

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D180/98

**Profit Tax** – acquisition and sale of property – intention at time of purchase – change of intention after purchase – date of change of intention – burden of proof on purchaser – whether tax chargeable upon revaluation of property – section 68(4) of the Inland Revenue Ordinance.

Panel: Robert Wei Wen Nam SC (chairman), Douglas C Oxley and Yu Yui Chiu.

Dates of hearing: 30 October, 10, 11, 12, 19 November and 3 December 1998.

Date of decision: 31 March 1999.

On 19 February 1982, Mr B and Mr C acquired Company A for the purpose of using it as a vehicle for dealing in the units of a building to be constructed in District D. On 5 March 1982 the building was purchased for a consideration of \$17,589,384.5. Construction was expected to be completed before 31 March 1983.

By pre-sales, Company A sold all the units of the building except the ground floor shops and first floor office units. After failed attempts to sell the remaining units, Company A sold some its units to Mr B. On 1 March 1983, Company A took out the assignment of its remaining units, namely 1 shop unit and 3 flat units on the first floor (collectively referred to as 'Property 1').

Property 1 was classified as 'trading properties' under 'current assets' in the audited accounts for the year ended 30 April 1983 up to and including the year ended 30 April 1990. From 1 May 1990 to 31 March 1991, Property 1 was reclassified as 'fixed assets' in the audited accounts and was revalued at \$11,000,000 on 31 July 1991.

The issue before the Board was the date when Company A changed its intention from that of selling the units at a profit to that of holding them as long-term investments (fixed assets). Company A's case was that the intention changed on 1 March 1983 while the Revenue contends that it took place on 31 July 1991, the date of the revaluation.

**Held** by the Board, after hearing the evidence:

- (1) Company A had the burden of convincing the Board that the classification of Property 1 as 'trading properties' in its own audited accounts for 8 years was a mistake. Evidence to substantiate this mistake must be given in the strongest terms (Chinachem Investment Company Ltd v CIR 2 HKTC 261, 273 applied);

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- (2) A long-term investment is a capital asset and not a trading asset. Profits arising from the sale of a capital asset is not taxable while profit arising from the sale of a trading asset is taxable. It is not possible for an asset to be both trading stock and a long term investment. Trading requires an intention to trade (Lionel Simmons v CIR 53 TC 461, 491 per Lord Wilberforce);
- (3) The stated intention of the taxpayers, although of great weight, is not decisive but must be viewed in the light of the whole of the surrounding circumstances (All Best Wishes Limited v CIR 3 HKTC 750, 771 per Mortimer J, followed);
- (4) Examination of the evidence in this case led to the inference that, until 31 March 1991, Company A did not have a firm intention to hold Property 1 as 'fixed assets';
- (5) Accordingly, Company A had failed to discharge its burden of proof under section 68(4) of the IRO;
- (6) The revaluation of Property 1 on 31 July 1991 at a value of \$11,000,000 would be taken as its market value of as at 31 March 1991 for the purposes of calculating Company A's profit (Sharkey v Wernher [1956] AC 58 applied).

### **Appeal dismissed.**

Cases referred to:

Lionel Simmons Properties Ltd v CIR 53 TC 461  
Sharkey v Wernher [1956] AC 58  
All Best Wishes Ltd v CIR 3 HKTC 750  
Chinachem Investment Company Ltd v CIR 2 HKTC 261

Ma Wai Fong for the Commissioner of Inland Revenue.  
Patrick Kwong of Messrs Ernst & Young for the taxpayer.

### **Decision:**

### **Nature of the appeal**

1. This is an appeal by a private limited company (Company A) against the additional profits tax assessment for the year of assessment 1990/91 and the profits tax assessment for the year of assessment 1991/92 raised on it as revised by the Commissioner of Inland Revenue in his determination dated 28 November 1997.

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2. Company A claims that it has held certain properties (collectively Property 1) as long-term investment for rental income since 1 March 1983, that the notional gains resulting from the revaluation of Property 1 on 31 July 1991 are non-taxable capital gains and that rebuilding allowance should be granted in respect of Property 1 for the year of assessment 1990/91.

### **Agreed facts**

3. Company A was incorporated as a private company with limited liability in Hong Kong on 30 January 1981. It commenced business in February 1982.

4. On 19 February 1982, a Mr B and a Mr C acquired Company A in equal shares for the purpose of using it as a vehicle for dealing in the units of a building in District D (the Building). At that time, the issued and paid up share capital of Company A was \$20. On 10 December 1983, Company A allotted 998 shares of \$10 each to Mr C. Mr C then became the majority shareholder of Company A.

5. Company A described its nature of business in the profits tax returns as follows:

<b>Years of assessment</b>	<b>Nature of business</b>
1983/84 to 1988/89 inclusive	Property trading
1989/90 and 1990/91	Property trading and investment
1991/92	Property investment

6. Company A's ultimate holding company is Company E, a company listed in the Hong Kong Stock Exchange since October 1991.

7. Mr C was the sole proprietor of Company E1, whose business was subsequently taken up by Company E. Company E1 is a subsidiary of Company E (hereinafter referred to collectively as Company E).

8. By agreement dated 5 March 1982 (the Agreement) Company A purchased the Building at a price of \$17,589,384.50. At the time of purchase, the Building was still under construction. According to the Agreement, the Building was to be built as a 16-storey building consisting of shops on ground floor, offices on first floor and 80 domestic units on second to fifteenth floors. The construction of the Building was expected to be completed on or before 31 March 1983.

9. By sub-sale, Company A sold all the units of the Building except a shop unit on the ground floor and 3 flat units on the first floor before the construction was completed. The profits derived from the sub-sales were offered for assessment in the profits tax return for the year of assessment 1983/84.

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10. Company A took out the assignment for shop unit on the ground floor and 3 flat units on the first floor of the Building (collectively Property 1) on 1 March 1983. Property 1 was shown as trading properties under current assets in the accounts for the year ended 30 April 1983 and the years thereafter up to 30 April 1990 inclusively.

11. Property 1 has been occupied by Company E since August 1983.

12. On 7 November 1988, Company A purchased 2 office units on the 10<sup>th</sup> floor of a building in District F (Property 2) at a price of \$2,000,000. Property 2 was shown as trading properties in the accounts for the year ended 30 April 1989. Property 2 was sold in May 1989. The profits on sale were offered for assessment in the profits tax return for the year of assessment 1990/91.

13. The assessor raised on Company A the following profits tax assessment for the year of assessment 1990/91 per return submitted:

(Basis period: year ended 30 April 1990)

Assessable profits	<u>\$1,127,463</u>
Tax payable thereon	<u>\$186,031</u>

Company A did not object against the profits tax assessment for the year of assessment 1990/91.

14. Company A failed to submit its profits tax return for the year of assessment 1991/92 within the stipulated time. The assessor raised on Company A the following profits tax assessment for the year of assessment 1991/92 in the absence of the return:

Estimated assessable profits	<u>\$1,410,000</u>
Tax payable thereon	<u>\$232,650</u>

15. Messrs Ernst & Young (the Representatives), on behalf of Company A, objected against the assessment for the year of assessment 1991/92 claiming that the assessment was excessive and not in accordance with the actual result of Company A during the year.

16. It was stated in the revised profits tax computation for the year of assessment 1990/91 that:

‘[Company A] changed its accounting year-end dated from 30 April to 31 March in order to conform with the financial year-end date of its holding company for the purposes of obtaining a floatation on the Hong Kong Stock Exchange.’

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17. In the accounts for the period from 1 May 1990 to 31 March 1991, Property 1 was shown as fixed assets at a valuation of \$11,000,000. In the notes to accounts, it was stated that:

‘The leasehold land and properties, previously treated as trading properties, have been classified as fixed assets on the basis of [Company A’s] intention to hold the leasehold land and properties on a long-term basis. No depreciation is provided in respect of the properties since the directors’ valuation takes into account the state of the properties.

The valuation of the leasehold land and properties was carried out by Company G, a professional valuer, as at 31 July 1991 on an open market basis which, in the opinion of the directors, approximated their value as at 31 March 1991.’

18. Company E had engaged Company G to conduct a valuation of Property 1. On 4 October 1991, Company G issued a valuation report in respect of the open market value of Property 1 as at 31 July 1991.

19. The assessor raised on Company A the following additional profits tax assessment for the year of assessment 1990/91:

(Basis period: 1 May 1990 – 31 March 1991)

Profits per revised tax computation	\$1,200,201
Add: Revaluation surplus for Property 1 \$(11,000,000 – 3,028,655)	<u>7,971,345</u>
	\$9,171,546
Less: Profits already assessed	<u>1,127,463</u>
Additional assessable profits	<u>\$8,044,083</u>
Additional tax payable thereon	<u>\$1,327,274</u>

20. Company A, through the Representatives, objected against the additional profits tax assessment for the year of assessment 1990/91 on the ground of excessiveness.

### Further facts not in dispute

21. The assessor proposes to revise the additional profits tax assessment for the year of assessment 1990/91 and the profits tax assessment for the year of assessment 1991/92 as follows:

#### Year of assessment 1990/91

	\$
Assessable profits before rebuilding allowance per revised tax computation	1,230,488

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<u>Less: Profits already assessed</u>	<u>1,127,463</u>
Additional assessable profits	<u>103,025</u>
Additional tax payable thereon	<u>16,999</u>
<b>Year of assessment 1991/92</b>	
	\$
Profits per return	307,236
Add: Revaluation surplus of Property 1 (\$11,000,000 - \$3,028,655)	<u>7,971,345</u>
Assessable profits	<u>8,278,581</u>
Tax payable thereon	<u>1,365,965</u>

22. On 28 November 1997, the Commissioner of Inland Revenue determined the objection by revising the additional profits tax assessment for the year of assessment 1990/91 and the profits tax assessment for the year of assessment 1991/92 as shown in paragraph 21 above.

