INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D60/87

Appeals:– burden of proof – hearing before Board of Review – Commissioner's failures to challenge taxpayer's evidence or produce contrary evidence – whether taxpayer had discharged his burden of proof – whether Board could draw inferences which were contrary to such evidence – s 68(4) of the Inland Revenue Ordinance.

Profits tax – sale of land – redevelopment of capital assets – whether profits were trading gains or realization of capital – s 14 of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Della P H Chan and Francis J Law.

Date of hearing: 10 December 1987.
Date of decision: 5 February 1988.

The taxpayer's father had acquired land in the early 1930s, and the taxpayer had inherited the land in 1947. In 1972, the taxpayer was approached by an adjoining property owner to redevelop the two sites. However, the taxpayer did not enter into a binding joint venture agreement with the other owner until October 1974, prior to which the other owner had drawn the redevelopment plans, commissioned architects and obtained all necessary approvals.

Development costs were to be shared between the two parties. The taxpayer borrowed the necessary funds from a bank, and sold seven of the new flats in order to repay the bank loan. He sold a further seven flats in order to finance his family's emigration. He retained ten flats for their rental income. He owned other rental property in Hong Kong, but had not sold any property previously.

The Commissioner assessed the taxpayer to profits tax, and argued that the taxpayer had embarked on a trading venture when the building plan was submitted in November 1972, rather than when he entered into the joint venture agreement in October 1974.

During the hearing before the Board of Review, the taxpayer gave evidence and offered himself for cross-examination. The Commissioner's representative did not challenge the taxpayer's evidence, nor did he call contradictory evidence.

Held:

The profits were not assessable because:

(a) A mere redevelopment of property, involving the sale of some of the new units in order to pay the redevelopment costs, does not necessarily amount to an adventure in the nature of trade.

(b) Even if there had been such an adventure, it could not be said to have commenced when the building plan was submitted in November 1972. At that time, the taxpayer was merely exploring the possibility of redeveloping his property.

(c) The taxpayer had discharged his burden of proof by offering unchallenged evidence. In the circumstances, it was not open to the Board to draw contrary inference.

Appeal allowed.

Cases referred to:

BR20/73, IRBRD, vol 1, 124
BR12/74, IRBRD, vol 1, 233
D11/80, IRBRD, vol 1, 374
D12/80, IRBRD, vol 1, 380
D3/86, IRBRD, vol 2, 231
Iswera v CIR [1965] 1 WLR 663
Lam Woo Shang v CIR (1961) 1 HKTC 123

Mr Lee Yun Hung for the Commissioner of Inland Revenue.
Mr Barrie Barlow for the taxpayer.

Decision:

This appeal relates to whether or not the Taxpayer when he developed property owned by him and sold some of the units in the resulting new building had embarked upon a venture in the nature of trade so that the gain derived therefrom was taxable.

The Commissioner contested the Taxpayer's appeal on what were primarily legal arguments and either agreed with the facts put forward by the Taxpayer prior to and in the course of the hearing of the appeal or decided not to challenge the same.

The facts, so far as they are relevant to the appeal, can be summarised as follows:

1. Some time in the early 1930's the father of the Taxpayer purchased a piece of land with a 4 storey building erected thereon ('the property') with a view to renting it out to residential tenants.

2. Up until 1957 the property was used for residential purposes and was either occupied by tenants or by relatives of the Taxpayer. The father of the Taxpayer died in 1947 and left the property to the Taxpayer. By 1957 the building was dilapidated and badly in need of refurbishing. When the Taxpayer came to refurbish the property in 1957 he converted its use from residential to commercial because residential tenants were protected under the Landlord and Tenant Ordinance. The Taxpayer let out the premises to commercial tenants from the time of the refurbishment until about 1974 when he declined to grant any new tenancies for the reasons mentioned below. The Taxpayer used the income which he received from the property and other properties which he owned to finance his personal needs.

3. In 1971 or 1972 the Taxpayer was approached by a third party who had purchased the premises which adjoined the property and a proposition was made to the Taxpayer for the Joint redevelopment of the two properties. The proposal was to join the two sites together, build a new multi-storey building which would accommodate more tenants and divide the new building equally between the Taxpayer and the third party. All expenses of the redevelopment would be split equally between the two parties.

