INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D29/92

Profits tax – whether gain on disposal of property was a capital gain.

Panel: William Turnbull (chairman), Edward Chow Kam Wah and Lincoln Yung Chu Kuen.

Dates of hearing: 7 and 8 July 1992.
Date of decision: 14 October 1992.

The taxpayer was a private company carrying on an advisory business. The company purchased two factory units in a multi-storey factory building then under construction and sub-sold the two units before completion. The taxpayer submitted that the two factory units had been acquired as long term capital assets with the intention of leasing the same to associated companies.

Held:

The onus of proof is upon the taxpayer. The evidence of the witness was not credible. At best when the factory units were acquired the intention of the taxpayer was uncertain as to its intention to hold the factory units as long term investments.

Appeal dismissed.

Cases referred to:

Wing on Cheong Investment Co Ltd v CIR 3 HKTC 1
Marson v Morton 59 TC 381
Kirkham v Williams [1991] STC 342
Simmons v CIR [1980] 2 All ER 798
D60/87, IRBRD, vol 3, 24
Beautiland Co Ltd v CIR [1991] 2 HKLR 511
Richfield International Land & Investment Co Ltd v CIR 3 HKTC 167
Hillerns and Fowler v Murray 17 TC 77
Cunliffe v Goodman [1950] 1 All ER 720
Miller V Minister of Pensions [1947] 2 All ER 372
Lionel Simmons & Others v CIR 53 TC 461
Gladstone Development Co Ltd v Strick 30 TC 131
Shadford v Fairweather 43 TC 291
CIR v Livingston 11 TC 538
Harrison v Griffiths 40 TC 281

Pickford v Quirke 13 TC 251

Patrick Tam for the Commissioner of Inland Revenue.
Stephen Nathanson of Lawrence Ong & Chung for the taxpayer.

Decision:

This is an appeal by a private limited company against a determination by the Deputy Commissioner of Inland Revenue. The Deputy Commissioner decided that the gain on disposal of certain property was subject to profits tax. The facts of the appeal are as follows:

1. The Taxpayer was a private company incorporated in Hong Kong engaged in advising and consulting with other companies in relation to China trade and manufacturing in China. The Taxpayer was owned by Mr W and his wife and they were also the directors of the Taxpayer. For practical purposes the Taxpayer was controlled by Mr W who was a long-time China trader and consultant.

2. The Taxpayer did not file its 1988/89 profits tax return within the stipulated time and in the absence of a return the assessor raised on the Taxpayer an estimated assessment with an assessable profit of $600,000.

3. By letter dated 17 January 1990 the Taxpayer lodged an objection against this assessment on the ground that the estimated profits were excessive. The Taxpayer submitted its 1988/89 profits tax return with supporting accounts which offered for assessment a net profit of $341,564. The accounts showed that a gain on disposal of properties of $463,440 had been made for the year ended 31 March 1989 but the same was excluded from the tax computation proposed on behalf of the Taxpayer on the ground that the same was a gain on the sale of a capital asset.

4. By virtue of two sale and purchase agreements dated 15 April 1988 the Taxpayer agreed to purchase from a developer ('the developer') two factory units ('the properties') in a multi-storey factory building then under construction at a consideration of $705,000 each making a total of $1,410,000. The completion date for the factory building was before 15 February 1989.

5. By an agreement dated 8 November 1988 the Taxpayer sold the properties to a third party at a consideration of $1,873,440. Pursuant to this agreement the Taxpayer entered into cancellation agreements dated 12 November 1988 by virtue of which the two sale and purchase agreements dated 15 April 1988 were cancelled and on the same date the third party entered into a sale and purchase agreement with the developer for the purchase of the properties. One of the terms of the agreement dated 8 November 1988 was that the third party would pay to the Taxpayer the sum of $463,440 being the difference between the price

of $1,873,440 at which the Taxpayer sold the properties to the third party and $1,410,000 being the contract price at which the Taxpayer had agreed to purchase the properties.

6. The net profit or gain made by the Taxpayer on the purchase and subsequent sale of the properties was the said sum of $463,440 less a legal fee of $4,240.

