

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D113/98

Profits Tax – whether profits derived from the sale of shares assessable to profits tax – section 68(4) of the Inland Revenue Ordinance.

Panel: Kenneth Kwok Hing Wai SC (chairman), Raphael Chan Cheuk Yuen and Alfred Chow Cheuk Yu.

Date of hearing: 12 January 1998.

Date of decision: 18 November 1998.

The taxpayer, a private company incorporated in Hong Kong and at all material times a wholly-owned subsidiary of a public company incorporated and listed in Hong Kong ('Company C'), objected to the profits tax assessment on the gain which arose from the sale of certain shares of two listed companies ('Company A and Company B' respectively) in the property sector. It appealed on the ground that the shares were acquired with the intention of holding them as long term investments and the profits made upon their subsequent realization were profits arising from the sale of capital assets which were excluded from assessment to profits tax in accordance with section 14(1) of the Inland Revenue Ordinance (Chapter 112) ('IRO'). As section 68(4) of the IRO placed the onus of proving that the assessment appealed against was incorrect on the taxpayer, the issue was whether the taxpayer has discharged such onus.

Held:

1. Section 68(4) of the IRO provided that the onus of proving that the assessment appealed against was incorrect was on the taxpayer. Section 2 of IRO defined 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) of the IRO excluded profits arising from the sale of capital assets.
2. It was unnecessary to refer to all the relevant authorities on whether there was an adventure in the nature of trade. Each case depends in its own facts.
3. The speeches of Sir Nicholas Browne-Wilkinson VC in Marson v Morton [1986] STC at pages 470-471 and Lord Wiberforce in Simmons v IRC [1980] 1 WLR 1196 at 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492 as well as the statement of law by Orr LJ at pages 488 and 489 of the report in Tax Cases were correct statements.

INLAND REVENUE BOARD OF REVIEW DECISIONS

4. The intention of a taxpayer at the time of the acquisition of the asset was a question of fact, no single test could produce the answer. In particular, the stated intention of the taxpayer could not be decisive and the actual intention could only be determined upon the whole of the evidence. It was trite to say that intention could only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it was rightly said that actions speak louder than words: see All Best Wishes Limited v CIR (1992) 3 HKTC 750 at 770 per Mortimer J.
5. The main area of business of Company C, the holding company of the taxpayer, was retail and wholesale. Company A and Company B, in which the taxpayer had acquired lots of its shares, did not fit with the areas of business of Company C at all.
6. The 'portfolio' of 1,500,000 shares in Company A and 870,000 shares in Company B could hardly be described as 'strategic'.
7. In addition to Company A and Company B, there were at least over 30 well-established Hong Kong companies. The Board has not been told as to the reason why no shares in other areas of business were in the 'portfolio'.
8. During the cross-examination session, the taxpayer's representative who was a director of the taxpayer, has mentioned that the primary focus of the acquisition of the shares concerned was to 'park' the surplus funds to secure a minimum return which hopefully should not be less than the case interest return on this fund if placed in bank deposits.
9. The choice of the word 'part' was entirely that of the director. He used the word 3 times in the course of his cross-examination.
10. According to the Concise Oxford Dictionary, it meant 'colloq. Deposit and leave, usu. temporarily' and according to the Oxford Dictionary, to park was 'to place or leave (a person or thing) in a suitable or convenient place until required; to put aside for a while.'
11. On the taxpayer's own evidence, the shares were not acquired with the intention of holding them as long term investments.
12. By reason of the aforesaid, the taxpayer has not discharged the onus under section 68(4) of the IRO of proving that the shares were acquired as capital assets.

Appeal dismissed.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Cases referred to:

Marson v Morton [1986] STC 463
Simmons v IRC [1980] 1 WLR 1196
53 Tax Cases (1980) 461
All Best Wishes Limited v CIR (1992) 3 HKTC 750

Doris Lee for the Commissioner of Inland Revenue.
Samuel Barns of Messrs Coopers & Lybrand for the taxpayer.

