

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D 11/80

Board of Review:

L. J. D'Almada Remedios, J.P., *Chairman*; Peter P. L. Li; G. A. Hope, *Members*.

19 November 1980.

Development and Sale of Property – whether activity in nature of trade.

Prior to 1975 the Appellants owned two properties. One was used for a dyeing and weaving business the other was used in the main as residential accommodation for the taxpayers' family and part of it was let out. The dyeing and weaving business was not successful and ceased in 1973.

These properties were used to secure a bank loan for the purchase of land in Kwai Chung. The Appellants arranged a further loan with another bank to construct a 14 storey factory on the land. All the floors except one were sold either during construction or immediately thereafter. The Appellants' profit exceeded \$1,000,000.00. The Revenue contended that this was a scheme of property development for resale at a profit. The Appellants contended that their intention was to retain the property as a long term investment however they were forced to sell the units to overcome financial difficulties encountered during construction.

Held:

- (i) The burden is on the Appellants to establish that their intention was to retain the property as a long term investment.
- (ii) The Appellants admitted that they were without funds and needed a loan to erect the building.
- (iii) The Appellants sold more units than all necessary to meet the mortgage loan and building costs.
- (iv) The Appellants had failed to show that their intention was to retain the property as a investment.
- (v) Taking all circumstances into account the Appellants had undertaken a trading activity.

Appeal dismissed.

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Lister Howell of Messrs. Howell & Co. for the Appellant.
Wong Ho Sang for the Commissioner of Inland Revenue.

Reasons:

This case raises the question of whether the appellants have been carrying on an activity in the nature of trade. The Revenue's contention is that the development and sale of a property which they owned in Kwai Chung amounted to such an activity. It will be convenient if we outline some aspects of this case.

The Appellants' Assets/Resources:

As we are concerned with the Appellants' property in Kwai Chung, we will refer to his other known assets. Prior to 1975, Nos. 3 and 19 H K Road were owned by the Appellants. Both are post-war buildings. No. 3 H K Road, which is a three-storeyed structure, was used as a factory by the Appellants in their business of dyeing and weaving. No. 19 H K Road is a four-storeyed structure. The family of the Appellants occupied three floors of this building and the other floor was let out. Both Nos. 3 and 19 H K Road will hereafter be referred to as 'the H K properties'. It appears that the Appellants' business of dyeing and weaving was not entirely successful. It sustained a loss in its last accounting year and it ceased operations in 1973.

The Land:

In 1964 the Appellants acquired a piece of agricultural land in Kwai Chung with negotiations in progress for its conversion into industrial land. The agricultural land was purchased for a price of \$288,355. To meet the cost of the purchase, a sum of \$200,000 was borrowed from the Wing On Bank on the security of H K properties. The balance of \$88,000 or thereabouts were paid out of the Appellants' own pockets. Negotiations for the conversion of the property from agricultural to industrial land were protracted. In September 1969, the Appellants were granted an area of 14 000 square feet of agricultural land in Kwai Chung by Government (hereinafter called 'the land') at a premium of \$308,148. The New Grant was dated the 13th of October 1969 and it specified the date for the completion of a super-structure, to cost not less than \$410,000, within 36 months.

The Development and Sale:

The appellants approached the Chung Khiaw Bank Ltd. for a loan to finance the payment of land premium and the development of the land. The bank agreed to a loan of \$2.25 million for the construction of a 14-storeyed factory building against the security of the land and building under a building mortgage. The advances under the building mortgage were to be by sixteen instalments against the architect's certificates showing the progress of development. Interest on the mortgage debt was agreed at 1% per month. The mortgage debt was to be repaid at the expiration of 12 months from the issuance of the occupation

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permit or at the expiration of 12 months after the time imposed by the New Grant for completing the erection of the building whichever is the earlier. A time imposed for completion of the building under the New Grant was the 13th of October 1972. In the mortgage deed the Appellants covenanted to complete the new building before the 31st of December 1971 or within the time imposed by the New Grant whichever was the earlier. It was represented to the bank by the architect for the Appellants that the building costs would be \$4.5 million. The building mortgage was dated the 23rd of September 1970 and part of the first advance under the mortgage was utilized by the Appellants to discharge the balance of the land premium. In November 1970 the Appellants negotiated the sale of the 4th to 6th floors of the proposed building to the architect for a price of \$820,000 to be satisfied by payments on the Appellants' behalf to contractors involved in the construction of the building. The agreement for the sale was later evidenced in writing dated the 4th of June 1971 and the purchaser was stated to be B Co. Ltd. of which the architect was a director.

Construction of the building was completed and the occupation permit issued on the 7th of December 1972. There are altogether 15 carparks and 14 floors with two units on each floor. Some units in the building was sold while construction was in progress. Immediately after completion of the new building, all units were sold with the exception of the ground floor, which was let for rental income. The Appellants' total indebtedness eventually came to \$5,183,312. The sale proceeds of the units sold amounted to \$6,409,804. The sale proceeds therefore exceeded the Appellants' total indebtedness by more than \$1 million.

The Revenue's Case:

On the facts which we have outlined above, the Revenue's case (without our need to amplify on it) is that the Appellants have embarked on a project geared for or having the attributes of a scheme of property development for resale at a profit so that the gains made are taxable.