7. The assessor was of the opinion that the Taxpayer should be charged to profits tax for the year of assessment 1988/89 as follows:

Assessable Profits as shown in the Taxpayer's computation	$341,564
Add : Gain on disposal of the Properties	463,440
Less : Legal fee	(4,240)
Revised Assessable Profits	$800,764

8. The Taxpayer did not agree with this proposed assessment and the matter was referred to the Deputy Commissioner for his determination. The Deputy Commissioner by his determination dated 11 April 1992 agreed with the assessor and determined that the estimated assessment with assessable profits of $600,000 should be increased to assessable profits of $800,764 with tax payable thereon of $136,129.

9. By notice of appeal dated 7 May 1992 the Taxpayer duly appealed to this Board of Review.

At the hearing of the appeal the Taxpayer was represented by Mr Stephen Nathanson and Mr W was called to give evidence.

In his evidence Mr W said that through indirect and direct share holdings and directorships which he held the Taxpayer was related to a company in Taiwan ('the Taiwan company') and two other companies in Hong Kong ('M Ltd' and 'K Ltd' respectively). He said that for all practical purposes of this appeal he made all of the decisions of the Taxpayer, the Taiwan company, M Ltd and K Ltd. He said that in January and February 1988 the Taxpayer through himself began to look for warehouse or factory premises in Hong Kong with the intention of leasing them to one of the two other Hong Kong companies on a long-term basis. He said that his strategy was that these two other companies needed premises in Hong Kong, one requiring warehouse space and the other requiring factory space. It was his evidence that he decided to purchase the properties to meet one or the other of those needs. He said that the long-term strategy of the company in Taiwan was to invest in The People's Republic of China using Hong Kong as a base. Because Taiwanese companies were not permitted by law to invest directly in The People's Republic of China and even indirect investments in The People's Republic of China at that time were 'risky', the Taiwan company planned to establish a company in Hong Kong, namely K Ltd, to manufacture products in Hong Kong until such time as it could implement its long-term plan of expanding or transferring its manufacturing operations into The

People's Republic of China. Mr W said that he looked for premises in February 1988 and found the properties in late February 1988. He made the decision to purchase the properties in the name of the Taxpayer for a total consideration of $1,410,000 and said that this decision was made on 1 March 1988 and was minuted in Chinese. He said that in early March 1988 M Ltd decided not to rent the properties from the Taxpayer and on 3 March 1988 the Taiwan company agreed to rent the two factory units from the Taxpayer. On 20 March 1988 the directors of the Taxpayer resolved to rent the properties to the Taiwan company for a period of two years. He said that no lease agreement between the Taxpayer and the Taiwan company was entered into because it was not necessary because of the relationship between the two companies and the fact that the properties had not yet been completed. He said that in May 1988 the Taiwan company changed its strategy because of political developments in Taiwan and The People's Republic of China which made it more favourable for the Taiwan company to set up a factory through K Ltd in The People's Republic China. He said that because of these events the Taxpayer decided to rent the properties to someone else and in August 1988 the Taxpayer engaged a real estate agent to rent the units. He said that advertisements were made but tenants could not be found and the real estate agent advised that the properties should be sold. On 8 November 1988, the Taxpayer entered into a subsale agreement.

The representative for the Commissioner cross-examined Mr W and challenged a number of documents produced in evidence by him.

The representative for the Taxpayer invited us to accept the truth of what Mr W told us and pointed out that the story which Mr W had told us was so complex that it could not have been invented by him and had the 'ring of truth' about it.