4. The Taxpayer was attracted to the Joint development proposal because it would enable him to receive a much higher rental income.

5. Though the proposals being put forward were attractive to the Taxpayer he did not wish to commit himself and was not prepared to enter into a binding agreement until the third party had made all the arrangements that were necessary to redevelop the two properties. The Taxpayer left it to the third party to prepare the development proposals, submit plans to the Building Authority for approval and handle all of the other preliminary matters. To enable plans to be submitted for approval to the Building Authority the Taxpayer signed an application form for approval of the plans which the third party submitted to the Building Authority. However the Taxpayer did not himself instruct the architects. The Taxpayer did not agree to be responsible for any part of the architects' fees until after he entered into the joint development agreement with the third party.

6. The development plans were approved by the Building Authority in late 1974 after which the Taxpayer consulted with his solicitors because the time had now arrived when he had to make a decision as to whether or not to proceed with a joint development. He decided to proceed with the joint development and proceeded to enter into a legally binding Joint venture agreement dated 21 October 1974 under which he and the third party agreed jointly to develop their two adjoining properties by the erection of a new building with all expenses being paid for in equal shares and the new building being divided into two parts namely, Block A and Block B, with one block being assigned to the Taxpayer and the other block being assigned to the third party. The joint venture agreement made no

reference to the building or any parts thereof being sold upon or prior to completion. However the Taxpayer said that it was his understanding at all times that the third party intended to sell its entire share in the joint venture as soon as possible at a profit. On the other hand it was his intention to retain his share in the joint venture for rental purposes with the exception of selling sufficient flats so as to recover his cost of the redevelopment including money which he had contributed and moneys borrowed from the bank.

7. The redevelopment was delayed whilst the third party took proceedings in the Tenancy Tribunal to obtain vacant possession of its premises. The Taxpayer was able to obtain vacant possession of his own property before the end of 1975 when his commercial leases expired because he had taken the decision in 1974 not to renew the leases.

8. In October 1976 a building mortgage was obtained for the sum of HK$3,000,000. To repay that portion of the bank mortgage which was attributable to the Taxpayer the Taxpayer decided to sell six of the twenty-three units to which he would be entitled as soon as possible. This was done and the money repaid to the bank.

9. At some indeterminate date prior to the end of 1976 or the beginning of 1977 the Taxpayer decided that he would only retain ten units in the new building for rental purposes and would sell the remainder. The reason given for this was that he wanted to raise additional cash to finance the cost of his wife and children emigrating to the United States of America. This evidence was not challenged by the Commissioner either in his determination or in the course of this appeal and accordingly it is not something on which this Tribunal need made a decision nor indeed open to challenge by this Tribunal. Though the date of this decision is not known, it was made subsequent to the Taxpayer entering into the Joint Venture agreement in 1974 and also subsequent to the first decision to sell only sufficient units to repay the bank loan.

10. At the end of 1976 or the beginning of 1977 all of the units in the new building were offered for sale before completion jointly by the Taxpayer and the third party. However it was the intention of the Taxpayer only to sell units until he had ten units left which he would retain for rental purposes. Prior to this offer for sale to the public seven units including the ground floor had already been sold presumably to repay the bank loan. (No explanation was given or questions asked as to why seven units and not six units were sold.)

11. As events transpired the Taxpayer ultimately retained only nine units for rental purposes because the third party approached him to sell one further unit which was required by a purchaser of a unit from the third party. This purchaser wished to acquire both units on one floor and the Taxpayer on the grounds of good friendship with his joint venture partner agreed to dispose of this further unit.

12. Following on from these sales the Taxpayer did not sell any further units and has repurchased from the market two of the units which were sold and which are now owned

by the Taxpayer for rental purposes. He has the wish to repurchase from the market additional units for rental in the future if he considers that market prices are suitable.

13. The Taxpayer owns other property in Hong Kong which he holds for rental purposes and other than the units in this redevelopment he has not sold any property in Hong Kong at any time.

