Case No. D170/98

Profits Tax – whether a sum received as compensation for premature termination of a tenancy is a trading receipt or a capital receipt.

Panel: Robert Wei Wen Nam SC (chairman), Robin M Bridge and Edward Chow Kam Wah.

Dates of hearing: 25 September and 5 October 1998.
Date of decision: 8 March 1999.

The taxpayer, a private limited company incorporated in Hong Kong appealed against the profits tax assessment on the compensation it received from its tenant upon premature termination of the tenancy concerned. In addition, the taxpayer also forfeited the rental deposit ('the Deposit') concerned by way of compensation. The issue was whether the compensation ('the Sum') received pursuant to the relevant surrender agreement was a trading receipt chargeable to profits tax.

Held:

(1) Any sum received is a trading receipt if the sum is for the user of capital assets and not for their realization: Greyhound Racing Association (Liverpool) Ltd v Cooper 20 TC 373, where it was held that user of a racing track did not create a new asset to the taxpayer.

(2) The correct view to take in this case is that the property, and not the tenancy agreement, was the capital asset of the taxpayer in this case.

(3) According to Short Bros Ltd v CIR 12 TC 54, a sum for releasing the parties from responsibilities under a contract in the ordinary course of business is revenue in nature, the Sum was for releasing the taxpayer and the first tenant from their respective responsibilities and liabilities under the tenancy agreement in the ordinary course of the taxpayer's property letting business, and was therefore revenue in nature.

(4) In London & Thames Haven Oil Wharves Ltd v Attwooll 43 TC 491, Diplock LJ formulated a rule that a sum is a trading receipt if it is a compensation for failure to receive trading receipts. The Sum is a trading receipt because it comes within the full terms of this rule. Being compensation for failure to receive, or for the loss of, trading receipts, that is, rental income for the unexpire residue of the terms of years, the Sum is itself

a trading receipt. Likewise, the Deposit, being compensation of the same nature, should also be treated as a trading receipt of the taxpayer.

(5) There is no evidence to show that the early termination of the tenancy agreement destroyed the taxpayer's profit-making ability, or destroyed or sterilized the property so as to attract the application of the principles stated in CIR v Fleming & Co (Machinery) Ltd 33 TC 57, London & Thames Haven v Attwooll (supra) and Glenboig Union Fireclay v CIR 12 TC 427.

(6) The tenancy agreement with the new tenant was part of the ordinary course of the property letting business. So was the time taken in finding a new tenant. The fact that the taxpayer was able to create a new tenancy with a much better yield is strong evidence that the taxpayer's profit-making ability was bit impaired. The taxpayer's profit-making ability lies in the property rather than the tenancy.

(7) There is no sufficient evidence that the calculation of the Sum was based on the realized value of the chattels and fixtures of the first tenant. Even assuming that was the case, it does not follow that the Sum was not intended as compensation for future loss of revenue. There is no relation between the measure and the quality of the figure arrived at.

(8) The capital asset which the taxpayer used to carry on the property letting business was the property. Destruction of the tenancy agreement did not destroy the property.

(9) The fact that the shares of the two companies were owned by Mr A does not follow that the two companies could not bargain, nor that the Sum received was a capital receipt.

(10) The concept of double taxation only exists in respect of a single taxpayer and not between two taxpayers. The deductibility of the payment of the Sum and the accessibility of its receipt are governed by separate sections of the Inland Revenue Ordinance.

Appeal dismissed.

Case referred to:

Short Bros Ltd v CIR 12 TC 54
Greyhound Racing Association (Liverpool) Ltd v Cooper 20 TC 373
CIR v Fleming & Co (Machinery) Ltd 33 TC 57
London & Thames Haven Oil Wharves Ltd v Attwooll 43 TC 491
Glenboig Union Fireclay Co Ltd v CIR 12 TC 427

Chan Tak Hong for the Commissioner of Inland Revenue.

