

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D15/94

Profits tax – purchase and sale of property – whether profit subject to profits tax.

Panel: Ronny Wong Fook Hum QC (chairman), Peter G Willoughby and Peter C White.

Date of hearing: 22 February 1994.

Date of decision: 8 June 1994

The taxpayer purchased and sold property. The taxpayer claimed that the property was purchased as a long term investment and sold because of political uncertainty.

Held:

The Board rejected the submission made by the taxpayer. The onus of proof is upon the taxpayer. The taxpayer had failed to satisfy the onus of proof.

Appeal dismissed.

Tam Kuen Chong for the Commissioner of Inland Revenue.
S Kambill of Messrs Ting Ho Kwan & Chan for the taxpayer.

Decision:

I. THE SUBJECT MATTER OF THE APPEAL

1. Company L (the Taxpayer) appealed against the determination of the Commissioner issued on 11 October 1993 in which he upheld an assessment to profit tax on the Taxpayer for the year of assessment 1989/90 at \$3,450,754. Such assessment arose as a result of disposals by the Taxpayer of its interests in the premises at Nos 74-76 of Place W in mid-1989.
2. The Taxpayer contended that:
 - (a) The profits generated by the sale in mid-1989 were profits from disposal of capital assets and therefore not taxable.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) Alternatively, in computing the profits assessed to tax the market value of the properties at the time of the sale should be substituted for the original purchase price of the properties.

II. THE FACTS

1. The Taxpayer is a private company incorporated in Hong Kong in August 1986 with an initial capital of \$2. Its issued share capital was increased to \$10,000 in 1987 and remained the same during the material period. As from 1987 it became a wholly owned subsidiary of Company M Ltd.
2. The Board of Directors of Company M Ltd resolved to purchase No 74 of Place W at a meeting held in late 1983. The minutes of that meeting recorded the attendance of Mr A and others but made no reference to the purpose of Company M Ltd in acquiring this property.
3. In early 1987, Company M Ltd commissioned 2 valuation reports. The first report related to Nos 74-76 of Place W. The second report was confined to No 76 of Place W alone and this was the only report before us. It described the then condition of No 76 in these terms:

‘On site stands a building which is currently maintained in poor condition. The existing building shares a common staircase with the adjoining No 74 of Place W. The ground floor of the building is for commercial use. The upper floors are for domestic purpose.’

No 76 of Place W was valued at \$2,400,000 on a vacant possession basis.

4. The directors of the Taxpayer resolved to purchase No 76 of Place W at a meeting held in February 1987. Only 2 directors attended this meeting. They were Mr B and Mr C. They resolved that the Taxpayer should execute an assignment for the purchase of No 76 at \$2,100,000. Mr B and Mr C were to be parties to that assignment as confirmors. The minutes made no reference to the reason why the Taxpayer was to acquire this property. Mr B and Mr C ceased to be directors of the Taxpayer in February 1987.
5. On 17 July 1987, Mr D, Mr E, Mr F and Mr A as the 4 new directors of the Taxpayer resolved at a directors meeting of the Taxpayer to purchase No 74 of Place W from Company M Ltd for \$650,000. The minutes of that meeting were also silent as to the Taxpayer’s reason for making this acquisition.
6. By letter dated 30 September 1987, Mr H of Company N Ltd approached the Taxpayer enquiring whether the Taxpayer would be interested to dispose of No 76 of Place W. The Taxpayer made no response.

INLAND REVENUE BOARD OF REVIEW DECISIONS

7. The Hang Seng index dropped by 421 points in October 1987. The Stock Exchange of Hong Kong closed for 4 days. When trading resumed on 26 October 1987, the index dropped a further 1,121 points. During the closure of the Exchange, the Taxpayer appointed Mr J as the authorised person for the preparation of building plans for the construction of a composite building at No 74 & 76 of Place W. Building plans were duly submitted in January 1988 and the Building Authority granted its approval in March 1988.
8. The Taxpayer experienced difficulties in obtaining possession of the roof of No 74 of Place W. Solicitors were engaged and vacant possession was eventually secured in September 1988. The Building Authority granted consent for demolition works in January 1989 and demolition works were completed by May 1989.
9. In July and August 1988, the Taxpayer were twice approached by the adjoining owners of Nos 78-80 of Place W with a view to a joint development. The parties failed to reach any agreement.
10. By letter dated 13 February 1989, Mr I, a property agency wrote to Company O Ltd offering Nos 74 & 76 of Place W 'for your purchase and combined redevelopment'. Company O Ltd was the then owner of Nos 78-80 of Place W. In or about March 1989, Company O Ltd sold No 78 & 80 of Place W to Company P Ltd.
11. By letter dated 22 March 1989, Mr K on behalf of a 'prospective Purchaser' offered the Taxpayer a sum of \$13,000,000 for Nos 74 & 76 of Place W. It is not clear who this 'prospective Purchaser' was.
12. By a sale and purchase agreement dated 1 May 1989, the Taxpayer sold to Company P Ltd Nos 74 & 76 of Place W for \$13,500,000. The sale was duly completed by assignment dated June 1989.
13. This disposal by the Taxpayer took place shortly after the students' unrest in Beijing which commenced in around the time of the death of Hu Yau Bang in April 1989.