The Appellants' case:

The testimony of Mr. A, one of the appellants who gave evidence before us is that from the outset the Appellants intended to construct a 4-storeyed structure on the land to be used exclusively as the business premises of their dyeing and weaving factory; that he approached the Chung Khiaw Bank Ltd. to finance the construction of such a building but the bank did not agree to a long-term loan. The interview which he had with the bank manager was in the company of his architect and it was suggested then that there be a fuller development of the land by erecting a taller structure. Mr. A's evidence is that the Appellants decided to construct a 14-storeyed structure to be retained as a long term investment. The ground, first and second floors were to be occupied by their dyeing and weaving factory and the other floors let out for rental income. His evidence is that he was given an estimate of the building costs in the sum of \$3,060,000 and as the bank agreed to let him have a loan of \$2.25 million he negotiated for the sale of the 4th, 5th and 6th floors to the architect for \$820,000 which added to the building loan could cover the cost of construction. In that way he felt the scheme could be implemented. He maintains that it was not his intention to sell units of the

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building (other than those to the architect) but that he was forced to do so when the bank declined to make further advances resulting in the suspension of building works as progress payments were not made to the contractors. In evidence, Mr. A also sought to lay the blame partly on the architect for giving him an underestimate of the building costs and later for delaying payment of the units which were sold to him. It was not shown how or when or what payments were delayed by the architect. It also appears from the correspondences and it is not disputed that the bank did not feel itself obligated to make further advances in mid-1972 when the building ought to have been completed by the end of 1971.

In essence the Appellant's case is that they arranged to sell three units to the architect so that with the proceeds of sale plus the loan from the bank there would be enough to cover the estimated building costs; that it was not their intention to sell any other units of the building but supervening events forced them to do so wherefore the sales were of capital assets so that the profits derived are not taxable.

Conclusion:

We have been referred to several cases. Among them is the case of **Iswera vs. C.I.R.** (1965) 1 W.L.R. 663. In that case the taxpayer wished to reside near the school which her daughters were attending. She tried to buy part of a site of 2½ acres of land but the vendor was unwilling to sell part. She contracted to buy the whole site, sub-divided it into 12 lots, nine of which she sold to nine sub-purchasers; one she sold back to the vendor and two she retained. She used the money derived from the sub-sales to complete the original purchase. The result yielded a substantial profit and it was found that she had embarked on an adventure in the nature of trade. This finding was adhered to by the Privy Council. In the course of the judgement it was said:

‘Clearly she did not buy the whole site as a capital investment. It was an essential part of her plan that the greater part of it should immediately be sold to sub-purchasers because without the money paid by them she could not have found the money to pay the balance due to the vendor. No doubt she acquired part of the site which she retained as a capital investment but in order to acquire it she had to buy, divide and immediately resell the rest of the site ... If in order to get what he wants the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose of object alone cannot prevail over what he in fact does.’

We do not think that the Iswera case raises any new principles. It goes no further than to show that on the facts the inference of trading was justified although it was accepted that what the taxpayer did was to enable her to retain part of the property for her own use.

When an owner of land exploits it by the development and construction of a multi-storey building and in the course of construction or shortly thereafter he sells units in the building, the inference that would be drawn is that the building was not erected for retention as an investment but for the purpose of resale. If the owner's case is that he intended to retain the property as a long term investment but supervening events outside his control forced him to

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dispose of the property, then before such a claim can succeed he must satisfy the Board that it was his intention to keep it as an investment or capital asset.

‘Intention’ connotes an ability to carry it into effect. It is idle to speak of ‘intention’ if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented.

Mr. A admitted that the Appellants were without funds and, therefore, had to resort to a loan to erect a multi-storeyed structure; that at the time of the loan he had arranged to sell three floors of the proposed building to the architect. Although the Appellants owned the H K properties (which were subsequently sold in 1975 for \$5.7 million) it was not their intention to have recourse to these properties, by sale or otherwise, to meet development expenses which by so doing may have enabled them to retain the developed land and building as an investment.

The Appellants sold more units in the building than were necessary to meet the mortgage loan and building costs. In the sale and purchase agreement to B Company Limited the recitals shows: (a) that ‘for the purpose of sale of Units or flats of the new building’ the land and building have been notionally divided into parts or shares; and (b) that pursuant to Special Condition No. 3 of the New Grant the Appellants have obtained the consent of the District Commissioner to enter into agreements for the sale and purchase of undivided shares of and in the land. It is evident that such an application for consent was made before the building was completed.

When we look to all the circumstances to see if the Appellants have launched themselves on a trading activity, we find the answer to be in the affirmative. The character to be attributed to what the Appellants did or did not do is inconsistent with what is to be expected of a person who intends to keep a developed property as an investment for rental income. The absence of any arrangements for adequate long term financial facilities to enable the Appellants to retain the property and the creation of a short term building mortgage to finance the project with knowledge that recourse must be had to sales to discharge the mortgage debt and to meet development costs bear the imprint of a course of action pursued with a motive that militates against retention for investment.

The evidence of Mr. A that he had a hope or expectation that the bank would grant an extension of the mortgage which may have enabled the Appellants to retain the property without sale, we find unacceptable and insufficient to outweigh other considerations. At the time the loan was applied for it was made clear to him that the bank would not agree to a long term loan.

This appeal fails and the assessment is confirmed. We would add that our decision relates only to the units that were sold and is not to be taken as indicating any view or comment as to whether the ground floor, which has been retained by the Appellants, is a trading or capital asset.