Case No. D5/88

Assessment – profits tax – statement of loss – whether an 'assessment' – whether 'final and conclusive' – s 70 of the Inland Revenue Ordinance.

Assessment – further assessment – whether such assessment can be based on information which was before the assessor at the time of the first assessment – extent to which information must have been disclosed – s 70 of the Inland Revenue Ordinance.

Profits tax – sale of land – whether profits were trading gains or realization of capital – evidential matters: prospectus, statement of intention, treatment in accounts and long holding period – s 14 of the Inland Revenue Ordinance.

Profits tax – sale of trading stock – compulsory acquisition – whether resumption proceeds could be assessable – s 14 of the Inland Revenue Ordinance.

Panel: Howard F G Hobson (chairman), William W L Chan and Robert C Kwok.

Dates of hearing: 9 and 10 December 1987; 26 and 27 January 1988.
Date of decision: 29 April 1988.

The taxpayer, a listed company, acquired land in 1973, some of which was compulsorily acquired by the government between 1976 and 1982.

The original assessment which had been issued to the taxpayer showed profits of $405,084. The taxpayer objected on the grounds that profits on the sale of one property were capital and therefore tax-free, and that losses on the sale of another property were revenue and therefore deductible. The Commissioner accepted the claim for a deduction and issued a 'statement of loss' showing losses of $2,131,614.

The assessor subsequently discovered that the profits had been calculated by taking the cost price to be a figure on revaluation and not the historical cost. He therefore raised a subsequent assessment which showed profits of $13,781,730.

The taxpayer claimed that the subsequent assessment was void because the 'statement of loss' was final and conclusive under s 70 of the Inland Revenue Ordinance and that the proviso thereto did not permit a subsequent assessment because the 'statement of loss' had been determined on objection.

Alternatively, the taxpayer claimed that the revaluations had been disclosed in the taxpayer's accounts which had been in the assessor's possession at the time he issued the

'statement of loss'. It argued that s 70 permitted subsequent assessments only if there was new information in the assessor's possession which had not been made available at the time of the prior assessment (that is, the 'statement of loss').

Held:

The assessment was valid.

(a) A 'statement of loss' is not an 'assessment' within the meaning of s 70. The first assessment had been effectively annulled by the issue of the 'statement of loss', so that there was no 'assessment' within the meaning of s 70 which could be 'final and conclusive'.

(b) Although the taxpayer's accounts referred to the revaluations, no figures had been given in the accounts and therefore the information in the accounts had not been sufficient to allow a correct assessment to be made.

The decision also discussed whether the gains were on capital or revenue account. Arguments accepted by the Board included:

(c) Where a taxpayer's prospectus values some of its properties on an open market sale basis and other properties on an investment basis, the taxpayer is making representations that the former is trading stock and the latter is held for long-term investment.

(d) A declaration by the taxpayer that it intended to redevelop properties is of little effect where the taxpayer has taken no steps to redevelop the properties.

(e) Land is capable of being held either for short-term speculation or long-term investment.

(f) The treatment of property as a 'fixed asset' in the taxpayer's accounts is, by itself, inconclusive of its true nature.

(g) A long holding period, by itself, is not sufficient to show a change of intention from trading stock to an investment asset.

(h) If land is trading stock, the compulsory acquisition of that land by the government gives rise to assessable profits.

Appeal dismissed.

Cases referred to:

BR23/74, vol 1, IRBRD 168
D11/80, vol 1, IRBRD 374
CIR v Sincere Insurance and Investment Co Ltd (1973) 1 HKTC 602
Hillerns and Fowler v Murray (1932) 17 TC 77
Mok Tsze Fung v CIR (1962) 1 HKTC 166
Tati Co Ltd v Collector of Income Tax 37 SATC 75

Wan Tsang Yuk Ling for the Commissioner of Inland Revenue.
David P H Wong of Wong Hui & Co for the taxpayer.