### **Grounds of appeal**

23. Company A appeals against the assessments as revised. Its grounds of appeal are principally to the following effect.

- 23.1 Company A has held Property 1 as long-term investment for rental income since 1 March 1983 and there has been no change of such an intention since then or on 31 July 1991. Therefore, the notional gains resulting from the revaluation of Property 1 on 31 July 1991 were non-taxable capital gains.
- 23.2 Property 1 was held for long-term investment for rental income since March 1983. Therefore rebuilding allowance should be granted in respect of Property 1 for the year of assessment 1990/91.
- 23.3 The Commissioner incorrectly concluded that Property 1 was held as trading stock before 31 July 1991 and that Company A only changed its intention to that of holding Property 1 as its capital asset on 31 July 1991. He incorrectly applied the principle of Sharkey v Wernher and assessed the notional gains on the basis of the market value as at 31 July 1991.
- 23.4 The Commissioner placed too much significance on the classification of Property 1 as 'current assets – trading properties' in Company A's

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accounts for the years up to and including the year ended 30 April 1990.

- 23.5 The Commissioner incorrectly concluded that Company A had changed its intention to that of holding Property 1 as its capital asset on 31 July 1991 in that he has taken into account the facts that Company A appointed a professional valuer to conduct an independent valuation of Property 1 as at 31 July 1991 and that Company A adopted the market value of Property 1 advised by the professional valuer in its accounts for the period from 1 May 1990 to 31 March 1991. However the valuation was carried out for the purpose of the listing of Company E, Company A's ultimate holding company in the Hong Kong Stock Exchange in October 1991. Correspondence between Company E and the valuer was copied to the parties involved in the floatation exercise including Ernst & Young, the auditors and reporting accountants. The valuation report was included in the prospectus of Company E. Therefore, the valuation of Property 1 has no relation to the intention of Company A.
- 23.6 The Commissioner failed to take into account the fact that Property 1 had been held by Company A since 1983 for letting to the related company as office. There was no change in the use of Property 1 from 1983 to 1991 and Property 1 continued to be used as the office of Company E after the flotation in the Hong Kong Stock Exchange in October 1991.
- 23.7 The Commissioner failed to give sufficient regard to the audited accounts for the period from 1 May 1987 to 31 March 1988 which was prepared for an intended listing in 1988. Property 1 was classified as 'fixed assets' and the auditors' report is the only unqualified report for the accounts for the period from 1983 to 1990.
- 23.8 The Commissioner failed to recognize that Property 1 was adjacent units intended to be used as the new office of the related company when the tenancy agreement of the then existing office expired in late 1983. The adjacent units were intentionally held not for sale in 1983 and Company A itself took out the assignment.
- 23.9 The Commissioner failed to recognize that the classification of Property 1 as 'fixed assets' in the accounts for the period from 1 May 1990 to 31 March 1991 is to reflect Company A's intention to hold Property 1 on a long-term basis. Such a classification was to correct the mistake of classifying Property 1 as 'current assets – trading properties' in the accounts of the previous years and was consistent with the classification in the accounts for the period from 1 May 1987

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to 31 March 1988 prepared by the same auditors in November 1988 (Ernst & Whinney later merged with Arthur Young to form Ernst & Young).

- 23.10 The Commissioner failed to take into account the fact that Company A had no financial difficulty in holding Property 1 for long-term purpose.

### **Parties and witnesses at the hearing**

24. At the hearing of this appeal, Company A was represented by Mr Patrick Kwong (the Representative) of Messrs Ernst & Young, certified public accountants, while the Commissioner of Inland Revenue was represented by Miss Ma Wai-fong, senior assessor. Mr Cheung and three other witnesses gave evidence for the Taxpayer.

### **Testimony of witness**

25. The testimony of the first witness, Mr C, may be summarised as follows:

In chief

- 25.1 Graduate of primary school. He had worked in construction industry for more than 30 years.
- 25.2 Since 1982 He has been a director of Company A. In 1982 and 1983 Mr B and he each owned 50% of the issued share capital.
- 25.3 In March 1982, Company A signed sale and purchase agreement to purchase the Building in question in District D with shops on ground floor, offices on first floor and domestic units on upper floors (Property 1). It was still under construction. It was to be completed in 2 or 3 months.
- 25.4 After purchase, they sold the upper floors. He wanted to sell the ground floor for months, but no one wanted to buy. The ground floor shops and the first floor commercial units could not be sold.
- 25.5 He paid for the whole building. When the date of completion was approaching, he sold 3 shop units to Mr B, while keeping 1 shop unit as well as 3 office units on the first floor.
- 25.6 There is a staircase leading from the remaining shop unit on the ground floor to the upper floor (witness pointing to a spiral staircase in a photograph).



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- 25.7 He used Property 1 as an office because it is too troublesome to sell it. He got another office in District H, but he still kept this property so that construction workers or workers doing the decorations can go direct into his office without passing through other people's premises. The workers are not dressed properly and are dirty from work.
- 25.8 Apart from Company A, he did construction, entertainment and flotation.
- 25.9 Construction workers come to Property 1 to get their wages. The ground and first floors of Property 1 were difficult to sell. Since his old office was in District D, he should have his new office also in District D. The tenancy agreement for the old office was expiring.
- 25.10 In 1982 and 1983, Mr B, his partner was responsible for keeping the books of account. Mr CT Chow was the auditor for 1982 and 1983. Mr B appointed him. They continued to appoint Mr Chow as auditor for the years 1984 to 1990.
- 25.11 He knew Mr Chow's father. He came to know Mr Chow on a social occasion.
- 25.12 He never discussed accounting matters with Mr Chow. He was not responsible for the accounts. Mr B and the accountant could handle it. Mr B left after they had paid tax to the government; it is 10 years ago.
- 25.13 He seldom saw Mr Chow the son. Sometimes they did not see each other for more than 2 or 3 years. Mr Chow did not enquire with him about his intentions towards Property 1. Nor did he tell Mr Chow about his intentions.
- 25.14 He did not know how Property 1 was classified in the accounts. He only knew that if he purchases property and sells it within 7 years, he has to pay tax.
- 25.15 He let Property 1 to his own company, Company E1. Both that company and Company A were entirely owned by him. He still owned Property 1. He cannot sell it, because, if he changed address, it would be inconvenient for the public to buy the entertainment tickets, for the workers to get the wages and for the Government to send letters.
- 25.16 In 1988, Company A bought two offices on the 10<sup>th</sup> floor of a building in District H (Property 2) from a Mr I and his younger sister. Mr I and he were partners in the laser-video business. He was a tenant of a unit on the 12<sup>th</sup> floor. Since it was too small, and Mr I wanted to sell the 2

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units on the 10<sup>th</sup> floor, he bought the two 10<sup>th</sup> floor units, intending to let them to the laser-video and computer animation business. He had an interest in that business, while Mr I was a majority owner of the business.

- 25.17 In May 1989, he sold Property 2 for lack of space. He could not let it, because it was too small. So he sold it, and moved to District J.
- 25.18 He does not know how Property 2 was treated in Company A's ledgers.
- 25.19 Neither Mr Chow nor any other auditor asked him about his intentions towards Property 2.
- 25.20 He did not object to the tax assessment on the profits from the sale of Property 2 because he knows that, if he sells a property within 7 years (of the purchase), he has to pay tax. Many people know that, many people said that. Mr Chow did not tell him that. He heard about it because many people in society said this. He did not discuss it with many other people but since it is common knowledge in the sense that many people knew this rule, so he knows it because he lives in Hong Kong and he knows he has to pay tax if he sells a property within 7 years. Even though he sell a property after 7 years, the Revenue did not ask him for any tax. He has to pay tax within 7 years.
- 25.21 Right now people tell him that the rule has been changed to 2 years instead of 7 years. He heard this recently. He is not sure whether this is true or not. He heard people discuss these kind of matters on social occasions.
- 25.22 Before he signed any accounts or tax returns, he would ask the accountants whether he had made a profit or not. If the amount of the profit is correct, then he will sign his name. The accountant did not say this was because of the 7 year rule or the 2 year rule.
- 25.23 Company A made a revaluation of Property 1 as at 1 July 1991 because they wanted to list Company E on the Hong Kong Stock Exchange, and Company A was going to be a member of Company E.
- 25.24 Apart from using Property 1 as head office of Company E he had no intention of using the premises for other purpose. For use by Company E1 and Company E2. They are two separate companies. They are in the same address and have the same boss, same owner.
- 25.25 In late 1983 he owned 999 out of 1000 shares of Company A and was effectively the sole owner of Company A. Since then he has been the

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sole decision maker of Company A. The other director Mr K is his son. Mr K did not do anything. He would sign the audited accounts first. His son also signed the accounts. Everytime two signatures are required for the accounts. Mr K did not ask any questions on the accounts before he signed because the accountants did the accounts.

