

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D 5/80

Board of Review:

S. V. Gittins, *Chairman*, D. Barret, Donald Q. Cheung, & R. Beynon, *Members*.

11 July 1980.

Inland Revenue Ordinance – development company – profits tax – additional assessment – cessation of business – period of assessment – application of s. 18D(2).

The appellant was a company incorporated in Hong Kong in 1971. In 1972 it acquired two properties and in 1972 together with three other companies entered into a joint development agreement for the development of the properties.

In the course of redevelopment the appellant entered into contracts for sale to members of the public of its entitlements in the new building under construction. These contracts were entered into between January 1975 and August 1975. On the 10 June 1975 an occupation permit was issued by the Building Authority. On the 24 February 1977 the appellant notified the Commissioner of Inland Revenue that it had ceased business on the 13 August 1975.

The appellant's Profits Tax return for 1975/76 showed adjusted profits of \$7,303,268.00 for year ending 31 December 1975 and assessable profits of \$4,381,961.00 which was expressed to be the average profit for the period 1 April 1975 to 13 August 1975. The assessor did not accept this and raised an assessment on the whole amount of the adjusted profits. The appellant objected and the Commissioner confirmed the assessment. The appellant appealed to the Board of Review.

It was agreed by both parties that section 18D(2) applied.

The appellant contended that its profits arose from the 1972 joint development agreement and that whilst for accounting purposes profits may be brought in at the date of the Occupation Permit this does not mean that the profits arose on that date. Furthermore since the company has always kept its accounts on a calendar year basis and the profits in this case arose in the year of account in which the Occupation Permit was issued, the Revenue is not entitled to break up the profits in that year of account.

The Commissioner contended that:

- (a) For taxation purposes profits cannot be anticipated.

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- (b) In the case of pre-selling flats under construction no profits can arise ahead of the occupation permit.
- (c) On the facts all profits arose in the period 1 April 1975 to 13 August 1975.

Decision: The majority of the Board found as follows:

- (a) No profits arose until after the issue of the occupation permit.
- (b) These profits were properly entered in the appellant's accounts for its accounting year commencing 1 January 1975.
- (c) Under s. 18D(2) in order to compute assessable profits for the year of assessment commencing 1 April 1975 it is proper and necessary to apportion the appellant's profits for its accounting year to its profits for the year of assessment.
- (d) The appellant acted correctly in applying the apportionment provisions of section 18E(3).
- (e) Appeal allowed and assessment reduced to \$4,381,961.00.

P. A. L. Vine of Messrs. Deacons for the Appellant.
A. K. Gill for Commissioner of Inland Revenue.

Reasons:

1. The facts upon which the Commissioner's determination was arrived at are agreed to by Taxpayer Company and are as follows: -
 - (1) The Company has objected to the additional Profits Tax assessment 1975/76 raised on it upon its cessation of business on 13 August 1975 claiming that the assessable profits should be computed by reference to the basis period 1 April 1975 to 13 August 1975 pursuant to section 18D(2) of the Inland Revenue Ordinance [the Ordinance] instead of the basis period 1 January 1975 to 13 August 1975 adopted by the Assessor under section 18D(1) of the Ordinance.
 - (2) The Company was incorporated in Hong Kong on 19 November 1971. In early 1972, the Company acquired the two old buildings in Hong Kong and entered into a joint development agreement dated 24 May 1972 with three other companies for development of the properties [the Agreement].
 - (3) The Agreement provided that the Company would be entitled to 2/7th of the equal and undivided shares or parts of interest or estate of the new building to be erected on the site.

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- (4) In the course of redevelopment, the Company offered its entitlements in the Building for sale to the public. All the units representing the Company's entitlements were taken up. Agreements for purchase and sale were entered into with the various purchasers from January 1975 to August 1975.
- (5) The Building was completed in 1975 and the Occupation Permit was issued by the Office of the Building Authority on 10 June 1975.
- (6) By a letter of 24 February 1977, the Company notified the Commissioner that it had ceased business in August 1975.
- (7) Through its auditor and authorized representative [the Representative], the Company filed a Profits Tax Return for 1975/76 showing Assessable Profits of \$4,381,961, supported by a tax computation as follows –

Section 18D(2)