Decision:

This appeal is concerned with the question of whether profits accruing from sales of certain agricultural land and from compensation on resumption of other agricultural land constituted capital gains or trading profits. These lands are herein referred to as the 'Land in question' to differentiate them from other property bought, sold or held by the Taxpayer.

1. BACKGROUND

1.1 The Taxpayer was incorporated in 1971 and converted to a public company in 1973 and was listed on the stock exchanges.

1.2 In the year ended 31 March 1973 the Company acquired (amongst others) the following land and properties:

(a) five floors of a building in Western;

(b) four flats in Mid-Levels;

(c) two lots in the New Territories;

(d) a further lot in the New Territories;

(e) a further lot in the New Territories; and

(f) nine lots in the New Territories.

1.3 The Land in question comprised 1.2(c), (e) and (f).

1.4 Of the Land in question, 1.2(c) was exchanged for Letters B and the latter were disposed of in the year ended 31 March 1980; and 1.2(e) and (f) were resumed in the year ended 31 March 1982.

2. ASSESSMENTS CONCERNED

2.1 The disposals at 1.2(a) gave rise to profits of $1,382,184 and $2,122,200 (total $3,504,384) and were the subject of a 1979/80 assessment.

2.2 The disposals at 1.2(a) resulted in a profit of $13,781,730 and were assessed to tax for the year 1981/82. The Taxpayer's representative began with a preliminary ground of appeal concerning the validity of the 1981/82 assessment which we will deal with at the end of this decision.

2.3 The attached summary (prepared by Mrs Wan, the Revenue's representative, to whom we are indebted for this very helpful précis) shows properties held by the Taxpayer and dispositions over the years referred to.

3. EVIDENCE

Mr A, the Managing Director of the Taxpayer, testified as follows:

3.1 His family together with Mr B were the majority shareholders. It was their intention that, having been converted into a public company and obtained listings, the Taxpayer should engage in manufacturing, and Mr B suggested the Taxpayer buy the agricultural land in that area of the New Territories which was zoned for light industry. In consequence, the Taxpayer bought the Land in question. Mr B believed that the Government would allow the Taxpayer to build on the land. Mr B and a Mr C, who Mr A said was influential in New Territories circles, were to conduct the necessary negotiations. Mr A was unsure why those negotiations were not fruitful; he said he was unaware that the Land in question might be resumed.

A subsidiary company of the Taxpayer began manufacturing in 1976. This was not done from premises owned by the Taxpayer.

In 1976 the Government resumed 1.2(c) and (d) and gave the Taxpayer Letters B in compensation which Mr A said the Taxpayer intended to exchange for developable land. However, nothing was done until 1979 because the Taxpayer's subsidiary's factory was in satisfactory operation and had been since 1976. In 1979, the Letters B entitlements relevant to 1.2(c) were sold. Mr A said this was done because he was not experienced in land matters and, since Mr B, who had left the Taxpayer by 1979, was no longer co-operating, Mr A decided to abandon the idea of using the Letters B to acquire land upon which to develop a factory for the subsidiary companies.

In cross-examination Mr A was unable to say whether the Taxpayer's minutes recorded that the reason for purchasing the Land in question was to build a factory for the Taxpayer or its subsidiaries.

After a long adjournment he said he had inspected the minute book but it did not disclose the reason for the purchase. The minute book was not tendered in evidence.

An extract from the February 1973 prospectus in connection with the Taxpayer's floatation was produced and Mr A acknowledged that:

(a) it made no mention whatever regarding the intention of the Taxpayer to engage in manufacturing, and

(b) he was described therein as having many years experience in property development. However, Mr A said he was at that time quite unfamiliar with the Crown Lands Resumption Ordinance, Letters B entitlements and land premiums.

The only approach made to an architect regarding redeveloping the Land in question was a verbal one when a four storey building was mooted but the architect suggested the Taxpayer first get the necessary approval for change of use. Mr A did call on the District Office several times but the approaches were informal, nothing was recorded so far as he was aware, there was no correspondence and he did not remember the names of those officers whom he met.