The representative for the Taxpayer submitted that it was necessary for the Board to decide the intention of the Taxpayer at the time when it decided to purchase the properties. He submitted that the intention was to purchase for long-term gain and that when Mr W made the decision on behalf of the Taxpayer to purchase the properties it was a decision to purchase with a view to renting the properties. He submitted that the Taiwan company had changed its plans in May 1988. He submitted that the fact that there had been a subsequent resale of the properties did not change the original intention of the Taxpayer and that it was the intention at the time of acquisition which was all important. He referred us to the cases of Wing On Cheong Investment Co Ltd v CIR 3 HKTC 1 and Marson v Morton 59 TC 381 and in addition tabled before us the following cases:

Kirkham v Williams [1991] STC 342

Simmons v CIR [1980] 2 All ER 798

D60/87, IRBRD, vol 3, 24

Beautiland Co Ltd v CIR [1991] 2 HKLR 511

Richfield International Land & Investment Co Ltd v CIR 3 HKTC 167

The representative for the Commissioner agreed that it was necessary to find the intention of the Taxpayer at the time of acquisition of the properties and said that the intention is to be tested by objective facts and circumstances. He referred us to Hillerns and Fowler v Murray 17 TC 77. He submitted that contemplation is not intention. Intention cannot be provisional, contingent or uncertain of fulfilment. He referred us to Cunliffe v Goodman [1950] 1 All ER 720 and Kirkham v Williams [1991] STC 342.

The representative for the Commissioner then asked us to refer to the contemporaneous documentary evidence to ascertain or test the intention of the Taxpayer. He pointed out that the Taxpayer did not maintain a minute book but had a number of loose leaf pieces of paper. He pointed out that the purported directors' resolution dated 20 March 1988 had been produced as evidence of the intention of the Taxpayer to rent the properties to the Taiwan company. He pointed out that this was an important document which had not been produced previously to the Commissioner in support of the objection of the Taxpayer and he challenged the authenticity of this alleged minute. He then drew attention to a memorandum which it was alleged had been written by the wife of Mr W in Hong Kong and signed by the controlling shareholder and director of the Taiwan company. He pointed out that this document had also not been produced to the Commissioner until the hearing of the appeal and had not been supported in evidence by the controlling director and shareholder from the Taiwan company. He submitted that the document was of low credibility.

The representative for the Commissioner then referred to the oral evidence given by Mr W and questioned the truth and credibility of what Mr W had said. He also pointed out that no evidence had been called from the real estate agent appointed by the Taxpayer to let the properties.

The representative for the Commissioner also tabled before us the following additional cases:

Miller v Minister of Pensions [1947] 2 All ER 372

Lionel Simmons & Others v CIR 53 TC 461

Gladstone Development Co Ltd v Strick 30 TC 131

Shadford v Fairweather 43 TC 291

CIR v Livingston 11 TC 538

Harrison v Griffiths 40 TC 281

Marson v Morton 59 TC 381

Pickford v Quirke 13 TC 251

Richfield International Land & Investment Co Ltd v CIR 3 HKTC 167

As was pointed out by the representatives for both the Taxpayer and the Commissioner it is necessary to ascertain what was the intention of the Taxpayer when it acquired the properties. The intention is obviously a subjective matter but it must be tested objectively.

As is well-known the onus of proof is upon the Taxpayer. Section 68(4) of the Inland Revenue Ordinance states that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the Taxpayer.

Prima facie the undisputed facts of this case point in the direction of property trading. The Taxpayer agreed to purchase two factory units when they were still in the course of development and disposed of the same before completion of the purchase took place. The disposal took the time honoured form of the Taxpayer arranging to have the sale and purchase agreements cancelled and new sale and purchase agreements entered into by the developer with a new purchaser. A substantial premium was paid to the Taxpayer for giving up its rights to acquire the properties. The period between the Taxpayer entering into the purchase agreements for the properties on 15 April 1988 and the Taxpayer disposing of the properties at a substantial profit on 8 November 1988 was less than 7 months. Whilst it is true to say that the sale of an asset does not convert a long-term asset into a trading asset, a sale of an asset in such a manner and after such a short period of time gives a strong indication that the asset was originally a trading asset and not a long-term investment. For an asset to be a long-term investment in such circumstances there must have been some superventing circumstances which make it clear that the original intention of the Taxpayer was fundamentally changed shortly after the asset was acquired. Furthermore there must be clear evidence to prove what the Taxpayer alleges has happened.