Decision:

1. This is an appeal against the determination dated 14 July 1997 by the Commissioner of Inland Revenue, rejecting the Taxpayer's objection to the profits tax assessment for the year of assessment 1991/92 dated 29 March 1994 showing assessable profits of \$5,788,879 with tax payable thereon of \$955,165 ('the Assessment'). The gain arose from the sale of certain shares.

2. The Taxpayer appealed on the ground that the shares were acquired with the intention of holding them as long term investments and the profits made upon their subsequent realisation were profits arising from the sale of capital assets which were excluded from assessment to profits tax in accordance with section 14(1) of the Inland Revenue Ordinance, Chapter 112 ('the IRO').

The facts

3. On the statement of facts in the determination, the documents produced at the hearing of the appeal, and the oral evidence given by the witness called on behalf of the Taxpayer, we make the following findings of facts.

4. The Taxpayer was incorporated as a private company in Hong Kong on 6 July 1990, and was at all material times a wholly-owned subsidiary of a public company incorporated and listed in Hong Kong ('Company C').

5. On 15 August 1991, Company C announced that it had agreed to acquire a well-known overseas department store and the freehold premises from which it operated for a total aggregate cash consideration of approximately \$709,000,000 subject to adjustments. On the same day, Company C also announced a proposed rights issue to raise a total of approximately \$1,090,000,000, before expenses. On the use of proceeds, Company C stated that the acquisition would be funded by the proceeds of the rights issue; that the rights issue would assist in the additional funding required for the future development of the operations of the acquisition; and that:

INLAND REVENUE BOARD OF REVIEW DECISIONS

'to the extent not immediately used for the above-mentioned purposes, it is the current intention of your directors that the net proceeds of the rights issue will be used as additional working capital for the group as enlarged by the acquisition.'

6. The directors of Company C met on 12 November 1991. The minutes recorded under "Corporate Investment Policy" that:

'It was put to the meeting that following the successful completion of the Company's rights issue in September 1991, the Company was holding surplus cash funds of in excess of \$450,000,000. It was also noted that interest rates were currently low and that the general view was that this situation would continue for some time to come.'

Having carefully considered how these surplus funds should be invested, IT WAS RESOLVED THAT the Company should build up a strategic portfolio of shareholdings in well-established Hong Kong companies for long-term investment purposes by utilising up to a maximum of \$150,000,000 of these funds. IT WAS FURTHER RESOLVED THAT [the Taxpayer], a wholly-owned subsidiary of the Company, be used as the vehicle through which the Company would build up and hold such a portfolio.'

7. The directors of the Taxpayer met on 13 November 1991. The minutes recorded that:

'Pursuant to a resolution passed by the Company's holding company, [Company C], on 12 November 1991, IT WAS RESOLVED THAT the Company should build up a strategic portfolio of shareholdings in well-established Hong Kong companies for long-term investment purposes and in connection therewith, IT WAS THEN RESOLVED THAT the Company purchase on The Stock Exchange of Hong Kong Limited up to 2,000,000 shares of [Company B] at a price of not more than \$22.80 per share and up to 3,000,000 shares of [Company A] at a price of not more than \$13.90 per share.'

8. On 13, 14, and 15 November 1991, the Taxpayer acquired 1,500,000 shares in a listed company in the property sector ('Company A'); 105,000 shares on 13 November at \$13.5 per share, 745,000 shares on 14 November at \$13.6 per share, 3,000 shares on 14 November at \$13.4 per share, 405,000 shares on 14 November at \$13.5 per share, and 242,000 shares on 15 November at \$13.5 per share.

9. On 13 November 1991, the Taxpayer acquired 870,000 shares in another listed company in the property sector ('Company B') at \$22.6 per share.

10. The total cost of acquisition of the shares in Company A and the shares in Company B (collectively 'the Shares') is \$39,850,567, after deducting pre-acquisition

INLAND REVENUE BOARD OF REVIEW DECISIONS

dividend received from Company A at 24 cents per share (\$360,000) and adding stamp duty, brokerage, etc. of \$224,367.