Yip Kwok Kei of Messrs Chan Lai Pang & Co for the taxpayer

Decision:

Nature of appeal

1. This is an appeal by a private limited liability company (the Taxpayer) against the profits tax assessment raised on it for the year of assessment 1992/93 as confirmed by the Commissioner of Inland Revenue in his determination dated 22 May 1998. The Taxpayer contends that the compensation received from its tenant upon premature termination of the tenancy agreement should not be assessable to profits tax.

Agreed facts

2. The Taxpayer was incorporated in Hong Kong on 20 November 1987. At all relevant times, its authorised share capital was $10,000 divided into 10,000 shares of $1 each, with 100 shares issued and fully paid up. Mr A and Mr B were the Taxpayer's shareholders and directors, holding 99 and 1 shares respectively. The 1 share was subsequently transferred to Mr C who held it on behalf of Mr A.

3. The Taxpayer has been carrying on a business of property investment.

4. On 2 February 1988, the Taxpayer purchased shop units and flat units and flat roofs in a building in District D ('the Property') at a consideration of $13,800,000.

5. By a tenancy agreement dated 7 July 1988, the Taxpayer let the Property to Company E for a term of 10 years commencing on 20 June 1988. The monthly rentals were as follows:

Period	**Monthly Rental**
20-6-1988 - 19-6-1992	$135,000
20-6-1992 - 19-6-1995	$162,000
20-6-1995 - 19-6-1998	$194,000

On signing the tenancy agreement, Company E paid to the Taxpayer a sum of $540,000 as deposit (the Deposit).

6. By an agreement dated 7 October 1992, the Taxpayer and Company E agreed to terminate the tenancy agreement prematurely on, among others, the following terms:

(a) Company E should deliver vacant possession of the Property to the Taxpayer on 30 September 1992.

(b) The Taxpayer would release Company E from all liabilities, claims and demands on condition that:

(i) a sum of $2,500,000 (the Sum) should be paid to the Taxpayer by way of compensation:

(ii) vacant possession of the Property should be delivered to the Taxpayer in a good clean and tenantable repair and condition; and

(iii) there was no outstanding breach on the part of Company E under the tenancy agreement.

(c) The Deposit be forfeited to the Taxpayer by way of compensation.

7. Pursuant to the termination agreement, Company E paid the Sum to the Taxpayer. Company E also forfeited the Deposit to the Taxpayer.

8. On 7 October 1992, and by a tenancy agreement of the same date, the Taxpayer let the shop units to a new tenant (Company F) for a term of 10 years commencing on 7 October 1992 as the following monthly rentals:

Period	**Monthly Rental**
7-10-1992 - 6-10-1996	$335,000
7-10-1996 - 6-10-1999	$435,500
7-10-1999 - 6-10-2002	$566,150

9. In its profits tax return for the year of assessment 1992/93, the Taxpayer declared a loss of $45,583. The Sum was classified as an extraordinary item and was not offered for assessment to profits tax.

10. In reply to the assessor's enquiries, the Taxpayer, through its auditors put forward the following arguments in support of its claim that the Sum should not be assessable to tax:

> 'The Property were acquired as fixed assets for letting purposes during the year 1988 and a tenancy agreement for a term of 10 years was made between the Taxpayer and Company E. In order to release from all liabilities that may be claimed by the Taxpayer on rental payable of the residue term of years under the said tenancy agreement, the tenant agreed to pay to the Taxpayer the Sum by way of compensation.
>
> The Sum received by the Taxpayer was due to unexpected termination of tenancy by Company E which constituted capital receipts and thus should be of capital nature and not subject to Hong Kong profits tax.'

11. The assessor was of the view that the Sum was a revenue receipt and should be assessable to tax. Accordingly she raised on the Taxpayer the following profits tax assessment for the year of assessment 1992/93:

Loss per return	$45,583
Less: the Sum	2,500,00
Assessable profits	$2,454,417
Tax payable thereon	$429,522

12. By letter dated 23 April 1994, the tax representatives of the Taxpayer objected on behalf of the Taxpayer against the assessment for the year of assessment 1992/93 on the ground that the Sum was capital in nature and should not be assessable to tax.