14. The Commissioner has assessed to Profits Tax the gains which the Taxpayer made when he sold the units in the joint development and the Commissioner in his determination decided that the Taxpayer had embarked upon a venture in the nature of trade with effect from 29 November 1972 being the date when the Taxpayer authorised the submission of building plans for the redevelopment to the Building Authority.

At the hearing of the appeal the Taxpayer gave evidence and offered himself for cross-examination. Though the representative of the Commissioner asked some questions in cross-examination, he did not challenge any of the primary or salient facts or evidence given by the Taxpayer. The truth of what the Taxpayer said was not challenged and no contradictory evidence was called. The representative of the Commissioner argued his case on the assumption that what the Taxpayer had said was true and put forward two arguments. The first was that the onus of proof is upon the Taxpayer. With due respect it is difficult to see how this has any application to the present case when there was no challenge to the evidence given by the Taxpayer. Furthermore there was no argument put forward on behalf of the Commissioner that there was any lacuna in the content of the evidence presented by the Taxpayer.

The representative of the Commissioner in the second part of his submission argued that if a person enters into a course of conduct which has the hallmarks of a venture in the nature of trade then that makes the transaction into a trading transaction. He said that it is immaterial why the Taxpayer decides to sell assets, because if it is necessary to embark upon a venture in the nature of trade to achieve an objective then it constitutes trading. With due respect we can find no substance in law or in the facts of this case as they have been accepted or conceded by the representative of the Commissioner to support his submissions.

As we can find no substance in the arguments put forward by the Commissioner it is appropriate to refer to them in some detail. We have already dealt with the point relating to the onus of proof, so it is not necessary to refer to it further.

The Commissioner's representative said that the Commissioner accepted that prior to 29 November 1972 when the building plan was submitted, the property in question was a capital asset of the Taxpayer. The Commissioner's representative then argued that on that date the asset became a trading asset of the Taxpayer. With due respect we cannot see any basis on which the Commissioner can so decide. The representative for the Commissioner argued that the following facts proved that from that date this was a venture in the nature of trade:

(a) The Appellant, in combination with a company engaged in property development, embarked upon this redevelopment project involving considerable expenditure. This expenditure was financed mainly by means of a short-term building mortgage. Financing by means of a short-term loan is consistent more with the intention to trade than with the intention to create a capital asset.

(b) As a matter of fact, the mortgage loan referred to above was to be fully repaid on the expiration of 24 months from the date of the Issuance of the occupation permit of the New Building.

(c) Even before the New Building was ready for occupation, the Appellant offered all the units for sale. The services of an estate agent were employed to facilitate the sale.

(d) Some units were sold before the occupation permit was issued and within a short period fourteen out of the twenty-three units had been sold. In offering all of the units for sale the Appellant did not indicate that he intended to retain any units in the New Building for rental income as claimed. With due respect to the Commissioner and his representative, this argument put forward by them might have carried some weight if they had challenged the truth of what the Taxpayer said. However it is not open to the Board to draw inferences from facts when uncontroverted evidence to the contrary is before the Board.

The facts before us which were not challenged by the Commissioner are that in 1972 the Taxpayer was doing no more than exploring the possibility of redeveloping his property and that he was doing so with the intention that he would retain the units in the new building for rental purposes other than such units as he had to sell to recover the costs of the redevelopment. As the Commissioner has not sought to challenge the truth of what the Taxpayer said he is bound by the fact that it was the intention of the Taxpayer, if he decided to redevelop his property when he authorised the submission of plans, to do so with a view to retaining as many units as possible for rental purposes.

We have no hesitation in finding that if 29 November 1972 was the date on which the Taxpayer embarked upon redevelopment of his property, then he did so with a view to long term investment and not property trading.

However with due respect to the representative of the Commissioner we cannot find on the facts that on the 29 November 1972 the Taxpayer was doing anything more than exploring the possibility of redeveloping his property. On this further ground the Commissioner would also lose this appeal.