- 25.26 Accounts for the years ended 30 April 1983, 1984 and 1985 were signed by him and Mr B. When they bought it, he owned 50% and Mr B the other 50%. Mr B signed the 1983 accounts first. He did not ask Mr B any questions on the accounts. At that stage Mr B and he were still 50 and 50 as to ownership. He cannot remember whether he or Mr B was the first to sign the 1984 and 1985 accounts. He cannot remember when Mr B divested himself of his 50%. As for the 1984 and 1985 accounts, he and Mr B did not ask each other any questions on the accounts before they signed the accounts.
- 25.27 In March 1983, he and Mr B reached agreement on the unsold units of the ground and first floors of Property 1 after the sale of all the residential units on the upper floors. 3 units on the ground floor were sold to Mr B, while he got the remaining unit on the ground and all the 3 units on the first floor. He used them as his head office.
- 25.28 At that time he consulted a fung shui master and was told that the remaining shop unit on ground floor and the first floor were particularly good for his business. The fung shui of this shop unit would be the best for construction and entertainment companies.
- 25.29 He took conveyance of the shop on the ground floor and the 3 units on the first floor by one deed of assignment because it was for his own purposes.
- 25.30 Before Company E moved into Property 1 in 1983, they did decoration work. They decorated the shop on the ground floor and built a staircase leading from the ground floor to the first floor.
- 25.31 As for Property 2, he rented the 12<sup>th</sup> floor for the business. Later he bought the 10<sup>th</sup> floor. Because the tenure was only one year. That was the primary reason for Company A to acquire Property 2.
- 25.32 After he bought out Mr B in late 1983, Company A's scope of business from 1984 to 1992 was construction. It was for property investment. Company A did not undertake any other business activities from 1984 to 1992.

In cross-examination

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- 25.33 He agreed that he signed the directors' report for the year ended 30 April 1983 as chairman of Company A on 31 December 1983. As to why he testified (see paragraph 25.26 above) that at the time he signed the 1983 accounts (that is, on 31 December 1983), he and Mr B still owned 50 and 50 shares of Company A, he explained that he did not read the accounts because he cannot read English, so when Mr B asked him to sign, he signed.
- 25.34 He is still chairman of Company A. He is also a director of Company E1 and Company E2. He is also chairman of the board of directors of those companies.
- 25.35 He agreed that he signed on behalf of Company A the Agreement for the sale and purchase of the Building in question. He cannot remember clause 5 relating to date of completion. It was so long ago and he cannot read English.
- 25.36 He was referred to clause 16 of the Agreement regarding consequences of failure by the purchaser to complete, he agreed that if he could not complete the transaction, the deposit would of course be forfeited.
- 25.37 He was referred to the Representatives' letter to the Inland Revenue Department dated 16 November 1993 in which it was asserted that in March 1983, Company A had changed its intentions towards Property 1 from an intention of holding it as trading stock to one of holding it as a long-term investment. He was asked whether there were any directors' minutes recording such change of intention. He stated that when he bought the 4 units, he knew that he would hold them for long-term purposes because he was told by the fung shui master that it was good for him. That is why he did it with one deed of assignment only. If his intention was to sell, then he would have done it in 4 deeds of assignment. He spent more money when he did it in one deed of assignment. It would be more difficult to sell with just one deed.
- 25.38 Whether there was any formal rental agreement between Company A and Company E is a matter between the accountants. He only knew that Company E paid rent to Company A. When Company A received the rent from Company E, Company A would issue something in writing. Everytime Company E pays the rent by cheque.
- 25.39 About the decoration made to the ground and first floors, he could not remember how much it was; it was over a decade ago. Nor could he remember whether the decoration expenses were incurred by Company A.

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- 25.40 The photographs showing the staircase from the shop on the ground floor to the first floor and the lift lobby and an entrance to one of the flats on the first floor, all these photographs were taken in 1998. The fung shui master told him the things which should be put in each corner, so everything is the same since 1983.
- 25.41 He was referred to the Chinese ledger accounts of 'acquired properties' for the relevant years in Company A's accounts. He stated that he did not look into the accounts. The accountants do their job. As for the words 'trading properties at cost' written in English in the upper left corner of page 76 for the year 1984, he did not know who wrote the words. He did not buy Property 1 for trading. Otherwise he would buy in 4 deeds of assignment because it would be much more convenient and easier to sell the units.
- 25.42 As for Company A's accounts, they had accountants to do the accounts and audit the accounts. Then they asked him to sign. Company A is a company only for property investment. He only knew there was a profit when he signed.
- [Mr Kwong concedes that all signatures purporting to be the signatures of Mr C in all the audited accounts and tax returns before the Board are the signatures of Mr C.]
- 25.43 By accountants he meant the bookkeepers in Company A, two sisters. At first it was the elder Ms L, and later it was the other sister who kept the accounts of Company A.
- 25.44 When they prepared a draft statement of account, the professional accountants would audit the accounts. The two sisters were responsible for the books of account. He did not examine the draft statement of account and balance sheet before they were sent for audit.
- 25.45 The auditors did not raise any queries about the accounts for 1983 to 1987.
- 25.46 He was referred to the auditors' report for the year ended 30 April 1984 and to the 2<sup>nd</sup> paragraph thereof: 'Value of trading properties was stated at cost instead of at the lower of cost and net realisable value,' and the 4<sup>th</sup> line: 'The directors of the company were of the opinion that the net realisable value of trading properties would not be lower than cost.' He agreed that the reference to the directors of the company includes himself, but stated that he had not read it before and no one

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explained it to him. Maybe the auditor asked Mr B about the value of the trading properties, but the auditor did not ask him.

- 25.47 He was referred to the auditors' reports for 1985, 1986 and 1987 and to the same auditors' comments in those reports about the value of the trading properties of the company. He stated that he never asked the auditors about the auditors' comments, because he had bought Property 1 in 1983 and had bought it for his own purpose, not for trading. He does not know what the auditors wrote in the auditors' report because they did not explain it to him.
- 25.48 He was referred to Company A's annual return made up to 30 May 1987 and was asked whether Mr B transferred his one share to Mr K on 30 August 1986. He stated that there was such a transaction but he could not remember the date.
- 25.49 The balance sheet of Company A as at 30 April 1987 was signed by two directors, that is, himself and Mr K. Mr B did not sign because he had transferred his one share and was no longer a director.
- 25.50 He did not notice that in the balance sheet as at 30 April 1987, Property 1 was classified under 'current assets, trading properties at cost'. When he bought Property 1 he finished all the transactions in the law firms and he did not care about anything after that.
- 25.51 When asked whether he had noticed that Property 1 was classified as trading properties at cost when he was signing the balance sheet, he stated that he bought property 1 for his own use, for use as a head office. How the accountants put it, he did not know.
- 25.52 The balance sheet as at 30 April 1985 was signed by him and Mr B. He cannot read English and he did not know about the accounting things. He just knew that he bought Property 1 for his own use. The accountants did not explain to him. Mr B put his signature first. He (Mr C) looked at the figure and it was not making a loss, so he did not ask for explanation.
- 25.53 He did not notice that in the balance sheet as at 30 April 1984, Property1, that is, the shop unit on the ground floor and the whole of first floor of the Building, was classified as trading properties under current assets, at the time when he signed it. Mr B also signed it. He did not notice it because he does not know English. Neither the professional accountant nor his company's accountant explained it to him. Nor did he ask his company's accountant or the auditor about the

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classification of Property 1 before he signed, because he knew Property 1 was for his own use.

- 25.54 He did not notice that Property 1 was classified as trading properties under current assets in the balance sheet as at 30 April 1983 before he signed it. He did not ask the company's accountant about the classification of Property 1 before he signed. He thought that Property 1 was for his own use, not for sale, so he did not think it necessary to ask the company's accountant. Nor did he ask the auditor about the classification before signing. They did not ask him and he did not ask them because he thought it was not necessary.
- 25.55 It was put to him that he did not ask his auditors or the company's accountant about the classification of Property 1 for the accounts for 1983 to 1987 because Property 1 was correctly classified as trading properties. He stated that if he was to sell Property 1, he would put the units into 4 deeds instead of one.
- 25.56 No decoration expenses were charged to Company A's account for the year ended 30 April 1984, because the decoration expenses is the responsibility of Company E1 and Company E2. He did not know that at the time.
- 25.57 He consulted the fung shui master about the whole building because he bought the whole building. The consultation of the fung shui master was never mentioned in Company A's correspondence with the Inland Revenue Department because he thought it was not necessary to tell them about it. It is necessary for him to mention it now because it is necessary to tell them that he bought Property 1 for his own use and not for sale.
- 25.58 He was referred to the accounts for the 11 months from 1 May 1987 to 31 March 1988 audited by Ernst and Whinney and to Ernst and Young the Representatives' letter dated 16 November 1993 to the Inland Revenue Department. The last paragraph at page 2 of the letter reads:

'Company A's audited accounts for the period ended 31 March 1988 were prepared for consolidation into group accounts for flotation purpose. Therefore extra care was taken to ensure that the accounts gave a true and fair view of Company A's financial position so that the responsibilities as a reporting accountant could be discharged. The reporting accountant with the confirmation from the management of Company A formed the opinion that the property concerned has been held as the company's fixed assets since 1 March 1983. Accordingly the auditor has reclassified the

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property from trading stock to fixed asset to reflect the actual nature of the property in the accounts for the period ended 31 March 1988.'

