale at a profit.
- (c) The directors of the company believed that this objective could be achieved on the strength of a verbal representation by the manager of the Bangkok Bank Limited that the Bank would grant further finance on the security of W. House to enable W. S. Building to be constructed, and on the expectation that the Bank would allow periodical repayment extensions so that the Bank’s over-draft could be repaid from rents derived from lettings.
- (d) As the anticipated further advance from the Bank was not forthcoming due to a sudden change of the Bank’s policy, the company attempted to raise a loan from the Hongkong & Shanghai Bank but without avail. In July 1970, the Bangkok Bank demanded repayment of the overdraft account and ultimately gave the company time to repay up to July 1971.
- (e) Confronted with such a situation, the company passed a resolution to sell a number of units in the building to the extent that the proceeds derived would be sufficient to discharge the overdraft account with the Bank.
- (f) Such sales as were concluded were, therefore, not sales in furtherance of a trade but of a capital asset made necessary from the circumstances of the case since the Bonham Strand property was acquired and developed with a view to retention as a long term investment.

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We have merely sketched the outline of the Company's case which, though not intended to be comprehensive, illustrates the substance of the company's contentions.

The Revenue, however, urges us to the view that the building is not a capital asset and in doing so the following points have been put forward or emerge from the evidence adduced before us : —

- (a) In November 1965, the Assessor wrote to the company's tax representatives (T. K. Lo & Co., certified accountants) enquiring if the company intended to develop No. X Bonham Strand, and if so whether it is intended to develop for resale or for the purpose of earning rental income. By way of a reminder for a reply, the assessor also wrote to the company on the 7th of January 1966 enclosing a copy of the letter sent to T. K. Lo & Co. On the 20th of January 1966, the company's tax representative answered the assessor's enquiry by letter stating that they were instructed that "the property is intended for re-development for resale". The Revenue's case is that as the property was for development for resale, it is a trading asset and profits made are liable to tax.
- (b) Foundation and piling works on the building began towards the end of 1969. Construction was completed in the middle of 1971. Before completion of the building there were forward sales of units in the building : an aspect of trading as opposed to investment.
- (c) When the building was in the course of construction brochures were issued advertising the offer of 21 units for sale and balance for letting. Advertisements for sale and letting also appeared in the press.
- (d) The company sold more flats than were advertised in its brochures and sales included units that were advertised for letting.
- (e) The sales proceeds amounted to \$2,944,484. The company's liability in its overdraft account with the Bangkok Bank stood at \$1,479,867 in July 1970. As more flats were sold than was necessary to pay off the Bank, the Revenue's inference is that this feature is inconsistent with the company's resolution but in keeping with the act of a property dealer.
- (f) Some of the contracts for sale were for payment of price by instalments. In some cases the instalment plan extended to payment within 7 years. The Revenue's suggestion is that one would expect contracts for lump sum payments to implement the resolution passed by the company so that its overdraft with the Bank may be discharged from the proceeds of sale.

It is hardly necessary for us to say that such characteristics as one would expect to find in property dealing are present in this case. We note that the company has not traded in property before. But evidence of a trading venture or activity is not displaced by showing

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that the company has not embarked in such business previously. We do not find the attempt by the company to escape the admission in writing made through its agents T. K. Lo & Co. satisfactory. Having heard the evidence we find it highly improbable or unlikely that the admission that the property was held for “re-development for resale” was not made by the company or that the circumstances were such that its tax representatives could have made a mistake in taking instructions. We find it unlikely that the situation created any room for mistake. It follows that we are unable to accept the expression of intention by the directors of the company that the property was held and developed as a rent-producing investment. The evidential value of such an expression of intention is almost minimal unless the company has acted in a way compatible or in line with the intention so professed. As Lord Hansworth M. R. said in **Hillerns & Fowler v. Murray**<sup>1</sup> : —

“But a declaration of an intention by the persons charged will not do to secure immunity from the Income Tax Act. The question is : what is the character to be attributed to the acts done . . .? The quality and the characteristics to be attached to the acts are all questions of fact, because they are questions of degree.”