13. Company E was a private limited liability company incorporated in Hong Kong on 4 August 1987. At all relevant times, its issued and paid up capital was $2,000,000 divided into 20,000 shares of $100 each. It operated a restaurant since incorporation until 31 March 1992 when the restaurant was closed down. Mr A has been a shareholder and director of Company E since 26 January 1989. Prior to 30 March 1992, Mr A held 11,562 shares in Company E. On that day, he acquired the remaining 8,438 shares through a nominee holding the shares on trust for Mr A.

14. In correspondence with the assessor, the tax representatives made the following representations:

(a) The tenancy was early terminated because Company E wanted to close its restaurant business.

(b) The Sum was determined through negotiation between the Taxpayer and Company E. It was approximately the amount that Company E could realise from its assets upon cessation of its business.

(c) The Taxpayer derived rental income of $1,280,000 and $4,218,000 for the years ended 31 December 1992 and 1993 respectively, details of which are as follows:

(i) Year of assessment 1992/93

Tenant	Period	Amount
Company E	20-1-1992 - 19-4-1992($145,000 × 3)	$405,000
	Forfeiture of the Deposit	540,000
Company F	7-10-1992 - 6-12-1992 (Rent free)	-
	7-12-1992 - 6-1-1992	335,000

			$1,280,000

(ii) Year of assessment 1993/94

Tenant	Period		Amount
Company F	7-1-1993 - 6-1-1994	Shop units ($335,000×12)	$4,020,000
	18-1-1993 - 17-12-1993	A flat unit ($18,000×11)	198,000
			$4,218,000

15. The Commissioner of Inland Revenue having confirmed the profits tax assessment for the year of assessment 1992/93 (see paragraph 11 above), the Taxpayer is dissatisfied with his determination. Hence this appeal.

Grounds of appeal

16. The grounds of appeal are to the following effect.

16.1 At all relevant times, the Taxpayer only held the Property to let out to Company E under one tenancy agreement. The rental income derived from the Shop and the Flat was the Taxpayer's only source of income. The tenancy agreement which governed the whole profit making apparatus of the Taxpayer's business was regarded as a capital asset and the termination of the tenancy agreement constituted a destruction of the said capital asset. Therefore the Taxpayer considers the 'Compensation Sum' received for compensation for termination of the tenancy agreement was a capital receipt and not taxable.

16.2 The new tenancy agreement made with Company F was a fresh and distinct asset exploited by the Taxpayer and should have no bearing on this case.

16.3 The Taxpayer considers the character of forfeited deposit $540,000 (the Deposit) was different from the 'Compensation Sum) because the Deposit was based on four-month rental income and the amount was clearly stipulated in the tenancy agreement while the 'Sum' was based on the realisable value of chattels and fixtures owned by Company E and was never stipulated in the tenancy agreement. Accordingly, the taxability of the 'Compensation Sum' is quite different from that of the Deposit.

17. As the Taxpayer's representative, Mr Yip Kwok-kei of Messrs Chan, Lai, Pang & Co, a firm of certified public accountants, took the following points in his opening.

17.1 The tenancy agreement was a capital asset by reason of the following characteristics:

(a) It was assignable.

(b) In view of the property's spacious area, it was mainly fit for restaurant usage and suitable tenants were very few. In order to secure a stable revenue and to attract prospective tenants, the term of lease under the said tenancy had to last for as long as 10 years, a period quite longer than those tenancies for office or residential properties. Tenants of the latter properties can be switched or interposed quite easily and so short-term tenancy can be accommodated.

(c) The rental income from the tenancy was the Taxpayer's only source of income and therefore the tenancy was regarded as a whole profit-making apparatus of the Taxpayer's business.

(d) Furthermore, the break-up of the 10-year tenancy is in its initial stage, nearly 4 years after its commencement and, unlike termination at its final stage, would constitute the destruction of the Taxpayer's profit-making apparatus.

Therefore, the destruction of the tenancy agreement means the destruction of a capital asset.