- 25.59 He did not read this letter. No one told him. To this day he has not read it.
- 25.60 At that moment the financial consultant was employed for listing purposes and he (Mr C) was not sure whether it would be successful or not. They asked Ernst & Whinney to do the whole account.
- 25.61 At that time he saw the owner of Ernst & Whinney. He has died.
- 25.62 He was referred to Company A's balance sheet as at 31 March 1988. The company's accountant did not explain to him before he signed it. The accountant of Ernst & Whinney explained the matter to the company accountant Miss L but not him. He did not notice that Property 1 was classified as fixed assets when he signed it. He had not noticed it since 1983.
- 25.63 When asked whether he instructed the company's accountant to send the accounts for the year ended 31 March 1988 audited by Ernst & Whinney to the Inland Revenue Department, he stated that he did not instruct the accountant to do anything.
- 25.64 It was pointed out to him (and Mr Kwong conceded) that the first time the Inland Revenue Department was provided with the accounts audited by Ernst & Whinney was when Ernst & Young enclosed them with their letter dated 5 May 1993 to the Commissioner. (The letter contained a paragraph almost identical in terms with a paragraph in their letter dated 16 November 1993 to the Inland Revenue Department (see paragraph 25.58 above which reproduces the paragraph).)
- 25.65 It was put to Mr C that Company A did not submit to the Inland Revenue Department the accounts audited by Ernst & Whinney earlier than they did because Company A did not have a fixed intention to hold Property 1 as a fixed asset in 1988. Mr C stated that since 1983 until now he did not know how the accountant classified Property 1. He thought it was for his own use.
- 25.66 He was referred to the accounts for the year ended 30 April 1988 audited by Wong Brothers. He agreed that he and Mr K signed the balance sheet as at 30 April 1988 on 28 April 1989. He was referred to the second paragraph of the auditors' report, which reads:



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‘The value of trading properties was stated at cost instead of at the lower of cost and net realisable value as required by the Statement of Standard Accounting Practice No 3 issued by the Hong Kong Society of Accountants. The directors of the company are of the opinion that the respective net realisable values of trading properties will not be lower than cost.’

- 25.67 When asked whether the auditor asked him about the value of the trading properties, he stated that since 1983 when he bought Property 1 for his own use, he had not noticed whether the market value of Property 1 has increased or not. It is not necessary to do a valuation because he did not want to sell it. He did not notice what Property 1 was classified to be in 1983 and he has not noticed it since then. He just asked his accountant if he had made a profit. If he did, he would sign it. If he did not make a profit, then he would ask his accountant.
- 25.68 He was referred to the balance sheets as at 30 April 1989 and 1990. When asked whether, when he signed them, he noticed that Property 1 was classified as trading properties under current asset, he stated that since 1983 he has not noticed it because he does not know what is fixed asset in English.
- 25.69 He was shown the profits tax return for year of assessment 1990/91, and he agreed that he signed it on 8 May 1991. It was put to him that Company A did not have a firm intention to hold Property 1 as a fixed asset since it was acquired in 1982 up to 8 May 1991. He stated that he was not sure about the classification in the accounts. From his point of view, he got an idea that it is a fixed asset. He does not know how the accountant classified it in English. He thinks it is a fixed asset. If it is not a fixed asset, he got a problem.
- 25.70 He was referred to the assignment of 2 flat units on the 10<sup>th</sup> floor of Property 2 to Company A on 7 November 1998. He said that he rented the 12<sup>th</sup> floor of that building. His partner wanted to sell the property on the 10<sup>th</sup> floor, so he bought it from his partner, and moved from the 12<sup>th</sup> floor to the 10<sup>th</sup> floor, and he let it to the laser video company. The tenancy agreement of the 12<sup>th</sup> floor had not expired when he purchased the 10<sup>th</sup> floor. Company A bought the 10<sup>th</sup> floor and let it to the laser video entertainment company which was using the 12<sup>th</sup> floor and in fact never moved to the 10<sup>th</sup> floor. So Company A never charged the laser video company any rent for the 10<sup>th</sup> floor.
- 25.71 He was referred to the balance sheet as at 30 April 1989 and the classification of Property 2 as trading properties under current assets. He stated that he did not notice that when he signed the balance sheet.

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Nor did he ask the company's accountant or the auditor about the classification before he signed the balance sheet.

- 25.72 He was referred to the profit and loss account for the year ended 30 April 1990. When asked whether he had noticed that the profit on sale of Property 2 was treated as trading profit in the profit and loss account, he stated that since he was not an accountant, he did not know how the accountant kept the account.
- 25.73 It was put to him that Property 2, like Property 1, were acquired by Company A for trading purposes. His answer was that it was not for trading purposes but for use by Company A.
- 25.74 Property 2 was bought with decoration, so Company A did not do any decoration itself. They later sold it because the space was not enough. He knew the space was not enough before he moved to the 10<sup>th</sup> floor. When they purchased it, he did not know the space was not enough because his partner did not tell him. Two months after the purchase, he noticed that the space was not enough. He knew the space was enough when he bought it, but, after several months, it became too small. Initially it only had about 7 or 8 staff, but later it expanded to about 30 to 40 staff, because there were many companies, the laser video and related companies, distribution rights for laser video, movies.
- 25.75 He was referred to Company A's audited accounts for the period from 1 May 1990 to 31 March 1991, with the directors' report signed by him on 30 September 1991, and the balance sheet with the comparative figures as at 30 April 1990. He was more particularly referred to the value of fixed assets being increased from zero under the 30 April 1990 column to \$11,000,000 under the 31 March 1991 column and the value of trading properties decreased from \$3,000,000 something under the 30 April 1990 column to zero under the 31 March 1991 column. When asked whether the trading properties referred to Property 1, he stated that he did not read it. Neither the company accountant nor the professional accountant told him because he did not sell the property.
- 25.76 He was referred to Note 5 of the Notes to Financial Statements which states:
- 'The leasehold land and properties previously treated as trading properties have been classified as fixed assets on the basis of the company's intention to hold the leasehold land and properties on a long-term basis ...

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The valuation of the leasehold land and properties was carried out by ... a professional valuer as at 31 July 1991 ...'

His response was that since 1983 he has thought that the property is a fixed asset instead of trading property.

25.77 It was put to him that only from 31 July 1991 onwards has Company A had the firm intention to use Property 1 on a long-term basis. His response was that he did not realise that it was reclassified until now.

26. The testimony of the second witness, Mr Chow, may be summarised as follows:

In chief

26.1 From the date of incorporation of Company A on 30 January 1981 up to 30 April 1990, he was the auditor of that company, and signed the auditors' report each period or year under the respective firm names of Chow & Co, then W Brother, then H & H and finally back to W Brothers again.

[Parties agreed that all accounts for the above period were signed by Mr Chow as auditor.]

26.2 He was first approached by Mr B and through Mr B he got appointed as auditor of Company A.

26.3 To the best of his recollection, for the first couple of years, Mr B handed over to him the books of account for audit. He knew Mr B first. Mr C was introduced to him by Mr B.

26.4 He was also the auditor of Company M which was initially owned by Mr B and Mr C, but later Mr C bought Mr B out.

26.5 From 1981 to 1992, Company M's business was property investment. Both companies were engaged in property investment.

26.6 By property investment, he meant that they engaged in purchasing properties and probably they would hold some of the properties for rental income or for medium to long term purpose.

26.7 He was auditor of Company M most probably for the same period as Company A.

26.8 Company N was another company previously audited by him and it was connected with Mr B as well.

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- 26.9 He was not auditor of Company E1 or Company E2. His professional relationship with Mr C was restricted to being the auditors Company A and Company M from 1982 to 1990.
- 26.10 Since he became the auditor of Company A, he has met Mr C face to face at the most once or twice. The first time was around 1982/83 at a lunch also attended by Mr B. The second time was about 1986 when Mr C arranged for artists to come to Hong Kong to do a show. During those two meetings he did not discuss normal accounting matters with Mr C. At the first time, he discussed with Mr C the matter of late reporting of income of one of the two companies, but he cannot remember which.
- 26.11 He was referred to the accounts of Company A (for the period from 30 January 1981 (date of incorporation) to 30 April 1982) and the balance sheet as at 30 April 1982 and the item 'deposits on trading properties' of \$3,517,876. He stated that that was the property in District D, the only property held by the company at the time. Most likely, that was the deposit on that property.
- 26.12 He was referred to the balance sheet as at 30 April 1983 and the item, trading properties, of \$2,927,565. When asked whether he enquired with Mr C about his intention towards this trading property, his answer was that Mr C gave him no indication on that. He never discussed personally with Mr C any accounting matters relating to this company or the other company. Most likely he enquired with Mr B when he classified the unsold units as trading properties in the accounts, in the balance sheet as at 30 April 1983, but he cannot remember exactly in what manner he made the enquiry.
- 26.13 He signed the 1983 accounts in January 1984. At that time, he did not know the shareholdings of Mr B and Mr C. Shortly thereafter, he became aware that Mr C had bought Mr B out.
- 26.14 He was shown the balance sheet as at 30 April 1984. He agreed that he continued to classify the unsold units as trading properties and that he signed the auditors' report on 29 April 1985. By then he knew that Mr C effectively became the 100% owner of Company A. Regarding the classification of the trading units he did not enquire of Mr C about his intention towards the properties referred to in the balance sheet. By then Mr B had already expressed that he had washed his hands. From 1984 to 1990, he continued to classify the properties as trading properties, and the same classification went on year after year. He has

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not personally enquired of Mr C about his intentions towards Property 1.