Greater weight must, therefore, be attached to what the law regards as “imputed intention” judged from what the company’s acts amount to. Trading in property is more readily inferred if, as we find in this case, that the work done and the operations involved are of the same kind, and carried out in the same way, as those which are characteristic of ordinary property dealing. We are not unmindful of the point taken by Mr. Vine—who conducted the case for the company with his usual skill and thoroughness—that improvement and development of property are, “*per se*”, colourless they being acts equally consistent with an investor who wishes to derive a better rental return and that it was only because the Bangkok Bank reneged on a verbal promise to finance the project, the company had to resort to sales of part of the building to discharge the company’s existing overdraft account with the Bank.

When a company’s business is the earning of profits out of land, and property is bought by the company not for its personal use or enjoyment but as part of its commercial enterprise, it may either intend to sell it at a profit or keep or develop it as a rent-producing asset. In the latter case the company is expected to show that its financial position is such that : (i) its intention is consistent with it, and (ii) it has adequate long term financial facilities to enable it to keep it. These two elements are not mentioned in the “Badges of Trade” but the more recent cases show how important this is : see **Turner v. Last**<sup>2</sup> and **Johnston v. Heath**<sup>3</sup>.

Although the company’s case is that it intended to retain the property as a lock-up investment, we are not satisfied that it took any real steps to formulate any constructive plan by which this could be done or make any real effort to secure finance for the purpose. If the Bangkok Bank verbally agreed to finance the project, one would expect that before commencement of development the company would have obtained some appropriate

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<sup>1</sup> 17 Tax Cases 77, 87.

<sup>2</sup> (1965) 42 T.C. 517.

<sup>3</sup> (1970) 3 All E.R. 915.

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undertaking or binding documentation from the Bank. It seems that no effort in this direction was made. Did the company at any time prepare or discuss a plan or scheme which could be put forward for the consideration of the financier? If so we have not been told about it. Not only did the Bank not make a loan for the development but it demanded repayment of the company's existing debt of \$1,479,867 which in 1970 had been outstanding for 8 years. In a situation like this it would not be unexpected if the company did not trouble itself to prepare or, perhaps, found difficulty in formulating the preparation of an acceptable proposal to the Bank for a further loan. It is also significant that the company did not offer a mortgage of the Bonham Strand properties although in evidence it was stated that the company was willing to do so after the building has been completed. Needless to say, it was over-optimistic to expect finance on that basis. In our view such overture as the company may have made to obtain a loan did not warrant an expectation that it would be acceded to particularly in the absence of any projection statement showing how, in what manner, from what source, in what amounts and during what period of time repayment could be made. It is also significant that the minutes of the company are silent on any resolution for a further loan to construct the building although in relation to W. House such resolutions appear. It would also appear that when regard is had to a letter from the company to the Bangkok Bank the company requested for time to repay the existing overdraft account of \$1,479,867 which it said can be discharged within 3 years on the basis that the Bonham Strand property will be unsold and the company will utilize all the rents from the building to pay off the debt within the time stated. As this letter implies that the company had available resources elsewhere to construct the building then, for reasons not disclosed to us, such available funds were not sought for by the company and, if this is so, the company's contention that the sales of units were "forced" sales lacks luster. As more units were sold than were required to satisfy the Bank's overdraft this militating feature against the company's contention cannot also be discounted.

The hearing of this case involved many sittings. The comments we have made are not intended to be exhaustive of all the aspects of this case but, all in all, having given careful consideration to the evidence we have come to the conclusion that the company has failed to discharge the onus of satisfying us that the gains from sales were not derived from an operation of business in carrying out a scheme of profit-making. The profits derived are, therefore, not accretions to capital but of a revenue nature. Accordingly, this appeal fails and the assessment is confirmed.