

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D37/89

Profits tax – acquisition of property – joint redevelopment – units in redeveloped building assigned to taxpayer and let for rental – subsequent sale of units – whether realisation of capital assets.

Panel: T J Gregory (chairman), Edward Chow Kam Wah and Wilfred Lee Chee Wah.

Date of hearing: 14 April 1989.

Date of decision: 22 August 1989.

The taxpayer acquired shares in a property which was a building site. The property was redeveloped under a joint venture under which certain units in the new building belonged to the taxpayer. The taxpayer sold some units before completion and was assessed to profits tax upon the resulting profit. The taxpayer unsuccessfully appealed to the Board of Review against this assessment. Subsequently the taxpayer sold further units at a profit and claimed that the profits arose on the realisation of capital assets. The assessor rejected this claim and assessed the profit to profits tax.

Held:

Whether or not the taxpayer is an investor in real estate or a dealer in real estate is a question of fact and the onus is on the taxpayer to prove its case. The taxpayer was unable to discharge the burden of proof.

Appeal dismissed.

Cases referred to:

Imperial Chemical Industries v Caro 39 TC 374

Shadford v H Fairweather & Co Ltd 43 TC 291

BR 9/74, IRBRD, vol 1, 153

Simmons v CIR 53 TC 461

D16/88, IRBRD, vol 3, 225

Wong Yui Keung for the Commissioner of Inland Revenue.

Taxpayer company represented by the director.

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Decision:

1. THE NATURE OF THE APPEAL

The Taxpayer appealed to the Board of Review against the determination of the Commissioner dated 25 May 1987, which rejected the Taxpayer's objection to profits tax assessments for the years of assessment 1982/83, 1984/85 and 1985/86 raised on it. The Taxpayer claimed that the profits in question were capital gains and not profits arising from an adventure in the nature of a trade.

2. THE FACTS

Whilst there was no 'statement of agreed facts', it was apparent that there was no dispute as to certain of the facts between the Taxpayer and the Revenue. The following may be said to be the factual background:

- 2.1 The Taxpayer was incorporated in Hong Kong in 1971.
- 2.2 In due course the Taxpayer acquired a 9/20 share of a property situated in Hong Kong ('the property') which, at the time, was a building site.
- 2.3 In 1977 the Taxpayer agreed to assign the property to developers in exchange for the agreement of the developers to assign certain parts of the new building to be erected on the site to the Taxpayer on completion.
- 2.4 In due course the redevelopment was completed and an occupation permit was issued on 2 May 1980 and in fulfillment of the agreement between the Taxpayer and the developers the parts of the new building to be assigned to the Taxpayer were either assigned to purchasers from the Taxpayer or to the Taxpayer. The end result was that one shop, seven car parks and five flats were assigned to the Taxpayer which then proceeded to obtain tenants for these units.
- 2.5 During the year of assessment 1980/81 the Taxpayer was assessed to profits tax on the sale of those of the flats and car parks in the building which were assigned to purchasers from the Taxpayer by confirmatory assignment, refer paragraph 2.4 above, and an objection against that assessment was the subject matter of a determination by the Commissioner issued on 1 August 1984 and an unsuccessful appeal to this Board whose determination was issued on 21 January 1987.
- 2.6 In the year of assessment 1982/83 the Taxpayer contracted to sell one of the flats which had been assigned to it, refer paragraph 2.4 above, together with a car park. The sale of the car park was completed but the sale of the flat fell

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through. The Taxpayer treated the profit on the sale of the car park as a capital gain.

- 2.7 In the year of assessment 1984/85 the flat referred to in paragraph 2.5 above was successfully sold and, again, the Taxpayer treated the profit on the disposal as a capital gain.
- 2.8 In the year 1985/86 the Taxpayer disposed of another of the flats and another of the car parking spaces from amongst those assigned to it in 1980 and, again, in its accounts treated the profit on the disposal as capital gain.
- 2.9 In the year ended 31 March 1985 the Taxpayer purchased a residential unit at a cost of \$898,195 and, although it is not relevant to this appeal, in the year ended 31 March 1987 the Taxpayer purchased a further property on Hong Kong Island.