26.15 When he reviewed the file, he found that the company was deriving rental income from the trading property, then he raised a query. It would be in 1985 if that was the first year the company received rental. He would raise audit queries through his audit staff with his clients. His staff would put his advice to the lay client that the property should be reclassified from trading properties to fixed assets, but that, if they decided to do so, they might have to take the consequence of the Inland Revenue Department charging the difference between the cost and the market value of the property at the time of the change of intention. He wrote it down in his audit query and asked his staff to clear that. The staff in question was Ms O. After she checked with the client she wrote the clearance on the review form. It was to the effect that the property was not going to be reclassified and that the client did not take his advice. He believed that Ms O contacted a Ms P of Company A, but he could not be sure.

26.16 He was referred to the qualification in the auditors' report in Company A's accounts from 1984 to 1988 relating to the valuation of the trading properties. [The parties agreed that Mr Chow's evidence in respect of the qualification should apply to all the relevant years.] The 2<sup>nd</sup> paragraph, the 2<sup>nd</sup> sentence of the report reads:

‘The directors of the company were of the opinion that the net realisable value of trading properties would not be lower than cost.’

He stated that he would make a recommendation that Property 1 should be reclassified. If he received a negative answer, then the next issue raised would be that the client had to do a valuation of the property as trading stock and that without a valuation, he might have to qualify the audit report. Before he released the accounts, the client was required to sign a letter of representation to him stating all the important matters relating to the accounts. In fact, in the standard letter of representation there was a specific sentence saying that in the directors' opinion, the stock is worth no less than cost. In this case, definitely the directors gave this information because the auditors must receive the signed letter of representation before they would release the accounts. The letter of representation, in the standard format as recommended by the Hong Kong Society of Accountants, was sent together with a full set of accounts for the client's signature. The client might send for the accounts, or the auditors' firm would deliver by hand or send by post.

In cross-examination

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- 26.17 Not too many clients give the auditors anything beyond a trial balance, a draft balance sheet and profit and loss account when they send over their books and records for audit. He could not say for sure in Company A's case.
- 26.18 He was referred to Company A's profit and loss account for the year ended 30 April 1983 and the gross profit of \$5,943,927, and was asked to state the basis on which the profit was classified as trading profit rather than as extraordinary gain. His answer was that first of all he would see whether there was a case for establishing the profit as exceptional gain. If he saw insufficient grounds for so doing, he would discuss it with the client, and it would be better to admit that as a trading profit and pay tax. The person he discussed this with in Company A's case should be Mr B. He did not discuss with Mr C. The audit for Company A was introduced to him by Mr B, and he was given to understand that Mr B was running the show at the time.
- 26.19 He was referred to the balance sheet as at 30 April 1983 and was asked about the basis on which Property 1 was classified as trading properties. He stated that if one purchased a property and sold a major portion of it, the remaining part would normally become trading property.
- 26.20 The financial statement, including the directors' report and the auditors' report, together with the notes to the accounts, would be sent with the letter of representation for his client's signature.
- 26.21 During 1984 to 1990, when he was auditor of Company A, he asked Company A about classification of Property 1 through his supervisor at least twice. The first time was a year or so after he first saw there was a trend of regular rental income. The second time was sometime in 1988, 1989.
- 26.22 He was referred to the accounts audited by Messrs Ernst & Whinney for the period ended 31 March 1988. He stated that Company A had not produced those accounts to him and that he had never seen them until now.
27. The testimony of the third witness, Ms L, may be summarised as follows:
- In chief
- 27.1 Qualification: Form 5 graduate, London Chamber of Commerce, intermediate level.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 27.2 She joined Company E1 on 8 March 1982 and left their employment on 31 July 1987. She was employed as an accounting clerk.
- 27.3 Between 1984 and 1985. Mr C handed to her the accounts of Company A. She was responsible for issuing invoices. When colleagues passed her vouchers, she would post entries in the books. She did trial balance end of year. Mr C usually handed to her documents of Company A directly. She was working for both Company A and Company E in those days. As far as she could recollect, she did trial balance for Company E once a month, and for Company A only once a year. She kept the books. Mr B had kept the books of Company A before her.
- 27.4 When she received the draft accounts from the auditors for Mr C's signature, she did not discuss with him, or Mr B or Mr K the accounting classification of Property 1 in the draft accounts. She would only explain to Mr C whether it was making a profit or loss. She had heard of fixed assets and trading property and came across them in her studies, but she did not really know the difference. When she received the draft accounts from the auditors, the classification of the properties in the draft accounts as trading properties did not come to her attention. It never came to her attention in respect of the 3 or 4 years accounts for which she was responsible. She just noticed whether it was making a profit or a loss. It was the responsibility of the auditor to prepare the directors' report and the tax return.
- 27.5 She knows Ms O. She had telephone conversation with Ms O a couple of times and met her once in her office when she was bringing the accounts to Ms O. She would only leave the documents and have a chat with Ms O without saying anything serious. They never discussed about the classification of Property 1 in the accounts of Company A. Only in one instance when they talked about Property 1. Ms O said that there would be two approaches: If the status remained unchanged and everything else would remain unchanged, and if the value went up, then it would need revaluation, Ms O asked her whether, if the value went up, the company would have to change the status of the properties. Ms O was using very professional and technical terms that she did not really understand. She thought that Mr C would not sell the property, so she suggested not to change the status. This phone conversation was about the time when she had some argument with some of her colleagues and she was pregnant at the time. It should be between 1986 and 1987.

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- 27.6 She did not mention her telephone conversation with Ms O to the two directors, because she had a feeling that the property would not be sold, and because Mr C was so busy she did not have a chance to discuss with him.
- 27.7 She first joined Company E1 in 1982, when it was located in District D. In the summer of 1983, Company E moved its head office to Property 1. She worked at Property 1 from the summer of 1983 to July 1987.
- [Witness agreed that she understands some English. Sometimes she did not have to wait for interpretation.]
- 27.8 She was shown the internal staircase at page 22 of the Taxpayer's bundle of documents. She stated that she recognised it. It was there when the decoration was in progress. It was in Property 1. The staircase was there in the summer of 1983.
- 27.9 Company E moved because the old office was rented and it was old and because there was not enough space. Property 1 were used as a single office by Company E1 and also Company E2. Visitors included sub-contractors, site workers, artists and people coming to buy entertainment tickets. The visitors gained access to Mr C's office on the first floor from the entrance on the ground floor and up the staircase.
- 27.10 The decoration was done by contractors of Company E1.
- 27.11 She left the employment of Company A in 1987.

In cross-examination

- 27.12 She learnt about the difference between fixed assets and current assets. Current assets are assets that can be sold and changed into cash fairly easily and quickly. She was shown Company A's balance sheet as at 30 April 1986. She noticed that the trading assets were under current assets. She wrote the words 'trading properties at cost' at page 76 of the ledger accounts of Company E. She had copied it from the statement of accounts from the auditors. She did not discuss with Mr C before she wrote the words, not before Mr C signed his name on the accounts, because they were so busy. They just looked to see whether it was making a profit or a loss. She did not see a problem there, so she just passed it to Mr C to sign. It was just her habit to copy the English words 'trading properties at cost' from the statement of account.



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- 27.13 She did not take over the accounts yet in 1983. She took over the accounts in 1984.
- 27.14 She was not sure whether she was responsible for sending the accounts for the year ended 30 April 1984 to the auditor.
- 27.15 She was responsible for sending the accounts for the year ended 30 April 1985 to the auditor. She did not explain the audited account to Mr C thoroughly. She just told him whether the company was making a profit or loss. She did not take Mr C through the items one by one on the balance sheet and the profit and loss account, because they had so many books, so they seldom explained the items one by one. She had not noticed that the trading properties were classified under current assets, but she noticed it now. She admitted that she did not check the classification of each item. She just looked at the profit and loss item, because she was not professional enough to know all about the classification.
- 27.16 She was referred to the auditors' report, 2<sup>nd</sup> paragraph of which reads:
- ‘The value of trading properties was stated at cost instead of at the lower of cost and net realisable value as required ... The directors of the company were of the opinion that the net realisable value of trading properties would not be lower than cost.’
- Her answer was that she read it but did not take real notice of it. So she never asked about it. They trusted the professionalism of the auditors so they did not really look into the auditors' report. There were professional, technical terms inside the report and she did not fully understand the contents and she trusted their professionalism.
- 27.17 When the auditors sent the audited account to the company for the directors' signature, they would send also a representation letter which had to be signed by the directors. She did not explain it to Mr C before he signed it because it was just everyday routine. She could not remember if she had read it.
- 27.18 Mr C never asked her about the classification of Property 1 when she explained the audited accounts to him.
- 27.19 Her telephone conversation with Ms O was the only time she discussed with Ms O about the classification of Property 1. She did not tell Mr C about her telephone conversation with Ms O because she thought it was something in the future and there was no need to talk to him about it.