17.2 The Commissioner should not have taken into consideration the subsequent tenancy agreement with Company F. Restaurant G operated by Company E was closed down half a year before a new tenancy agreement could be procured. The new 10-year tenancy agreement made with Company F should have no bearing on this case. It was a fresh and distinct capital asset exploited by the Taxpayer.

17.3 The 4-month forfeited deposit of $540,000 could not be regarded as of the same nature as the Sum. It was used to settle the default in rental payment for the period up to delivery of vacant possession, and therefore it was revenue income and subject to profits tax.

17.4 The Taxpayer and Company E were both wholly owned by Mr A. It was unlikely and pointless that the Taxpayer would sue Company E for future loss of revenue. Furthermore, the calculation of the Sum was not linked with any future revenue but based on the realization value of chattels and fixtures of Company E. As such, the Sum was not intended to replace the future loss of revenue. The Sum could not be regarded as being of a nature to release Company E from all liabilities and claims

arising from rental payable for the residue of the term of years under the tenancy, which was over $12,000,000.

17.5 The Sum was not arrived at through bargaining between the Taxpayer and Company E which were both wholly owned by Mr A. Therefore this receipt could be regarded as capital money rather than trading receipt.

17.6 As Company E did not claim the Sum paid as deductible expense for tax purpose, there would be an element of 'double taxation' in this sense.

Hearing, parties and witnesses

18. At the hearing of this appeal, the Taxpayer was represented by Mr Yip Kwok-kei of Messrs Chan, Lai, Pang & Co, certified public accountants, while the Commissioner of Inland Revenue was represented by Miss Chan Tak-hong, assessor. Mr A gave evidence for the Taxpayer. No other witness was called.

Testimony of Mr A

19. The testimony of Mr A is principally to the following effect.

Evidence in chief

19.1 The purpose of the Taxpayer in acquiring the Property was to hold them for long-term investment.

19.2 The Property (that is, the shop units and the flat units) was used as a restaurant when the Taxpayer bought it. Mr A re-named the restaurant operated by Company E to 'Restaurant G'.

19.3 Mr A and his partners acquired Company E because they wanted a new company with new shareholders joining in to run the new restaurant. At first Mr A's shareholding in Company E was 12.5%. Company E was incorporated one or two months after the Taxpayer acquired 'Restaurant G'. Mr A became a majority shareholder in Company E in December 1991. By March 1992, Mr A had acquired all the shares in Company E.

19.4 When he acquired the Taxpayer, Mr A owned 99% of the share capital. The other 1% was held by Mr B, Mr A's assistant.

19.5 Restaurant G sometimes made a profit, and sometimes made losses. Mr A bought up all the shares in Company E because some shareholders were not co-operative. He decided to close down Restaurant G because it was making losses. In March 1992, Restaurant G closed.

19.6 After Restaurant G had closed down, Mr A looked for new partners to re-open the restaurant. He also looked for a new tenant who had the expertise and knew how to run a restaurant.

19.7 There were a lot of chattels and fixtures in the premises. They were of no value except for restaurant purposes.

19.8 Company E was a shelf company which he and his partners bought for running a restaurant.

19.9 Mr B left the employment of the Taxpayer two years ago, and the one share held by him was transferred to Mr C, Mr A's younger brother who held it on behalf of Mr A.

19.10 Prior to its acquisition, the Property was in use as a restaurant. The Taxpayer acquired it because Mr A wanted to run the business of a restaurant. The Property was delivered with vacant possession at acquisition. After acquisition, the Taxpayer did not advertise or look for tenants, because Mr A wanted to run a restaurant himself. It is easy for a restaurant to make money. A restaurant can employ many people.

Evidence in cross-examination

19.11 Mr A agreed that there was no substantial change in the financial position of the Taxpayer, apart from the sum of $2,500,000, in 1991 as compared with 1992.

19.12 Mr A first acquired an interest in Company E on 26 January 1989. Company E was set up in mid-1988.

The law

20. The following legal principles with be referred to below.

(a) Sum for releasing the parties from responsibilities under a contract in the ordinary course of business is revenue in nature.