3. DOCUMENTATION

During the appeal the Board had before it copies of the following documents:

- 3.1 Profits tax return for 1979/80 and supporting accounts and schedules.
- 3.2 Profits tax return for 1980/81 and supporting accounts and schedules.
- 3.3 Profits tax return for 1981/82 and supporting accounts and schedules.
- 3.4 Profits tax return for 1982/83 and supporting accounts and schedules.
- 3.5 Profits tax return for 1983/84 and supporting accounts and schedules.
- 3.6 Profits tax return for 1984/85 and supporting accounts and schedules.
- 3.7 The determination of the Commissioner with respect to the year of assessment 1980/81 and dated 1 August 1984.
- 3.8 Profits tax return for 1985/86 and supporting accounts and schedules.
- 3.9 Profits tax return for 1986/87 and supporting accounts and schedules.
- 3.10 Taxpayer's letter dated 9 February 1982.
- 3.11 The decision of the Board of Review with respect to the Taxpayer's appeal against the assessment for the year of assessment 1980/81 dated 21 January 1987.

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- 3.12 The determination of the Commissioner dated 25 May 1987.
- 3.13 Notice of appeal dated 20 June 1987.
- 3.14 A copy of a further letter containing what the Board treated as grounds of appeal dated 6 April 1989.

4. THE CASE FOR THE TAXPAYER

- 4.1 The Taxpayer was represented by a director Mr A who, having been duly sworn, gave evidence.
 - 4.1.1 In essence his evidence-in-chief was that:
 - 4.1.1.1 the properties in question were acquired for investment but were sold when they became vacant because the rentals were too low, with the proceeds of sale being invested in other properties which produced a higher return. He stated that sales were advertised in newspapers.
 - 4.1.1.2 after the hearing of the Taxpayer's appeal against the profits tax assessment for the years of assessment 1980/81 the Taxpayer's directors had met to determine to hold its real estate for investment purposes and had prepared a minute of the meeting but that he had not brought a copy with him.
- 4.2 Cross-examination:
 - 4.2.1 Having been taken through the history of his previous appeal and the fact that the Taxpayer accepted the decision of that Board Mr A agreed that there was no contemporaneous evidence that the Taxpayer had all along intended to invest in real estate.
 - 4.2.2 Mr A was questioned as to the use of a firm of certified public accountants throughout, which was confirmed, and was then taken through the format and content of the audited accounts of the Taxpayer. He agreed that whilst depreciation was charged on furniture and fittings no provision was made in the accounts for depreciation on land and buildings. He was unable to explain this.
- 4.3 Concluding submission:
 - 4.3.1 Mr A commented on the Taxpayer's letter of 6 April 1989 namely:
 - 4.3.1.1 In the year of assessment ended 31 March 1981 the Taxpayer's accountants decided that as the flats sold had not yield any income the proceeds did not qualify as capital gains.

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- 4.3.1.2 The loss referred to in paragraph 1(9) of the previous determination was less than half of the actual loss.
- 4.3.1.3 When the sales of flats which had been let were completed the auditor considered the proceeds of sale as capital gains.
- 4.3.2 The Taxpayer wanted a line drawn: the Taxpayer was of the view that all of the properties owned by it were investments and that when disposals were effected it was to acquire a better investment with a better yield.

5. THE REVENUE'S SUBMISSION

The submission of the Revenue was by way of a written submission and may be summarised as follows:

- 5.1 The onus of proof was on the Taxpayer and that when the Board was requested to consider tax relief in the form of exclusion from the charge to profits tax of the profits arising from the sale of capital assets, as prescribed by section 14 of the Inland Revenue Ordinance ('the Ordinance'), it is for the Taxpayer to establish that it is entitled to the relief, refer Lord Eversheld M R in Imperial Chemical Industries v Caro 39 TC 374 at page 385.
- 5.2 In the previous appeal, the appeal against the assessment for the year of assessment 1980/81, the Board had found that the redevelopment of the site was entered into in the nature of a trade whereby the profits in question fell within section 14 of the Ordinance.
- 5.3 As to the grounds of appeal:
- 5.3.1 Ground 1 reads:
- 'From 1973 when the land was acquired to 1980 when the building was completed, since our intention was never clearly stated it was determined by your office that we procured the property for the purpose of trade. As it was an oversight on our part, we accepted the consequences.'
- The Revenue submitted that that acknowledgement applied to the acquisition of all of the flats and car parks acquired in the building and in the absence of evidence to substantiate the change of intention such continued to apply.
- 5.3.2 Ground 2 reads:
- 'Since 1980, our intention of investing has been clearly stated in our tax return prepared by our accountant. Therefore, the flats in the subject building should

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be viewed as two separate lots, both sold before 1980 as one and the rest of them as another.’