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- 27.20 She admitted that it was her mistake that she did not take notice of the fact that it was classified under current assets.
- 27.21 Ms O told her that value would go up and she thought it was something for the future and at the moment Mr C would not consider selling it, so it was not a concern at the moment. Ms O told her that value would go up or go down, and asked her whether they should change the status. She said because it was not going to be sold they need not change the status. She could not remember clearly what Ms O said about the consequences in terms of tax if it went up. Ms O tried to explain but she did not really understand so she said, 'Since it is not going to be sold, just leave it.'
- 27.22 Mr C never gave her any instruction to classify Property 1.
- In re-examination
- 27.23 Mr C never asked about classifying Property 1 as trading properties under current assets. Mr C was rather passive and seldom asked questions.
28. The testimony of the fourth witness, Ms P, may be summarised as follows:
- 28.1 She was first employed in 1983 as personal assistant to Mr C and had remained so since.
- 28.2 She only had telephone conversations with Ms O, and she had never her face to face on business occasions. She had met her once or twice at social functions organised by Company E1.
- 28.3 She never discussed with Ms O of Wong Brothers & Co the accounting classification of Property 1 in the accounts of Company A.
- 28.4 From 1983 her office had been on the first floor. But she had to gain entrance from the entrance of the ground floor and go upstairs, one floor up. In 1983 she started work for Mr C in Property 1. It was then a new office under decoration. Before that Mr C's office was in District D. As far as she knew, Mr C wanted to use Property 1 as the head office. From 1983 till now, she had been working for Mr C without any change.
- 28.5 The tenancy of the old office expired, and they wanted to take back Property 1 for their own use.

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- 28.6 All the units from the second floor up were sold.
- 28.7 She was shown the photos at page 22 of the Taxpayer's bundle of document, and stated that the internal staircase in the photo was located at Property 1, leading from the ground floor to the first floor. Apart from the elevators this was the only way to go up. It was there since she worked there. She started work there in September 1983, so it was there in 1983. Mr C's office was on the first floor. Most of the visitors of Mr C were the sub-contractors or their owners. They went there to collect cheques from the accounts department or for a meeting with her boss. They would go to the first floor through the ground floor by using the staircase inside the shop unit. That was the only way they used. There was another exit but not for the staff or the visitors, but just for the cleaner to throw away the rubbish. On the first floor, one exit only. That was the one near the lift lobby.

In cross-examination

- 28.8 The company's accountant would not show her the accounts. They just sent the books to the auditor. She did not see the accounts, not even the ledger. Sometimes, but not always, the company's accountant would explain to Mr C the audited accounts and representation letter in her presence.

### Relevant law

29. The following principles and propositions are applied in this case.

Intention

- 29.1 *Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? (Per Lord Wilberforce at page 491 in Lionel Simmons Properties Ltd v CIR 53 TC 461.)*

Change of intention

- 29.2 *Intention may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa. If findings of this kind are to be made, precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax (of. Sharkey v Wernher*

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*[1956] AC 58). (Per Lord Wilberforce at page 491 in Lionel Simmons v CIR.)*

- 29.3 *But it appears to me that when it has been admitted or determined that an article forms part of the stock-in-trade of the trader, and that upon his parting with it so that it no longer forms part of his stock-in-trade some sum must appear in his trading account as having been received in respect of it, the only logical way to treat it is to regard it as having been disposed of by way of trade. If so, I see no reason for ascribing to it any other sum than that which he would normally have received for it in the due course of trade, that is to say, the market value. (Per Viscount Simonds at page 298 in Sharkey v Wernher 36 TC 275.)*

Either trading stock or permanent investment

- 29.4 *What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset. It must be one or other. (Per Lord Wilberforce at page 492 *ibid.*)*

Proof of intention

- 29.5 *But as it (intention) 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 ... 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. (Per Mortimer, J, as he then was, at page 771 in All Best Wishes Ltd v CIR 3 HKTC 750.)*

Onus of proof

- 29.6 *The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant (section 68(4) of the Inland Revenue Ordinance).*

Mistake in accounts

- 29.7 *If a taxpayer wishes to challenge the accuracy of its own audited statements and tax declarations made by a director it is not sufficient merely to say that either a mistake was made or that the accounts were kept in a particular form which was incorrect 'for convenience'. Evidence to substantiate the mistake must be given in the strongest*

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*terms. (Per Board of Review at page 273 in Chinachem Investment Company Ltd v CIR 2 HKTC 261.)*

- 29.8 *I am unable to fault this (the above stated) line of reasoning. (Per Macdougall J, as he then was at page 296 in the Chinachem case.)*
- 29.9 *I entirely accept that the matter (whether an item is held as capital or as stock-in-trade) is not concluded by the way in which it has been treated in the taxpayer's books of account, but it seems to me that the way in which the properties have been treated in the accounts is by no means an insignificant factor to be taken into consideration, particularly where there has also been no attempt to claim depreciation in respect of those properties. (Per Macdougall J, at page 302 in the Chinachem case.)*
- 29.10 *It is accepted by the Commissioner that the accounts are not conclusive evidence of the matter in issue ... Nevertheless the accounts must remain important and call for credible explanation ... I agree with the judge that the way in which the properties have been treated in the accounts is by no means an insignificant factor. (Per Sir Alan Huggins, V-P at page 308 in the Chinachem case.)*

### **Findings and reasons**

30. On 19 February 1982, Mr B and Mr C acquired Company A in equal shares for the purpose of using it as a vehicle for dealing in the units of a building to be constructed in District D (the Building) (see paragraph 4 above).

31. By agreement dated 5 March 1982 (the Agreement) Company A purchased the Building at a price of \$17,589,384.5. The Building was expected to be constructed on or before 31 March 1983 and was to consist of 16 storeys with shops on the ground floor, offices on the first floor and 80 domestic units on the second to fifteen floors (see paragraph 8 above).

32. By pre-sales, Company A sold all the units of the Building except the ground floor shops and the first floor office units which could not be sold even though Mr C had wanted to sell them for months (see paragraph 25.3 above). With the date of completion approaching, Mr B and Mr C agreed to divide up the shops on the ground floor and the offices on the first floor between them by Company A selling 3 shop units on the ground floor to Mr B while completing the purchase of the remaining shop units on the ground floor and all the 3 office units on the first floor (see paragraph 25.5 above).

33. On 1 March 1983, Company A took out the assignment of the remaining shop unit on the ground floor and 3 flat units on the first floor of the Building (collectively Property 1) (see paragraph 10 above).

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34. On 10 December 1983, Company A allotted 998 shares of \$10 each to Mr C. By reason of such allotment Mr C became the majority shareholder of Company A, holding 999 shares out of a total of 1,000 (see paragraph 4 above).

35. Property 1 was classified as trading properties under current assets in the audited accounts for the year ended 30 April 1983 and the years thereafter up to and including the year ended 30 April 1990 (see paragraph 10 above). Nor was any rebuilding allowance claimed in those accounts.

36. Property 1 was reclassified as fixed assets and was revalued at \$11,000,000 in the audited accounts for the period from 1 May 1990 to 31 March 1991. The revaluation was based on the value of \$11,000,000 found by a professional valuer to be the open market value of Property 1 as at 31 July 1991.

37. It is common ground that:

37.1 Company A acquired the Building with the intention of selling the units thereof at a profit.

37.2 With regard to the units the subject of this appeal, namely, the shop unit on the ground floor and 3 office units on the first floor, Company A changed its intention from that of selling the units at a profit to that of holding them as long-term investments, that is, as fixed assets.

### Issue

38. The issue is, when did the change of intention take place? Company A's case is that it took place on 1 March 1983, the date of the assignment of Property 1, while the Revenue contends that it took place on 31 July 1991, the date of the revaluation.

### Accuracy of audited statements

39. The main hurdle in the way of Company A's case is that in its audited accounts filed with the Inland Revenue Department for the year ended 30 April 1983 and the years thereafter up to and including the year ended 30 April 1990, Property 1 was classified as trading properties under current assets. The classification conflicts with Company A's case that it has held Property 1 as long-term-investments, that is, fixed assets ever since 1 March 1983. It was therefore necessary for Company A to challenge the accuracy of its own audited accounts.

40. It was held by a previous Board in the Chinachem case that, if a taxpayer seeks to challenge the accuracy of its own audited statements, it must do so with evidence given in the strongest terms (see paragraph 29.6 above). Subsequently, in the same case, the Court of Appeal held that credible explanation is required (see paragraph 29.9 above).

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### Company A's case

41. Company A's contentions are summarised below together with our comments.

#### Property 1 for use as new office of Company E

- 41.1 Company A alleges that Property 1 was intended to be used as the new office of the related company (that is, Company E) when the tenancy agreement for the then existing office expired in late 1983, that Property 1 was intentionally held not for sale in 1983 and that Company A itself took the assignment (see paragraph 23.8 above). The allegation about an intention not to sell Property 1 in 1983, but to hold it for use by Company E as its office is untrue. It is in evidence, and we find, that Mr C had wanted to sell the ground floor shops and the first floor offices for months but no one wanted to buy. The shops and the offices could not be sold (see paragraph 25.3 above). We find that that is why Mr B and Mr C divided up the shops and offices between themselves (see paragraph 25.5 above), and that Company A had no alternative but to take the assignment of the remaining shop unit on the ground floor and offices on the first floor (Property 1) by way of completion of the purchase. We find that Property 1 was used by Company E as its office because it was 'too troublesome', in the language of Mr C, to sell it (see paragraph 25.7 above).
- 41.2 The fact that Company A did not sell Property 1 along with the rest of the Building shows, Company A argues, that it had a long-term-investment intention towards Property 1. For reasons stated in paragraph 41.1 above, we are unable to accept the argument.
- 41.3 (a) Company A also relies on the fact that only one deed, and not four (in the sense of one deed for each of the four units, that is, the shop unit on the ground floor and 3 office units on the first floor), was used in the assignment. It cites that fact as an indicator pointing to its purported intention of holding Property 1 on a long-term basis. Mr C stated in evidence that he took conveyance of the four units by one assignment because Property 1 was to be for his own use (see paragraph 25.29 above). If his intention was to sell, he would have done it in four deeds of assignment. He had spent more money doing it in one deed. It would be more difficult to sell with just one deed (see paragraph 25.37 above). With four deeds, it would be much more convenient and easier to sell the units (see paragraph 25.41 above).

