

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D45/87

*Board of Review:*

Henry Litton, *Chairman*, Chiu Chun-bong and Eric K. C. Lo, *Members*.

**5 November 1987.**

Profits Tax—whether an exchange loss realised by the company on repayment of a US dollar loan deductible in arriving at the assessable profits of the company.

The Appellant company borrowed a large sum of US dollars in March 1981 when the rate of exchange was HK\$5.27 to US\$1. In September 1981 the company repaid the sum in full, by which time the Hong Kong dollar had depreciated in value as against the US dollar, the rate of exchange then being HK\$6.011 to US\$1. The Appellant company therefore suffered an exchange loss. The loss came about in consequence of the Appellant company borrowing a large sum. The sum borrowed was for the purpose of increasing the working capital of the Appellant company and to enable the Appellant company to acquire further fixed assets.

*Held:*

The exchange loss was of capital nature.

Appeal dismissed.

D. J. Gaskin for the Commissioner of Inland Revenue.

Alex Chang Kwok-wah of Messrs Wilfred Wan & Co for the Appellant.

*Reasons:*

1. This appeal concerns a simple point; whether an exchange loss realised by the company on repayment of a US dollar loan is deductible in arriving at the assessable profits of the company. The loss arose in this way:—

- (i) On 18 March 1981, the company borrowed from R Limited a sum of US\$800,000. At that time, the rate of exchange was HK\$5.27 to US\$1. Thus, expressed in Hong Kong dollar terms, the sum borrowed was HK\$4,216,000.
- (ii) On 15 September 1981, the company repaid R Limited the US\$800,000 in full. At the date of repayment, the Hong Kong dollar had depreciated in value as against the US dollar, the rate of exchange then being HK\$6.011 to US\$1. Thus, in Hong Kong dollar terms, the company had to repay HK\$4,808,800.00 in order to discharge its obligation.
- (iii) The company therefore suffered an exchange loss of HK\$592,800.

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2. In its 1981/82 Profits Tax Return, the company claimed as a deduction the sum of \$592,800 as a “loss on difference in exchange”. On 29 June 1983, after the assessor had ascertained further details from the company’s tax representative (Messrs Wilfred Wan & Company), an additional assessment was raised on the company by disallowing the claimed loss on exchange in the sum of \$592,800.

3. In objecting to the additional assessment, the tax representative stated as follows:—

“... we wish to add that the US Dollar Loan/Facilities of US\$800,000 obtained from R Limited was for the purposes of further acquisition of Capital Assets—Leasehold Land and Buildings and Furniture and Fixtures for the Company totalling to \$5,273,101.00 for producing more rental income to the Company which is assessable to Profits Tax Assessment. You are kindly invited to note that both the Capital Assets and Rental Income have been greatly increased during the past few years ...”

4. In a further letter dated 10 January 1984, the tax representative stated:—

“The relevant facts of our clients ere now summarised as below:—

- (a) that our clients were aware of an expansion of its activities in landed properties which expansion entailed more increased rental income to the company ...
- (b) that the purposes of the borrowings were to finance the expansion of the Company and to provide the additional working capital which the expansion required”.

5. The Commissioner dismissed the objection and confirmed the additional assessment.

6. On 8 October 1985, the company through its representative (Wilfred Wan & Co) lodged its appeal against the assessment as confirmed by the Commissioner. The grounds of appeal in the form of a “memorandum of submission” are rambling and in places incomprehensible. We derived little assistance from its contents.

7. At the hearing before us, no further evidence was adduced by the representative on behalf of the company beyond stating that the primary facts, as set out in the Commissioner’s determination, were agreed. The facts of relevance, for the purposes of this appeal, are as follows:—

- (i) The company was incorporated on 30 April 1974 and its issued capital has always been \$1 million.
- (ii) The company has built up over the years in extensive real-estate portfolio, predominantly for rental purposes, which as at 31 March 1984 stood at a figure of \$22.6 million. The company as also acquired a portfolio of shares in the Hong Kong Telephone Company Limited and owns 49.99% of the issued capital of a private company.

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- (iii) In its letter dated 9 March 1981 to the company, setting out the terms under which the US\$800,000 facility was made available to the company, R Limited referred to it as for “general working capital purposes”. The expiry date for the repayment of sums drawn under the facility made available by R Limited was stated in the letter of 9 March 1981 to be 30 April 1982 but the letter went on to say:—

“Prior to the expiry date, however, we shall be pleased to consider a renewal of the facility”.

- (iv) The facility was drawn down in one lump sum on 18 March 1981 when R Limited drew a cheque, in favour of the company, in the sum of HK\$4,216,000 (this amount represented US\$800,000 at the exchange rate of US\$1=HK\$5.27).
- (v) The loan was included in the company’s Balance Sheet as at 31 March 1981 under the heading “Mortgage Loan”.
- (vi) The capital assets and rental income of the company have increased substantially between the years 1980 to 1983 as follows:—

<i>Y/E</i>	<i>Capital Assets</i>	<i>Rental Income</i>
1980	7,598,464.48	603,376.70
1981	12,871,565.48	1,019,401.60
1982	11,401,073.48	1,352,350.19
1983	23,117,383.98	2,063,342.90

- (vii) The facts set out above are wholly consistent with the statement in the representative’s letter to the Commissioner, dated 10 January 1984 (referred to in paragraph 4 above), to the effect that the borrowings were to finance the expansion of the company.
- (viii) In fact, the US\$800,000 was fully repaid on 15 September 1981. No explanation has been given by the company, and no evidence was adduced before us, as to why the company should have repaid the sum before the expiry date. It is possible (and we put the matter no higher than that) that the company’s Directors, fearing the further depreciation of the value of the Hong Kong dollar as against the US dollar, thought it prudent to reduce the company’s exposure to the risk of greater exchange loss. If this were so, the Directors would have been wise in their decision, as things subsequently transpired.

8. On the facts as we have set out above, the question for our determination is whether the exchange loss is one which should properly be treated as being on revenue account or on capital account. The onus of proof is upon the appellant company to satisfy us that it is a

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“revenue loss” in which case it would be properly allowable as a deduction in computing the company’s assessable profits.

9. The loss came about in consequence of the company’s borrowing of the sum of US\$800,000. The sum borrowed was for the purpose of increasing the working capital of the company and to enable the company to acquire further fixed assets. The borrowing was therefore plainly on capital account. We cannot see how, in the circumstances, the exchange loss which came about on the repayment of the loan could be otherwise than on capital account.

10. This is not a case of a company borrowing money for the purpose of increasing its circulating capital, such as often happens with finance companies. Nor is this a case of a company turning over its trading stock for profit, and seeking to increase its trading stock by borrowing.

11. A number of cases were cited to us in argument by Mr. D. J. Gaskin, the Commissioner’s representative at the hearing but, appreciating as we do his careful citation of authority, we do not feel it necessary to refer to those authorities in coming to a decision. We regard this as a plain and obvious case.

12. For the reasons given above, the appeal is dismissed and the assessment is confirmed.