In Short Bros Ltd v CIR 12 TC 54, the taxpayer company contracted to build two steamers but the contract was subsequently cancelled. The taxpayer company received compensation for the cancellation. The Court of Appeal ruled that the compensation was a trading receipt. At page 973, Lord Hansworth, MR, stated:

'It seems to be simply the sum paid in order that, as a matter of business, the responsibility and liability under the contract should be terminated and the business should be free to engage in other. Looked at from this

point of view, it appears clear that sum received was received in ordinary course of business, and that there was not in fact any burden cast upon the company not to carry on their trade. It was not truly compensation for not carrying on their business: it was a sum paid in ordinary course in order to adjust the relation between the shipyard and their customers.'

(b) Trading receipt if the sum is for the user of capital assets and not for their realisation.

In Greyhound Racing Association (Liverpool) Ltd v Cooper 20 TC 373, the taxpayer company granted to another company a licence to use its racing track, the taxpayer company's only capital asset, for a term of 9 years with effect from May 1932. The licensee went into liquidation in 1934. The taxpayer company received compensation for the early termination of the licence. Lawrence, J ruled that the sum was a trading receipt of the taxpayer company. The judge considered that the capital asset of the company was the racing track and its equipment; the user of the track did not create a new asset to the company. At page 378, Lawrence, J stated:

'… in my opinion, that, if the sum in question is received for what is in truth the user of capital assets and not for their realisation, it is a revenue receipt, not capital.'

'But here, in my opinion, the only capital asset in fact acquired by the appellant company was the track and its equipment. The user of that track, whether by the appellant company or its licensee, did not create new capital assets, nor did it realise the original capital asset, which remains the property of the appellant company …'

'…the licence here in question was not an agreement which related to the whole structure of the appellant company's business, nor was it a fundamental organisation of their activities …'

(c) Capital receipt if the whole structure of the profit-making apparatus is destroyed.

In CIR v Fleming & Co (Machinery) Ltd 33 TC 57, the company was an agent of a manufacturer. The agency was terminated and the company received compensation which was held to be a trading receipt by the court. At page 63, Lord Russell stated:

'When the rights and advantages surrendered on cancellation are such as to destroy or materially to cripple the whole structure of the recipient's profit-making apparatus, involving the serious dislocation of

the normal commercial organisation and resulting perhaps in the cutting down of the staff previously required, the recipients of the compensation may properly affirm that the compensation represents the price paid for the loss or sterilisation of a capital asset and is therefore a capital and not a revenue receipt.'

(d) Trading receipts if it is compensation for the loss of trading receipts.

In London & Thames Haven Oil Wharves Ltd v Attwooll 43 TC 491, the taxpayer company owned an oil storage installation. Its jetty was damaged by a third party and was put out of use for 380 days. The taxpayer company received compensation for the loss of profitable use of the jetty. It was held that the compensation was a trading receipt. Diplock LJ, at page 515, stated the rule as follows:

'When pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have ben treated if it had been received instead of the compensation.'

At page 517 Diplock LJ referred to '*cases where compensation is paid for the destruction or permanent deprivation of the capital asset used by a trader for the purposes of his trade'*, and continued:

'*Here the asset thereafter ceases to be one by the use or exploitation of which the trader carries on his trade. As a result of such destruction or deprivation the trader ipso facto abandons that part of his trade which involves the use of the capital asset of which he has been deprived by destruction or otherwise, and profits which he would but for its destruction have made by its use or exploitation will thereafter no longer form part of the profits arising from the trade which he continues to carry on.'*

(e) A sum of money paid to an owner of property to prevent him from using it to make a profit is not profit but capital money. It is money paid in respect of the sterilisation of the capital asset.