Mr A was quite unclear ('we did not think of it so carefully') as to whether the intention was to convert the Land in question to industrial use on payment of premium or to exchange it for industrial land.

Mr A agreed that the valuation reports (obtained at the time the Taxpayer went public) mentioned the possibility of resumption. However, he thought that merely referred to areas for building roads 'and other purposes'. None of the lots abutted on any main road.

Amongst the papers produced by the Taxpayer was a letter from the Taxpayer to the District Office dated 14 May 1984 requesting a plan of the Land in question and the laying out of the boundaries. Mr A said he could find no reply to that letter: nor would it seem that any attempt was made to follow up. In chief, he said he believed a plan was received; it was not however produced in evidence.

The papers before us disclosed that 1.2(c) and (d) were acquired by the Taxpayer from Mr B for $505,000 and were valued at that price by the surveyors, whereas 1.2(e) and (f) were bought from persons evidently unconnected with the Taxpayer for a total of $678,624 and valued 10 days later at $2,269,000, that is, nearly three and a half times the purchase price.

The surveyors also valued the other properties mentioned at 1.2 above. So far as the built-up properties were concerned, some valuations were based on an investment basis and particulars of tenancies were referred to, but one was based on an open

market sale basis, even though it was let out. All of the Land in question was based on an open market sale basis. Mr A said he had not given any instructions (through his subordinates) to the surveyor to make such a differentiation. In a letter written for the purpose of the hearing the surveyor in effect explained that the differentiation should not be attributed to instructions from the Taxpayer – it was simply the approach decided upon by him.

4. THE TAXPAYER'S SUBMISSIONS

The Taxpayer's representative submitted that the Land in question had been acquired with its own funds and held either as land or Letters B for some seven years and nine years as long term investments and treated as such in the accounts; that they intended to develop the said lots into factory premises to house the Taxpayer's manufacturing activities or to turn the land into income-producing assets; that the Letters B were disposed of following Mr B's departure from the Taxpayer; and that the Land in question was not sold but resumed by the Government under the Crown Lands Resumption Ordinance, and that consequently the gains derived from such disposals were capital gains not chargeable to Profits Tax.

The Taxpayer's representative urged the Board to view the purchase of the Land in question as one single purchase so as to discount the factor of frequency as one of the badges of trade.

Finally it was submitted that the Commissioner was wrong to draw any inference from the differentiation contained in the valuations or from the small or lack of income from those properties.

5. THE REVENUE'S SUBMISSIONS

The Revenue's representative submitted that the Taxpayer failed to adduce sufficient evidence of its stated intention to retain the Land in question for long term investment. It is a well settled principle that a mere declaration of intention will not do to secure immunity from tax (Hillerns and Fowler v Murray (1932) 17 TC 77, 87). In order to ascertain the true character of an asset, it is necessary to consider the full circumstances of the case (Tati Co Ltd v Collector of Income Tax 37 SATC 75) in which regard the following should be noted:

(a) The Taxpayer has been carrying on a business of property dealing. It has turned over properties without development in the case of three further properties in Hong Kong. In each of these instances, profits had been assessed and losses allowed. The transactions in the Land in question should not be viewed in isolation from these transactions. As to the argument that the Land in question should be viewed as a single transaction, the fact remains that there were four separate and distinct purchases from four different vendors.

(b) The Taxpayer accepted the 1973 valuations of the Land in question on an open market basis without demur. Despite the surveyor's statement, he failed to throw light on the doubt as to why an investment basis was adopted with some properties and an open market sale basis was adopted for others including the Land in question: the surveyor was not available for cross-examination nor is the original version of his statement factually incorrect: and it is not clear whether the surveyor approved the amendment made at the beginning of the hearing. Moreover, contrary to the surveyor's statement of policy, another property, which was let at the time of valuation at $7,800 per month, was valued on an open market sale basis. The prospectus is an important document and, by permitting valuations on different bases, the Directors were making representations to the public that some of its property-holdings were earmarked for long term holding and some for trading.