11. The directors of the Taxpayer met on 20 January 1992. The minutes recorded that:

'It was noted that at the directors' meeting of the Company held on 13 November 1991, the Company had resolved to build up a strategic portfolio of shareholdings in well-established Hong Kong companies for long-term investment purposes. Pursuant to this resolution, the Company had purchased 1,500,000 shares of [Company A] and 870,000 shares of [Company B].

It was then put to the meeting that the Company's holding company, [Company C], was giving serious consideration to a major acquisition project running into hundreds of millions of dollars and was looking to put itself in a more liquid cash position in the event of a due diligence review proving positive and such an acquisition taking place. Since the Company's shareholdings were easily convertible into cash, IT WAS THEN RESOLVED THAT the Company dispose of its share investment portfolio in order to assist in its holding Company's investment strategies and expansion plans.'

12. On 20 and 21 January 1992, the Taxpayer sold all the 1,500,000 shares in Company A; 296,000 shares on 20 January at \$15.2 per share, 704,000 shares on 21 January at \$15.2 per share, 150,000 shares on 21 January at \$15.3 per share, 150,000 shares on 21 January at \$15.4 per share, and 200,000 shares on 21 January at \$15.5 per share.

13. During the period from 23 January 1992 to 10 February 1992, the Taxpayer sold all the 870,000 shares in Company B; 100,000 shares on 23 January at \$25.6 per share, 110,000 shares on 23 January at \$25.7 per share, 90,000 shares on 23 January at \$25.8 per share, 181,000 shares on 3 February at \$26.8 per share, 30,000 shares on 7 February at \$26.7 per share, 100,000 shares on 7 February at \$26.8 per share, 70,000 shares on 7 February at \$26.9 per share, 14,000 shares on 10 February at \$27 per share, and 175,000 shares on 10 February at \$26.9 per share.

14. The total sale proceeds from the sale of the Shares amounted to \$45,914,300. After deducting stamp duty, brokerage, etc. for the sale of the Shares, the net gain from the purchase and sale of the Shares is \$5,801,674.

15. The Taxpayer submitted its profits tax return for the year of assessment 1991/92 together with the first set of accounts for the period from 6 July 1990 to 31 March 1992 and a proposed tax computation. In the report of the directors, the Taxpayer declared that it commenced business on 13 November 1991 and the nature of business was 'investment holding'. The accounts showed a nil turnover; an extraordinary item – profit on disposal of long term investments of \$5,801,674, and a proposed dividend of \$5,500,000.

INLAND REVENUE BOARD OF REVIEW DECISIONS

16. The Taxpayer did not offer the 'profit on disposal of long term investment' for assessment.

17. The assessor did not accept that the Shares were the Taxpayer's capital assets. On 29 March 1994, the assessor raised on the Taxpayer the Assessment.

18. The Taxpayer objected against the Assessment on the ground that the gain on disposal of the Shares was capital in nature.

19. The Commissioner rejected the Taxpayer's objection and the Taxpayer appealed.

The Taxpayer's case

20. The only witness called by the Taxpayer was the then group finance director of Company C, a chartered accountant, and a director of the Taxpayer ("the Director"). His evidence was that the surplus from the rights issue after the acquisition was \$299,000,000; that Company C had surplus funds in excess of \$450,000,000 after taking into account surplus funds in hand before the rights issue; that at a meeting of the directors of Company C held on 12 November 1991, it was noted that Company C was holding surplus cash funds in excess of \$450,000,000; that interest rates were then low and that the general view was that this situation would continue for some time; and that it was resolved that Company C should build up a 'strategic portfolio' of shareholdings in well-established Hong Kong companies for long-term investment purposes by utilising up to a maximum of \$150,000,000 of these funds.

Relevant provisions

21. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is incorrect is on the Taxpayer. Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

The issue

22. The issue is whether the Taxpayer has discharged the onus of proving that the Assessment is incorrect in that the gain arising from the sale of the Shares is not assessable to profits tax in accordance with section 14(1) on the ground that the Shares were acquired as capital assets.

Authorities

23. We do not find it necessary to refer to all the relevant authorities on whether there was an adventure in the nature of trade. Each case depends on its own facts.