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- (b) We find it difficult to accept that he could have paid more for taking one assignment instead of four. We would have thought that some costs might have been saved by using just one deed of assignment. We are also unable to see what the 'difficulty' is in selling the units in the future if they are bought with one deed of assignment.
- 41.4 (a) As both Company A and Company E were owned by Mr C, Property 1 could be said to be 'owner-occupied' properties. That, coupled with the alteration works carried out on Property 1 before Company E moved in, Company A contends, is strong evidence that Property 1 became fixed assets of Company A on 1 March 1983.
- (b) Company E's tenancy in respect of Property 1 commenced in August 1983. There was no tenancy agreement in writing, nor any specific expiry date. The informal arrangement was no doubt due to the 'owner-occupier' relationship between Company A and Company E which were both owned by Mr C. However, we fail to see why this special relationship necessarily means that Company A had a long-term-investment intention towards Property 1. We accept Miss Ma's submission that the absence of a written tenancy agreement indicates a lack of commitment on the part of Company A to hold Property 1 on a long-term basis. The informal and special arrangement might make it easier for Company A to terminate the tenancy if Company A wished to sell Property 1 at an opportune moment in the future than would have been the case if the tenant had been a stranger.
- 41.5 A number of photographs were put before us. They were taken in 1998 but are said to represent the works carried out on Property 1 for the purposes of the tenancy. The main feature of the works was a staircase connecting the shop unit on the ground floor with the offices on the first floor. Having examined the photographs, we are of the view that none of the works were 'major works' as the Representative put it, and that they could be dismantled and removed without difficulty. It is alleged that some decoration was also carried out, but Mr C could not recall how much it cost or who paid for it, although later in evidence he stated that after enquiries he had found out that it was paid by Company E.

### Witnesses

- 41.6 (a) According to Mr C, Mr Chow the auditor of Company A from the date of incorporation to 30 April 1990 did not enquire of him



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about his intentions towards Property 1, nor did he tell Mr Chow about his intentions. He stated that he did not know how Property 1 was classified in the accounts (see paragraph 25.13 and 14 above). He does not read English. He did not notice how Property 1 was classified in 1983 and he has not noticed it since then. He would just ask his accountant or accounting clerk if Company A had made a profit. If it had, he would sign the accounts. If not, then he would ask his accountant (see paragraph 25.67).

- (b) Mr C stated that he knew a rule that if he purchased property and sold it within 7 years, he had to pay tax. He had heard about it from many people in society (see paragraphs 25.14 and 20 above). Right now people were telling him that the rule had been changed to 2 years. He was not sure whether this was true. He had heard people discuss these kind of matters on social occasions (see paragraph 25.21 above).
- (c) When asked why Company A made a revaluation of Property 1 as at 1(sic) July 1991, Mr C stated that that was because they wanted to list Company E on the Hong Kong Stock Exchange and Company A was going to be a member (see paragraph 25.23).
- (d) Mr C stated that he got an idea that Property 1 was a fixed asset. He did not know how the accountant classified it in English. He thought it was a fixed asset. If it was not a fixed asset, he would have a problem (see paragraph 25.69). He stated that since 1983 he had thought that Property 1 was a fixed asset instead of trading property (see paragraph 25.76).
- (e) There was an air of unreality about Mr C's testimony. The picture presented is that of a controlling shareholder of Company A who would only ask the company's accountant whether the company had made a profit before he signed the audited accounts, who since 1983 had thought that Property 1 was a fixed asset but did not know how it was classified in English in the accounts, who realised that he would have a problem if it was not a fixed asset, and who nevertheless did not consult his auditor about it. Furthermore, he claimed to know the so-called 7-year rule regarding liability to pay tax on profits on property sales. He had heard people talk about it on social occasions. More recently he had heard about the so-called 2-year rule and was not sure whether it was true. There is no evidence that he consulted the auditor about the 'rules'. We find by inference that Mr C in fact never consulted Mr Chow the auditor about it.

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- 41.7 (a) Ms L, former accounting clerk or accountant of Company A, also gave evidence for the company. She took over the company's accounts in 1984 and left the employment on 31 July 1987. She stated that she did not explain the audited accounts to Mr C thoroughly. She just told him whether the company was making a profit or loss. She was not professional enough to know all about classification. (see paragraph 27.15 above). In 1986 or 1987, she had a telephone conversation with a Ms O of the auditor Mr Chow's firm, during which Ms O asked her whether, if the market value went up, the company would change the status of the properties. She thought that Mr C would not sell Property 1, so she suggested not to change the status (see paragraph 27.5 above). She did not tell Mr C about her telephone conversation with Ms O because she thought it was something in the future and there was no need to talk to him about it (see paragraph 27.19).
- (b) We find Ms L's testimony about the telephone conversation she had with Ms O, about how she suggested not to change the status of Property 1 and about how she made the suggestion without Mr C's prior knowledge and consent nor his subsequent ratification most unconvincing. What is also difficult to accept is her perfectly matching statement to confirm Mr C's allegation that in 'explaining' audited accounts, she just told him whether the company was making a profit or loss.
- 41.8 Mr Chow the auditor also gave evidence. From the date of incorporation of Company A on 30 January 1981 up to 30 April 1990, he was the auditor of that company and signed the auditors' report for each period or year under various firm names. In relation to the balance sheet as at 30 April 1983, Mr C gave him no indication as to his intentions towards the trading property. He never discussed personally with Mr C any accounting matters (see paragraph 26.12 above). As for the balance sheet as at 30 April 1984, he continued to classify Property 1 as trading properties. Regarding the classification, he did not enquire of Mr C about his intentions towards the properties. From 1984 to 1990, he continued to classify the properties as trading properties. He has not enquired of Mr C about his intentions towards Property 1 (see paragraph 26.14 above). Mr Chow referred to his efforts to seek instructions from Company A through his supervisor Ms O in about 1985 on whether Property 1 should be reclassified from trading properties to fixed assets, and Company A's response was to the effect that Property 1 was not going to be reclassified (see paragraph 26.15 above). When asked about the basis on which Property 1 was classified as trading properties, he stated that, if one

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purchased a property and sold a major portion of it, the remaining part would normally become trading property (see paragraph 26.19 above). He was referred to the accounts audited by Messrs Ernst and Whinney for the period from 1 May 1987 to 31 March 1988. He stated that Company A had not produced those accounts to him and that he had never seen them until now (see paragraph 26.22 above).

- 41.9 The last witness was a Ms P, personal assistant to Mr C since 1983. It is not necessary to cite her evidence which is summarised in paragraphs 28.1 to 28.8 above.

### Audited accounts

- 41.10 (a) For all the years up to and including the year ended 30 April 1990, Property 1 was classified as trading properties under current assets in the accounts audited by Mr Chow. However, in the accounts audited by Ernst & Whinney for the 11-month period from 1 May 1987 to 31 March 1988, and in the accounts audited by Ernst & Young for the 11-month period from 1 May 1990 to 31 March 1991 and for the ensuing year ended 31 March 1992, Property 1 was classified as a fixed asset.
- (b) The audited accounts for the period from 1 May 1987 to 31 March 1988 were disclosed to the Inland Revenue Department as an enclosure with a letter dated 5 May 1993 from the Representatives to the Department to support Company A's case that 'it changed its intention from holding Property 1 from trading stock to long-term investment on 1 March 1983.' The relevant paragraph of the letter reads as follows:

'In 1987, Mr C decided to float Company E having Company A as one of its subsidiaries on the Hong Kong Stock Exchange and Ernst & Whinney (which later merged with Arthur Young to form Ernst & Young) was appointed the reporting accountant. It was also decided that the accounting year-end date of Company A was to be changed from 1 (sic) April to 31 March in order to conform with that of its ultimate holding company. Accordingly, audited financial statements of Company A for the period from 1 May 1987 to 31 March 1988 had been prepared for the intended listing. A copy of the audited financial statement is enclosed.

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Company A's audited accounts for the period ended 31 March 1988 had been prepared for consolidation into the group accounts for flotation purpose. Therefore, extra care has been taken to ensure that the accounts give a true and fair view of Company A's financial position so that the responsibilities as a reporting accountant could be discharged. The reporting accountant, with the confirmation from the management of Company A, formed the opinion that Property 1 concerned has been held as the company's fixed asset since 1 March 1983. Accordingly, the auditor has reclassified Property 1 from trading stock to fixed assets to reflect the actual nature of Property 1. Furthermore, a prior year adjustment had been made to accrue all those accumulated depreciation on Property 1 which had not been provided for since 1983 due to the wrong classification of Property 1 as trading stock.'