(c) The Taxpayer maintained that its board of directors intended to develop the Land in question into factory premises to house the Group's manufacturing activities. Again there is a complete lack of evidence to support such an intention. The prospectus does not support that claim.

In D11/80, vol 1, IRBRD 374, the Board of Review commented:

> '"Intention" connotes an ability to carry into effect. It is idle to speak of "intention" if the person so intending ... had made no arrangements or taken any steps to enable such intention to be implemented.'

During the period of ownership by the Taxpayer whether of the actual land or the Letters B, the Taxpayer took no positive steps to implement its so-called 'intention'. The only documentary evidence adduced by the Taxpayer was a copy of a letter said to have been sent to the District Office and a copy of a letter dated 5 March 1976 purporting to show that Mr C was authorized to negotiate with the District Office on behalf of the Taxpayer. The latter is of little evidential value because the purpose is not mentioned. Apart from these, the Taxpayer failed to produce any cogent documentary evidence to show that positive steps had been taken to implement a development intention, for example, such as an application to convert the land into building land or to exchange the lots for building land, to arrange long-term financing for the project, and to conduct feasibility studies on the viability of such a project.

Given the special conditions in Hong Kong, where land is constantly in short supply, land is as much the object of speculation as any other type of investment and almost as readily realizable (CIR v Sincere Insurance and Investment Co Ltd (1973) 1 HKTC 602).

(d) The Taxpayer also rested its claim on the fact that the Land in question had been classified as fixed assets in its balance sheet. However, the courts have

repeatedly ruled that account presentation is, of itself, inconclusive in deciding the true nature of a transaction.

However, in its accounts, all the immovable properties were habitually shown as fixed assets, even one property which was admittedly acquired for trading.

(e) As to the lengthy period during which the land or the Letters B were held, that factor alone is inconclusive in deciding the nature of an asset. The courts have held that the mere effluxion of time (of itself) would not convert trading assets into an investment (see BR23/74, vol 1, IRBRD 168).

(f) The Taxpayer argued in any event that it did not trade in agricultural land or Letters B. The lots were simply resumed by Government under the Crown Lands Resumption Ordinance. However, that argument does not advance the Taxpayer's case any further: it has been accepted that where an item is acquired and held as trading stock, the fact that disposal is by way of compulsory resumption does not make the receipt less assessable than if by way of sale.

(g) At different stages the Taxpayer advanced different reasons for the sale of the Letters B. In its letter dated 17 July 1981, it was said to be due to a lack of harmony between the directors. During the hearing, we were told that the disposal (which realized almost $4,000,000) helped the Company to alleviate its financial position and to acquire capital investments in subsidiaries. The Taxpayer failed to produce any evidence to show how the timing of the proceeds was tied in with the cash flow of the Group.

As to the Taxpayer's representative's argument that the fact that the Taxpayer opted for Letters B rather than cash compensation supported the view that the Taxpayer intended to exchange land for long term development – otherwise it would have cashed in the profit – it should be noted that to have chosen cash at that stage was not in the Taxpayer's interest because, at the rate of $10 per square feet, the Company could only receive compensation of $250,263 whereas it had paid $505,000 as purchase consideration. The Taxpayer was therefore bound to choose Letters B to avoid a loss. (The argument of the Taxpayer's representative mentioned in this paragraph was in fact dropped when a member of the Board drew his attention to the figures.)

6. CONCLUSIONS ON THE FOREGOING

We were not impressed by Mr A's evidence or the manner in which he gave it. Frequently he sought to avoid giving straightforward answers. Consequently we are unwilling to put much credence on his testimony.