INLAND REVENUE BOARD OF REVIEW DECISIONS

24. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] STC 463 at pages 470 – 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr L J at pages 488 & 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

25. In All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771, Mortimer J., as he then was, was reported to have said:

‘Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.’
(at page 770).

‘The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.’

*I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the **Simmons** case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person’s intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.’* (at page 771).

Our decision

26. The main area of business of Company C is retail and wholesale. We were told by the director that Company C was constantly on the look out for good investments in this area, and that Company C was focusing on luxury brand name retail and wholesaling business, that was their bread and butter.

INLAND REVENUE BOARD OF REVIEW DECISIONS

27. Company A and Company B did not fit in with the areas of business of Company C at all.

28. The 'portfolio' of 1,500,000 shares in Company A and 870,000 shares in Company B could hardly be described as 'strategic'. We have not been told by the Taxpayer whether it considered the Shares as constituting the 'strategic portfolio', and if the answer is in the negative, the reason or reasons, if any, why the Taxpayer had not acquired any more shares to implement its alleged decision to 'build up a strategic portfolio of shareholdings in well-established Hong Kong companies for long-term investment purposes'. In addition to Company A and Company B, there were at least over 30 well-established Hong Kong companies. We have not been told why no shares in other areas of business were in the 'portfolio'.

29. In the course of cross-examination, the director stated (emphasis added):

Q: 'Beside bank deposit and shares in Hong Kong, there are many other investment tools like the property market or the loans market.'

A: 'You see because our group is focusing on luxury brand name retail and wholesaling business, that is our bread and butter, that we never engage in any speculation, and as you understand all this was talking about parking surplus funds to safeguard and secure a minimum return. The pressure on us at that time was as I said worrying about further declining of interest rate, that is the primary driver of that decision at that time. So we did not consider any other forms of investment.'

Q: 'But my question is, why choose the listed shares in Hong Kong, why not, why purchase of property and receive rental income, my question is why choose?'

A: 'But that become locking up our surplus funds for a period of time that may affect our future expansion you know. Because our expansion always, we always want to acquire other companies, that is our primary objective, you know, as you can see from our history, all the brand names and all this, so when we have got surplus fund we would like to invest in an investment which has a ready market if we need it at any time. If we invest in a property then it doesn't have a ready market.'

Q: 'yes, so the reason is not your group didn't want to lock up your funds in the property, in other investment tools, because the liquidity of the shares in hong kong are high so you can easily convert them into cash, is it correct?'

A: 'Yes, we have chosen listed shares because of the liquidity.'

Q: 'Yes, thank you.'

INLAND REVENUE BOARD OF REVIEW DECISIONS

A: *'And the marketability. Ready marketability.'*

...

Q: *'Yes. So from the dividend yield of these two shares, it is not better than the same deposit rate. Was [the Taxpayer] expecting something more than the dividend income from these shares?'*

A: *'As I said, the primary focus was to park the surplus funds to secure a minimum return which hopefully should not be less than the cash interest return on this fund if placed on bank deposit.'*

...

Q: *'So if the funds advanced, so if the funds advanced by [Listco] to [the Taxpayer] to acquire the listed shares in question were really needed for the acquisition of the [major acquisition project], the advance could not have been long-term in nature, do you agree that?'*

A: *'Sorry, I mean in November when we decided to park this fund to secure not a declining return, because we were worried about declining interest rate, at that time we didn't know that we were going to acquire [the major acquisition project], all we knew was there was this possibility, when this will materialise, when they will tell us they are indeed wanting to sell and what are the prices we will know, we didn't know.'*

30. The choice of the word 'park' is entirely that of the director. He used the word 3 times in the course of his cross-examination. According to the Concise Oxford Dictionary, it means 'colloq. deposit and leave, usu. temporarily'. According to the Oxford Dictionary, to park is 'to place or leave (a person or thing) in a suitable or convenient place until required; to put aside for a while'. On the Taxpayer's own evidence, the Shares were not acquired with the intention of holding them as long term investments.

31. For reasons given above, the Taxpayer has not discharged the onus under section 68(4) of proving that the Shares were acquired as capital assets. We dismiss the appeal and confirm the Assessment.