In the Glenboig Union Fireclay Co Ltd v Commissioners of Inland Revenue 12 TC 247, the taxpayer company carried on business as manufacturers of fireclay goods and as merchants of raw clay, and was lessee of certain fireclay fields over part of which ran the lines of the Caledonian Railway. In 1908 the railway company, to whom the lands belonged, though not the minerals beneath, instituted an action to

restrain the taxpayer company from working the fireclay under the railway and the taxpayer company was interdicted from working under the railway. In 1911 the House of Lords decided against the railway company, which thereupon exercised its statutory powers to require part of the fireclay to be left unworked on payment of compensation. The compensation was settled by arbitration and was duly paid. Lord Buckmaster stated at page 463-464:

'In truth the sum of money is the sum paid to prevent the Fireclay Company obtaining the full benefit of the capital value of that part of the mines which they are prevented from working by the Railway Company. It appears to me to make no difference whether it be regarded as a sale of the asset out and out, or whether it be treated merely as a means of preventing the acquisition of profit that would otherwise be gained. In either case the capital asset of the Company to that extent has been sterilised and destroyed, and it is in respect of that action that the sum … was paid … I am unable to regard this sum of money as anything but capital money …'

Lord Wrenbury stated at page 465:

'Is a sum profit which is paid to an owner of property on the terms that he shall not use his property so at to make a profit? The answer must be in the negative. The whole point is that he is not to make a profit and is paid for abstaining from seeking to make a profit.'

(f) Method of assessment of compensation does not identify what it is paid for.

'The method by which the compensation has assessed in the particular case does not identify what it was paid for; it is no more than a factor which may assist in the solution of the problem of identification' (per Lord Diplock in the London Thames Haven case at page 515).

'But there is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test' (per Lord Buckmaster in the Glenboig case at page 464).

Findings and reasons

21. At all relevant times, the Taxpayer carried on the business of property investment. It did so by letting its only property consisting of certain shop units and flat units and flat roofs in a building in District D (the Property) or part thereof (see paragraphs 5 and 8 above).

22. By a tenancy agreement dated 7 July 1988, the Taxpayer let the Property to Company E (the First Tenant) for a term of 10 years commencing on 20 June 1988 (see paragraph 5 above).

23. Mr A owned 99% of the issued share capital of the Taxpayer until two years ago, when he acquired the remaining 1% through a nominee (see paragraphs 2 and 19.9 above).

24. On the other hand, Mr A has been a shareholder and director of the First Tenant since January 1989. Prior to 30 March 1992 he held 11,562 shares out of a total of 20,000 shares in the First Tenant. On that day, he acquired the remaining 8,438 shares through a nominee (see paragraph 13 above).

25. The First Tenant carried on the business of a restaurant until March 1992 when the restaurant closed down because it was making losses. Mr A bought up all the shares in the First Tenant because of differences of opinion between him and some other shareholders (see paragraphs 13 and 19.5 above).

26. In the circumstances, it is not surprising that the First Tenant was 'desirous of vacating the Property on 30 September 1992 and surrendering the residue of the 10-year term', to borrow the language of a recital in the surrender agreement entered into between the Taxpayer and the First Tenant on 7 October 1992. The terms of the surrender agreement are set out in paragraph 6 above. Material to this decision are the terms that a sum of $2,500,000 (the Sum) should be paid to the Taxpayer by way of compensation and that the Deposit amounting to $540,000 be forfeited to the Taxpayer by way of compensation. Pursuant to the surrender agreement, the First Tenant paid the Sum to the Taxpayer. The Deposit was also forfeited to the Taxpayer.

27. On 7 October 1992, and simultaneously with the making of the surrender agreement, the Taxpayer let the shop units of the Property to Company F ('the New Tenant') for a term of 10 years commencing on 7 October 1992 (see paragraph 8 above).

28. The issue is whether the Sum received by the Taxpayer from the First Tenant pursuant to the surrender agreement is a trading receipt chargeable to profits tax.

29. The Taxpayer contends that the Sum was a capital receipt and was for that reason not chargeable to profits tax. That contention is based on the proposition that the 10-year tenancy was a capital asset and that the early termination of the tenancy amounted to a destruction of the capital asset to the extent of the unexpired residue of the term (some 5 years 8 months). The Sum being compensation for the destruction of a capital asset, it was itself capital in nature and was a capital receipt. The Sum is therefore not chargeable to profits tax.