In the present case we have the benefit of the evidence of Mr W. He produced a number of documents and was subject to cross examination. Unfortunately for the Taxpayer we do not find the evidence of Mr W to be credible. We do not accept as a fact that at the time of acquiring the properties it was the intention of the Taxpayer to lease the same to any of the associated companies. Mr W asked us to believe that he was the motivating force behind the Taxpayer, the Taiwan company, and the two Hong Kong companies. Both Mr W in his evidence and the representative for the Taxpayer said clearly and positively that for all practical purposes of this case it was Mr W who controlled all of the various companies which were involved. This is the foundation of the case for the Taxpayer and it raises some very grave doubts in our minds about the accuracy of the evidence of Mr W. Apparently in February 1988 Mr W looked for and found two factory units intending to lease the same to associated companies which were controlled by him. We are told that one of these companies required warehouse accommodation and one required factory premises. We are then told that in March 1988 M Ltd decided not to rent the two factory units because Mr W thought they would be better for the Taiwan company. He said that he thought that it would be more economical for the Hong Kong company to purchase its own warehouse space. We find this quite incredible. We are asked to believe that on 1 March 1988 the Taxpayer made its decision to purchase two factory units with the

intention that they would or might be leased to another company also controlled by Mr W. Within a period of days, that is early March, Mr W decided that he had changed his mind and that the Hong Kong company would not rent the units.

We are told that an agreement was reached on 3 March 1988 with the Taiwan company, also de facto controlled by Mr W, to rent the properties. Then in May 1988 the Taiwan company decided to change its strategy and not to lease the properties. We have no evidence of the alleged political developments which took place in Taiwan and in the People's Republic of China in the months of March, April and May which are supposed to have caused Mr W to have such a change of intention. We also note that the sale and purchase agreements for the acquisition of the properties by the Taxpayer were made on 15 April 1988 and this is of course the relevant date.

Mr W asked us to believe that in August 1988 the Taxpayer engaged the services of a real estate agent for the purpose of renting out the properties. No one from the agency was called to give evidence to substantiate this and there was no documentary evidence even though we were told that 'tenants were invited to rent through advertising but could not be found'. Perhaps it is not surprising that tenants could not be found for a building which was not due for completion until February the following year. If it had been the genuine intention of the Taxpayer to rent the properties then we would have expected to have more evidence of a longer and more genuine attempt to lease the same out. We do not know for how long the properties were offered for rent and we do not know when the agent advised the Taxpayer to sell. We do not know how long it took to find a purchaser. All that we know is that by 8 November a purchaser had being found, negotiations for sale had been completed and a sale agreement dated that date could be executed.

We find the documentary evidence given to us on behalf of the Taxpayer in relation to the intention of the Taxpayer to be unsatisfactory. If the documentary evidence had existed when the matter was being argued with the assessor or prior to the determination of the Deputy Commissioner we would expect that it would have been produced at that time. We do not accept as proved to our satisfaction to be genuine the various minutes tabled before us nor the alleged memorandum or agreement in Chinese dated 10 March 1988.

As we have stated above the onus of proof is upon the Taxpayer. We do not accept the evidence of Mr W in relation to the intention of the Taxpayer at the time when it agreed to purchase the properties. We find as a fact that at the time when the Taxpayer decided to purchase the properties it did so with the intent of turning the same to account as a trading transaction as soon as it saw fit so to do.

Even had we accepted the evidence of Mr W we would still find in favour of the Commissioner and against the Taxpayer. At its best the evidence of Mr W was no more than that when the Taxpayer acquired the properties it hoped that it might be able to lease the same to an associated company. Clearly from the subsequent facts at the time of acquisition no final or positive decision had been taken. If the Taiwan company had decided to rent the properties then the Taxpayer would have agreed to do so. If on the other

hand the Taiwan company decided not to rent the properties then the Taxpayer would sell the same as it in fact did. In such circumstances it would not be possible to hold that the Taxpayer acquired the properties as a long-term capital investment.

For the reasons given we dismiss this appeal and confirm the determination of the Deputy Commissioner.