Basis Period: 1 April 1975 to 13 August 1975

Profits for the year ended 31 December 1975 as per
accounts now submitted

HK\$7,307,648

Deduct: Prior Year Adjustment – Audit Fee &
Disbursement under-provided \$2,741

Overheads applicable to Property

Redevelopment b/f:

Year ended 31.12.73 HK\$ 320

Year ended 31.12.74 1,319 1,639

4,380

Adjusted Profits

HK\$7,303,268

Average Profit for the period from 1 April 1975
to 13 August 1975 as based on the
above figures: -

135/225 of \$7,303,268

HK\$4,381,961

- (8) This was not accepted by the Assessor who raised an assessment on the whole amount of the adjusted profits, viz. \$7,303,268.
 - (9) The Company objected to this assessment.
 - (10) The Company's first set of accounts covered the period from 19 November 1971 (date of incorporation) to 31 December 1972. Thereafter accounts were prepared annually to 31 December.
2. The Commissioner confirmed the assessment for the following reasons: -

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- (1) That moneys received are not earned until all the conditions attaching to their receipt are fulfilled and profits do not arise until they can be ascertained.
 - (2) In this case the profits flowed from just one development project and did not arise until the issue of the Occupation Permit on 10 June 1975.
 - (3) All the profits arose after 10 June 1975, i.e. within the period from 1 April 1975 (the beginning of the year of assessment) to 13 August 1975 (the date on which the Company ceased business).
 - (4) No profits arose in the period 1 January 1975 to 31 March 1975 so that there is no case for apportionment under section 18E(3).
3. At the hearing it was agreed that section 18D(2) applies. This subsection provides as follows: -
- “18D. (2) Where in any year of assessment commencing on or after the 1 April 1975 a person ceases to carry on a trade, profession or business in the Colony which was commenced by him in the Colony before the 1 April 1974, the assessable profits from that source for the year of assessment in which the cessation occurs shall be computed on the amount of the profits therefrom arising in or derived from the Colony during the period beginning on the 1 April in that year and ending on the date of cessation.”
4. It was not disputed by the Commissioner’s representative that the Company’s method of keeping its accounts was other than in accordance with accepted accountancy practice.
5. *Contentions on behalf of the Company.*
- (a) The revenue earning capacity and consequently its profits, arose from the joint development agreement dated 24 May 1972.
 - (b) While it is accepted accountancy practice in property development to bring profits in at the date of the Occupation Permit, this does not mean that the profits arose on that date.
 - (c) The Company had always kept its accounts on a calendar year basis. The profits in this case arose in the year of account in which the Occupation Permit is issued and the Revenue is not entitled to break up the profits in that year of account.
6. *Contentions on behalf of the Commissioner*
- (a) For taxation purposes profits cannot be anticipated.

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- (b) In the case of pre-selling flats, no profits can arise ahead of completion of the sales. Where completion is dependent on the issue of the Occupation Permit, as in the present case, no profit can arise ahead of that Permit.
 - (c) The profits arose in the Company's accounting year 1 January 1975 to 13 August 1975. But the facts show that no profits arose in the period 1 January 1975 to 31 March 1975 and that they all arose in the period 1 April 1975 to 13 August 1975.
 - (d) In the circumstances the assessment was properly raised on the basis that the whole of the profits arose after 1 April 1975.
7. *Minority Decision* (Mr. R. Beynon)
- (a) I accept the Revenue's contentions in their entirety.
 - (b) I would dismiss the appeal and confirm the assessment.
8. *Decision of the Majority of the Board*
- (a) We accept the Revenue's contention that in this case no profits arose for the purpose of Profits Tax until after the issue of the Occupation Permit on 10 June 1975.
 - (b) These profits were properly entered in the Company's accounts for its accounting year commencing on 1 January 1975. The Company had kept its accounts on this basis since its incorporation except for a 13½ months period in its first year.
 - (c) We are of the opinion that in order to compute the assessable profits for the year of assessment commencing on 1 April 1975 for the purposes of section 18D(2), it was proper and necessary to apportion the Company's profits for its accounting year to its profits for the year of assessment.
 - (d) We are of the opinion that it was proper to apply the apportionment provisions of section 18E(3) as was done by the Taxpayer.
 - (e) The Appeal is allowed and the assessment is reduced to \$4,381,961 as submitted by the Company.