5.3.2.1 The Revenue drew attention to the manner in which the Taxpayer’s accounts were maintained and pointed out that the uniform presentation in the balance sheet did not justify any different treatment of the properties which were all developed in a single venture. It was submitted that the change in the preparation of the accounts was not conclusive and it was necessary to weigh that change against other evidence so as to decide the nature of the transaction, refer Buckley J at page 299 of Shadford v H Fairweather & Co Ltd 43 TC 291.

5.3.2.2 Notwithstanding the impact of the prior appeal the Taxpayer had not produced any contemporaneous documentary evidence at this appeal to substantiate its claim that the flats were intended for investment. Reference was made to BR 9/74, IRBRD, vol 1, 153 which dealt with the question of intention and submitted that the actions of the Taxpayer did not bear out its alleged intention of investing.

5.4 The first sentence of the final material paragraph reads:

‘If it is your determination that our intention in 1973 was property trading, then clearly our intention in 1980 has changed as stated in our tax return.’

The Revenue cited the well-known passage of the statement of Lord Wilberforce at page 49 of Simmons v CIR 53 TC 461 and then to the remarks made by the Board of Review in D16/88, IRBRD, vol 3, 225.

The Revenue pointed out that prior to the notice of appeal dated 20 June 1987 the Taxpayer had never advised the Inland Revenue Department that there had been a change of intention in 1980 nor was there anything in the profits tax return for the year of assessment 1980/81 to substantiate the genuineness of any such change of intention and that the Taxpayer’s alleged change of intention entirely lacked the precision required, as stated by Lord Wilberforce.

5.5 The second sentence of the final material paragraph reads:

‘To settle the matter in a fair manner, I sincerely request that for tax purposes, consider all units were sold and bought at market value in 1980 and profits tax for the year re-assessed.’

The Revenue pointed out the impracticality of this suggestion.

5.6 The Revenue’s submission concluded by stating that the flats and car parks assigned upon completion of the redevelopment, refer paragraph 2.4 above, should be treated as trading stock and its property dealing business or trade as a

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continuing trade both in the year of assessment 1980/81 and in subsequent years for the following reasons:

- 5.6.1 The determination of the Board at the previous appeal was to this effect;
- 5.6.2 There was no justification in differentiating between the flats and car parks in the development and that the leasing of flats was not indicative in an intention to retain for investment as unsold units were frequently let by developers until they could be sold;
- 5.6.3 The Taxpayer was using a competent firm of accountants for preparing its accounts and its returns and neither the Taxpayer nor its accountants advised the Revenue of a change of intention, that is, to cease conducting a property dealing business and commence an investment business;
- 5.6.4 No depreciation had been charged with respect to the real estate, although it was charged with respect to other fixed assets;
- 5.6.5 That an examination of the Taxpayer accounts from the year of assessment 1980/81 to the year of assessment 1986/87 disclosed that the Taxpayer had now sold 80% of the originally acquired flats and car parks.

6. REASONS FOR THE DECISION

- 6.1 The Board would wish to record the fact that it has some considerable sympathy with the Taxpayer. Additionally, Mr A came across as an entirely straightforward and honest individual: the Taxpayer had been through an appeal of an identical nature with respect to the year of assessment 1980/81 as recently as December 1986, with an adverse decision handed down on 31 January 1987, but no attempt had been made by Mr A to suggest that that decision was incorrect because of a failure on the Taxpayer's part to appreciate the type of evidence the Board required and no attempt was made to produce documentation allegedly to establish the allegations as to the intent of the Taxpayer prior to the year of assessment 1980/81.
- 6.2 Whether or not the Taxpayer is an investor in real estate or a dealer in real estate has to be a question of fact and the onus is on the Taxpayer to prove which business it conducts.
- 6.3 In this appeal the Taxpayer had no contemporaneous or other documentation to establish what the intentions of the Taxpayer were at the time it acquired the property or its intentions with respect to the flats and car parks owned following redevelopment. The only evidence was the oral evidence of a director, Mr A.

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- 6.4 There was no evidence that the sale of some part of the flats and car parks which were to be assigned to the Taxpayer upon completion of the redevelopment was effect either to repay any borrowings, the account reflects no borrowings, or for the purpose of investment in a more satisfactory investment. Similarly, it was not until the year of assessment 1985/86 that a further property investment was made and notwithstanding disposals in the years of assessments 1982/83 and 1984/85.
- 6.5 The accounting treatment of the affairs of the Taxpayer is inconsistent with an investment, as opposed to a trading business.
- 6.6 The Board is of the view that the Taxpayer has failed to discharge the burden of proof which the Board accepts from the authorities quoted is imposed upon a taxpayer in an appeal of this nature.

7. DECISION

For the reasons given the Board dismisses this appeal.