With that in mind and the fact that the burden is upon the Taxpayer to convince us that the Commissioner was wrong, we examined with care the submissions of both the

representatives. We were particularly impressed with the arguments put forward by the Revenue's representative (Mrs Wan) and with their clarity and have no hesitation in adopting all of them without qualification. We would only add that, in so far as Mr A's claim that resumption compensation paid for 1.2(e) and (f) was used by the manufacturing subsidiaries, we note that in that same year another property was purchased for $11,302,500: we do not of course know if that purchase was financed by a mortgage. Accordingly we find against the Taxpayer in regard to the foregoing.

7. 1981/82 ASSESSMENT

7.1 On 20 January 1983 the Assessor assessed the profits for 1981/82 at $405,084.

7.2 Pursuant to s 64, on 18 February 1983 the Taxpayer objected on the grounds that:

(a) the profit on disposal of fixed assets of $2,030,540 was a long term capital gain and accordingly was not subject to profits tax;

(b) the loss of $2,536,698 on the sale of other flats was a trading loss since that property was originally purchased for trading;

(c) (not relevant); and

(d) (not relevant).

7.3 On 10 March 1983 the Assessor, though not then convinced as to 7.2(a), accepted the contention at 7.2(b) above and 'cancelled the 20 January 1983 assessment by issuing' a statement of loss ('the loss computation') viz:

profits as previously assessed	$405,084
less'loss on sale of flats'	$2,536,698
Loss 'reassessed'	$2,131,614

7.4 In the Commissioner's findings of fact, it is stated that the Assessor 'subsequently noted that the properties held on 31 March 1981 were substantially revalued by the Taxpayer in the accounts of the year ended 31 March 1981'. In the result, the profit figure of $2,030,540 referred to at 7.2(a) was wide of the mark because it was based on the revaluation figures and not on the original cost of the land concerned.

7.5 On 11 July 1983 the Assessor raised the 1981/82 assessment, which is the subject of this appeal.

7.6 The Taxpayer's representative maintained that:

(a) the 11 July 1983 assessment was null and void because there had been a determination by the Assessor (7.3 above) which by virtue of s 70 was final and conclusive, and the proviso to s 70 could not be invoked because that determination had been reached as a result of objection, and

(b) in any event all the material from which an assessment could be made was before the Assessor on 10 March 1983 so that the dictum of Mills Owens J that 'the section [70] thus contemplates an assessment which has crystallized ... and at the same time an additional assessment for the same period based upon new material' (Mok Tsze Fung v CIR (1962) 1 HKTC 166, 180) was not applicable.

7.7 To this, the Revenue's representative replied as follows:

(a) s 60 permits the raising of an assessment (whether original or additional) at any time (within six years) upon further information coming to light if a person chargeable with tax has not been assessed or was under assessed.

(b) The Taxpayer was not 'assessed' on 10 March 1983.

(c) The information available to the Assessor on 10 March 1983 was inadequate since he was unaware that the exact amount of the surplus (that is, excess of cash compensation over original purchase price) had been understated until he received the Taxpayer's letter dated 14 June 1983 (sent in response to an enquiry about its 1976/77 affairs) enclosing the detailed schedule setting out the cost price of each individual property.

8. CONCLUSION ON 7 ABOVE

8.1 In our opinion, the word 'assessment' connotes a liability to tax (see the definitions of 'assessable income' and 'assessable profits' in s 2) whereas a loss computation implies that there is no liability to tax and hence no assessment can be made. It therefore follows that for all practical purposes the effect of allowing the loss computation was to annul the former assessment the subject of the objection at 7.2 above and hence there was no assessment upon which section 70 could bite.

8.2 If however we are wrong in that conclusion, then it seems to us, and we so find as a matter of fact, that although the company's earlier accounts (which were presumably available to the Assessor before 10 March 1983) do refer to 1980 revaluations, that was not information upon which an assessment could be based because no figures were given; they were only forthcoming on 14 June 1983, and accordingly the dictum of Mills Owens J at 7.6(b) would apply.

Accordingly this appeal fails on all the grounds argued before us.