30. On the other hand, Miss Chan, the Commissioner's representative submitted that the capital asset in this case was the Property and not the tenancy agreement. She referred us to the Greyhound Racing case (see paragraph 20(b) above) where the court

identified the capital asset as the racing track and its equipment and not the licence. It was held that user of the track did not create a new asset to the taxpayer. We think that the comparison is appropriate. The correct view to take is that the Property, and not the tenancy agreement, was the capital asset of the Taxpayer in this case.

31. We accept Miss Chan's submission on the ordinary course of a property letting business. In our view, the activities in the ordinary course of that business include the finding of a tenant, the negotiation of the terms of tenancy, the grant of the tenancy, the collection of rent, and the termination of the tenancy, whether by effluxion of time, surrender, re-entry or otherwise, and the cycle starts again with the finding of a new tenant. As was the case in the Short Brothers case (see paragraph 20(a) above), the Sum was for releasing the Taxpayer and the First Tenant from their respective responsibilities and liabilities under the tenancy agreement in the ordinary course of the Taxpayer's property letting business, and was therefor revenue in nature.

32. In the London & Thames Haven case, Diplock, LJ formulated a rule which is set out in paragraph 20(d) above. Put shortly, a sum is a trading receipt if it is compensation for failure to receive trading receipts. The Sum is a trading receipt because it comes within the full terms of the rule. Being compensation for the failure to receive, or for the loss of, trading receipts, that is, rental income for the unexpire residue of the term of years, the Sum is itself a trading receipt. Likewise, the Deposit, being compensation of the same nature, should also be treated as a trading receipt of the Taxpayer (see paragraph 26 above).

33. There is no evidence to show that the early termination of the tenancy agreement destroyed the Taxpayer's profit-making ability, or destroyed or sterilised the Property so as to attract the application of the principles stated in such cases as CIR v Fleming & Co, London & Thames Haven v Attwooll, and Glenboig Union Fireclay v CIR (see paragraph 20(c), (d) and (e) above).

34. As to the Taxpayer's grounds of appeal, it is not necessary to take them all, as there is quite an amount of overlapping. We shall deal with the main points.

34.1 The tenancy agreement with the New Tenant was separate and distinct from the tenancy agreement with the First Tenant and was irrelevant.

The tenancy agreement with the New Tenant was part of the ordinary course of the property letting business. So was the time taken in finding a new tenant. The fact that the Taxpayer was able to create a new tenancy with a much better yield is strong evidence that the Taxpayer's profit-making ability was not impaired. In our view, such ability lies in the property, rather than the tenancy.

34.2 The calculation of the Sum was not linked with any future revenue but based on the realisation value of chattels and fixtures of the First Tenant. As such, the Sum was not intended to replace the future loss of revenue.

There is no sufficient evidence that the calculation of the Sum was based on the realised value of the chattels and fixtures of the First Tenant. Even assuming that that was the case, it does not follow that the Sum was not intended as compensation for future loss of revenue. There is no relation between the measure and the quality of the figure arrived at (see paragraph 20(f) above).

34.3 Destruction of the tenancy agreement means the destruction of a capital asset.

The capital asset which the Taxpayer used to carry on the property letting business was the Property. Destruction of the tenancy agreement did not destroy the Property.

34.4 The Sum was not arrived at through bargaining between the Taxpayer and the First Tenant which were both wholly owned by Mr A. Therefore the receipt of the Sum should be regarded as capital receipt.

Just because the shares of the two companies were owned by Mr A, it does not follow that the two companies could not bargain, nor that the Sum received was a capital receipt.

34.5 As the First Tenant did not claim the Sum as deductible expense for tax purposes, there would be an element of 'double taxation'.

The concept of double taxation only exists in respect of a single taxpayer, and not between two taxpayers. Furthermore, as Miss Chan pointed out, we are not concerned with the deductibility of the payment of the Sum, but only with the accessibility of its receipt. These two matters are governed by separate sections of the Inland Revenue Ordinance. There is therefore no question of double taxation in the present case.

Conclusion

35. It follows that this appeal is dismissed and the profits tax assessment for the year of assessment 1992/93 under appeal is hereby confirmed.