III. THE COMMISSIONER'S DETERMINATION

1. The Commissioner took the view that in purchasing and selling the properties the Taxpayer concluded a very successful adventure in the nature of trade.
2. The Commissioner took into account the following factors:
 - (a) The properties were held for a comparatively short period of time;

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) The difficulties in evicting tenants should have been anticipated as the properties were acquired with sitting tenants;
- (c) The activity responsible for the greatest effect on the Taxpayer's results was the purchase and sale of the properties;
- (d) The Taxpayer did not have a firm 'capital' attitude towards the properties as demonstrated by assertions made on its behalf in correspondence with the Revenue:
 - (i) It planned first to redevelop the properties.
 - (ii) Later it planned to redevelop the properties in conjunction with an adjacent property.
 - (iii) Later still it received an offer that it simply could not refuse.
- (e) Its paid up capital of \$10,000 is more indicative of a company with an intention to bank in property than one which intended to hold property for investment purposes.

IV THE ORAL EVIDENCE ADDUCED BY THE TAXPAYER BEFORE US

1. The Taxpayer called Mr G to give evidence. Mr G was first appointed an assistant to Mr A in December 1988. Mr A was then the Chairman of the Taxpayer. Mr G subsequently became a director of the Taxpayer in January 1993. Prior to December 1988 Mr G was not involved with the activities or business of the Taxpayer at all.
2. Mr G told us that:
 - (a) Mr A headed the Q group of companies and that group had many trade associates and customers who came from China to Hong Kong. The Q group of companies had to spend a lot of money on their accommodation in hotels in Hong Kong.
 - (b) The management of the Taxpayer thought it desirable to redevelop the 2 properties into service apartments to provide accommodation for the trade associates and customers of Q group. When No 76 of Place W was acquired in 1987, the management of the Taxpayer focused on this need.
 - (c) In 1989 Mr A decided to sell these investments of the Taxpayer because of his concern about the way in which the market was likely to react as a result of the students' movement in Beijing. The Chairman was getting 'cold feet' because of what he thought was happening in China.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) In April 1991 he prepared a so-called Feasibility Study in response to enquiries from the Revenue. He relied on 'the previous idea from the directors' which was quite different from the technical data provided by the architect. According to that Feasibility Study, the redevelopment was to be divided into 2 parts. The first part consisted of 'Residential accommodation of 3,644 square feet estimated to yield rent at \$12 per square feet. The second part consisted of 'Commercial accommodation of 2,464 square feet estimated to yield rent at \$30 per square feet.

V. OUR DECISION

1. Section 68(4) of the Inland Revenue Ordinance provides that the onus of proving that the assessment is incorrect lies with the Taxpayer. The Taxpayer has to satisfy us that, on a balance of probabilities, the profit was not taxable.
2. The relevant minutes shed no light on the Taxpayer's intention in acquiring the 2 properties. Mr A is the only person who has first hand direct knowledge on this crucial issue. The Taxpayer chose not to call him. Mr G has no personal knowledge of the company's affairs prior to December 1988. What he told us in relation to the Taxpayer's intention to redevelop the premises in question as apartments to meet the requirements of Q group's business associates received scant mention in the lengthy correspondence between the Revenue and the Taxpayer prior to the hearing before us. We are therefore of the view that the Commissioner had rightly placed reliance on the Taxpayer's 'flexible approach' to the use of the properties.
3. The Taxpayer had also failed to satisfy us that it was the events in Beijing that prompted the eventual disposal. Mr I of a property agency purported to offer the premises to Company O Ltd in February 1989. This was before the students' movement in Beijing had started. It also lends weight to the fact that the 2 premises were on offer and that this resulted in the letter from Mr K making a bid at \$13,000,000.
4. In these circumstances we are of the view that the Commissioner was right to conclude that the profits in question arose from a successful adventure in the nature of trade.
5. In relation to the alternative submission put forward on behalf of the Taxpayer, we were urged by the Taxpayer's representative to exercise our 'discretion' to calculate its profit on the value of the properties at the time of sale. We have no such discretion and we are of the clear view that the computation by the Revenue was made on a proper basis.
6. For these reasons, we dismiss the Taxpayer's appeal and confirm the assessment. It remains for us to thank Mr Kambil, tax representative of the

INLAND REVENUE BOARD OF REVIEW DECISIONS

Taxpayer for his thorough preparation. He has said everything that can be said on behalf of his client.