In the audited accounts for the period from 1 May 1987 to 31 March 1988, Mr C signed the report of directors; and Ernst & Whinney signed the report of the auditors, giving their unqualified opinion that the financial statements give a true and fair view of the state of affairs as at 31 March 1988 and have been properly prepared in accordance with the Companies Ordinance. The balance sheet shows the following comparative 'fixed asset' figures as at the current and prior year-ends:

	Notes	31 March 1988	30 April 1987
Fixed asset	5	\$2,846,933	\$2,877,220'

Note 5 is as follows:

'Fixed Assets				
	1 May 1987	Additions	Disposals	31 March 1988
	\$	\$	\$	\$
Cost:				
Leasehold properties	3,028,655	-	-	3,028,655
Depreciation:				
Leasehold properties	151,435	30,287		181,722

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Net book value	<u>2,877,220</u>	<u>2,846,933</u>
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- (c) The accounts audited by Ernst & Whinney for the period from 1 May 1987 to 31 March 1988 (and signed by Mr C and his co-director on 8 November 1988) were not submitted to the Inland Revenue Department to support Company A's profits tax return for the year of assessment 1987/88, and we note that the accounts audited by Mr Chow for the year ended 30 April 1987 (and signed by Mr C and his co-director on 1 March 1988) had been submitted on 26 April 1988 for that purpose.
- (d) The accounts audited by Ernst & Whinney were prepared on the basis that Property 1 had been held as a fixed asset since 1983 and therefore were consistent with Company A's case. In our view, Company A's audited accounts should have continued to be prepared on that basis if it was true. But they were not so prepared. On the contrary, Company A continued to appoint Mr Chow as its auditor for the years ended 30 April 1988, 1989 and 1990 respectively. The accounts for those 3 years continued to be prepared on the basis that Property 1 was trading property, and were signed and approved by Mr C and his co-director on 28 April 1989, 10 April 1990 and 29 January 1991 respectively. At no time until he gave evidence at the hearing of this appeal was Mr Chow shown the accounts audited by Ernst & Whinney (see paragraph 26.22). All those circumstances cast a serious doubt on the 'fixed asset' contention.
- (e) Mr C stated that the company's accountant did not explain to him the balance sheet as at 31 March 1988 before he signed it, that the accountant of Ernst & Whinney explained the matter to the company's accountant Ms L but not to him and that he did not notice that Property 1 was classified as fixed assets when he signed it. The Ms L referred to in the present context would have been the younger sister of the other Ms L who had worked as the company's accountant before the younger sister and had left the company in July 1987. The younger Ms L was not called to confirm Mr C's story, which we do not find credible.
- (f) The Representative, Messrs Ernst & Young, took over as auditors of Company A for the period from 1 May 1990 to 31 March 1991 and for the year ended 31 March 1992. The audited accounts for the 11 month period disclose a reclassification of Property 1 from trading property to fixed asset. The balance sheet as at 31 March

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1991 presents the comparative figures relating to Property 1 as follows:

	31 March 1991	30 April 1990
Fixed assets	\$11,000,000	-
Current assets		
Trading properties	-	\$3,028,655

- (g) Note 5 of the Notes to Financial Statements 31 March 1991 stated that Property 1, previously treated as trading properties, has been classified as fixed assets on the basis of Company A's intention to hold Property 1 on a long-term basis and that the valuation of Property 1 was carried out by a professional valuer as at 31 July 1991 on an open market basis which, in the opinion of the directors, approximated their value as at 31 March 1991 (see paragraph 17 above).
- (h) We note that there is nothing in Note 5 or other part of the audited accounts for the period from 1 May 1990 to 31 March 1991 to suggest that Property 1 had in the past been wrongly classified as trading properties. We find that the comparative figures show that, in the year ended 31 March 1991, there was a transfer of Property 1 from the category of trading properties to that of fixed asset, rather than a rectification of wrong classification, in which case it would not have been necessary to revalue Property 1.
- (i) Mr C was referred to the audited accounts for the period from 1 May 1990 to 31 March 1991, particularly to the value of fixed assets being increased from zero under the 30 April 1990 column to \$11,000,000 under the 31 March 1991 column and the value of trading properties decreased from 3,000,000 something under the 30 April 1990 column to zero under the 31 March 1991 column. Mr C stated that he did not read it and was not informed about it, and that he did not realize that Property 1 was reclassified until now. Like his many previous denials of knowledge of classification in the audited accounts from the year ended 30 April 1983 onwards, we do not find this one credible either.
- (j) We accept Miss Ma's submission that the change of status whereby Property 1 was transferred from trading properties (as at 30 April 1990) to fixed assets (as at 31 March 1991) as shown in the financial statement for the period from 1 May 1990 to 31 March 1991 was made to reflect Company A's change of

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intention towards Property 1. We find that the change of intention of Company A and the transfer to Property 1 from trading property to fixed asset took place on 31 March 1991. We also find that the open market value of \$11,000,000 as at 31 July 1991 was adopted as being the open market value as at 31 March 1991 because of the approximation of value.

### Conclusions

42. Having considered all the circumstances, we have reached the following conclusions:

42.1 Company A has to prove by convincing evidence that the classification of Property 1 as trading properties in its own audited accounts for 8 years was a mistake and that Property 1 has in fact been held as a long-term investment, that is, as a fixed asset since 1 March 1983 the date of its assignment. In our view, Company A has failed to do so for the following reasons:

- (a) The allegation about an intention not to sell Property 1 in 1983 but to hold it for use by Company E as its office is untrue. We have found that Company A had no alternative but to take the assignment of Property 1 for lack of buyers (see paragraph 41.1 above).
- (b) The fact that only one deed was used for taking the assignment of Property 1 (see paragraph 41.3 above); the 'owner-occupier' relationship between Company A and Company E (see paragraph 41.4 above) and the execution of alteration and decoration works on the premises of Property 1 (see paragraph 41.5 above) do not necessarily point to a long-term-investment intention towards Property 1.
- (c) We find it difficult to accept Mr C's testimony when he stated that the only question he would ask the company's accountant before signing audited accounts was whether the company had made a profit or loss, that since 1983 he had thought that Property 1 was a fixed asset, that he would have a problem if it was not, that he did not know how Property 1 was classified in the accounts and that he had heard people talk about the '7-year rule' and more recently the '2-year' rule which he was not sure was true. We find Mr C's statements unconvincing. All the doubts and uncertainties he might have entertained could have found their solutions if he had consulted Mr Chow the auditor, but he did not (see paragraph 41.6 above). We are not satisfied that Mr

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C's knowledge of the contents of audited accounts was limited to the question of profit and loss, that he did not know how Property 1 was classified in the accounts or that he had heard anything about the 'rules'.

- (d) We are unable to accept Ms L's testimony about the telephone conversation with Ms O of the auditor's firm on the question of whether there should be a change of status of Property 1 if the market should go up, about her suggesting to Ms O not to change the status and about her not reporting to Mr C on the matter. We also find it difficult to accept her matching statement to confirm Mr C's allegation that before signing audited accounts, he would just ask the company's accountant whether the company had made a profit or loss (see paragraph 41.7 above).
  - (e) Mr C alleged that the accountant of Ernst & Whinney explained the balance sheet as at 31 March 1988 to Ms L the company's accountant but not to him and that the company's accountant did not explain it to him either. This Ms L would have been the younger sister of the other Ms L who had worked as the company's accountant before the younger sister and had left the company in July 1987 (see paragraph 27.11 above). The younger sister was not called to confirm Mr C's story. We do not find his testimony credible.
  - (f) Despite the fact that the accounts audited by Ernst & Whinney were prepared on the basis that Property 1 had been held as a fixed asset since 1983, the accounts for the 3 years ended 30 April 1988, 1989 and 1990 respectively continued to be prepared on the basis that Property 1 was trading property (see paragraph 41.10 (d) above). The inference is, and we find, that until 31 March 1991, Company A did not have a firm intention to hold Property 1 as a long-term investment, that is, as a fixed assets.
- 42.2
- (a) We find that there is no mistake as to the classification of Property 1 as trading properties in the accounts audited by Mr Chow for all the years up to and including the year ended 30 April 1990.
  - (b) We find that Company A had a trading intention towards Property 1 ever since it was built until 31 March 1991.
  - (c) The financial statements for the 11-month period ended 31 March 1991, particularly the comparative figures in the balance sheet and Note 5, show, and we find, that what happened on 31 March



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1991 was a transfer of Property 1 from the category of trading properties to the category of fixed asset and not a rectification of wrong classification (see paragraphs 41.10 (f), (g), (h) and (j) above). Like many previous instances, we are unable to accept Mr C's denial of knowledge of the contents of the audited accounts for the period ended 31 March 1991 (see paragraph 41.10 (i) above).

- (d) We are of the view that the principle of Sharkey v Wernher applies to the present case.
- (e) We have already found that the open market value of \$11,000,000 as at 31 July 1991 was adopted as being the open market value as at 31 March 1991 because of the approximation of value (see paragraph 41.10 (i) above). In consequence, we find that the open market value of Property 1 as at 31 March 1991 was \$11,000,000 for the purpose of calculating Company A's profit in accordance with the Sharkey v Wernher principle.

### **Property 2**

43. We have considered the purchase and sale of Property 2 (see paragraph 12 above) and have decided not to make any findings regarding that property on the ground that it is of very marginal relevance to the subject of this appeal.

### **Decision**

44. The assessments under appeal are to be revised in accordance with our finding that Property 1 is a fixed asset of Company A and attained that status on 31 March 1991. This case is hereby remitted to the Commissioner for a revision of the assessment in such terms as may be agreed between the parties. Failing such agreement, liberty to apply to the Board for directions. Subject to the foregoing, this appeal is dismissed.