It was not argued by the Commissioner's representative that the Taxpayer embarked upon a venture in the nature of trade subsequent to 29 November 1972. The representative for the Taxpayer submitted that if the Board were to hold that the Taxpayer had embarked upon a venture in the nature of trade then the Taxpayer did not do so prior to the 21 October 1974 when the Taxpayer entered into a binding joint venture agreement.

Though the Commissioner's representative did not argue this point, we have reviewed it and find that on the facts before us there is no more evidence to suggest that the Taxpayer was embarking upon a venture in the nature of trade on 21 October 1974 than there was prior thereto. Here again we are confronted with the unchallenged testimony of the Taxpayer that at that date when he entered into the joint development he had the intention of retaining the units in the new building to which he was entitled with a view to holding the same for rental purposes with the exception of those units which it was necessary to sell to recover the capital costs of the redevelopment. In the determination of the Commissioner as in his representative's submission it would appear that the Commissioner may have doubted the truth of the evidence before us regarding the raising of funds to enable the wife of the Taxpayer to emigrate to the United States of America. However the case proceeded on the assumption that the statements made by the Taxpayer in this regard were true and correct and the same were not challenged by the Commissioner. Accordingly it is a fact of this case that the Taxpayer decided to raise money by the sale of additional units to enable his wife to emigrate to the USA and that he did not make this decision until some time after he entered into the binding agreement with the third party to redevelop the property. The fact that when he entered into the joint development he intended to retain the units for rental purposes and not sell the same to finance his wife's emigration was not challenged by the Commissioner's representative.

The Commissioner's representative placed considerable emphasis on the case of Iswera v CIR [1965] 1 WLR 663. That case can have no application to the present appeal. In that case the Taxpayer wished to achieve an objective which she could only achieve by embarking upon a venture in the nature of trade. In the present case when the Taxpayer embarked upon this redevelopment, be it in November 1972 or October 1974, he did not do so intending to raise money for his wife's emigration to America or indeed for any other purpose. He did so with a view to improving the rental income of his property.

The Taxpayer's representative referred us to case BR20/73. This case was cited to demonstrate that the earlier case of Lam Woo Shang v CIR (1961) 1 HKTC 123 did not apply. Perhaps the converse is the case. In the Lam Woo Shang case the Commissioner had agreed that it is not a venture in the nature of trade for a land owner to redevelop property, sell sufficient units to repay a bank loan and retain the remainder for rental purposes or occupation by the Taxpayer. There was no suggestion that the decision by the Commissioner that such facts do not amount to a venture in the nature of trade was incorrect and indeed we consider that such a decision by the Commissioner is correct. The facts in this present case are identical in all material respects.

The Commissioner's representative then referred us to case BR12/74 relating to the redevelopment of inherited properties. With due respect case BR12/74 has no application to the present case. The only similarity is that the property redeveloped was inherited. In BR12/74 the intention of the party developing the property was to do so with a view to selling the units. It was clearly a venture in the nature of trade. In the present case the Taxpayer, on uncontroverted evidence, did not intend to sell the units when he embarked upon the redevelopment.

The Taxpayer's representative then referred to D11/80. This case has no application to the present appeal. It was a case relating to disputed facts. The Taxpayer claimed that property was redeveloped with a view to its retention and the Commissioner argued that the property was redeveloped with a view to it being resold. The Taxpayer gave evidence which was challenged by the Commissioner that the intention at the time of redevelopment was a long term investment. The Board of Review did not believe the evidence given by or on behalf of the Taxpayer and rejected the same. In the present case the evidence given by the Taxpayer is unchallenged even though the Taxpayer offered himself for cross-examination.

The Commissioner's representative then referred us to D12/80. It would appear that the Commissioner's representative in referring to this case wished to imply that if a transaction had the 'hallmarks' of a typical Hong Kong business of development of property for sale as set out in paragraph 14 of the decision in D12/80 then that constitutes property trading. If that was the decision in D12/80 then it would be incorrect. However that was not the decision. The decision of that Board of Review was that on the facts before them the Taxpayer had embarked upon a venture in the nature of trade. We find it impossible to read into that case that every person who decides to redevelop property in Hong Kong intending to retain all of the units other than those which must be sold to pay for the redevelopment is entering into a venture in the nature of trade.

The final case cited to us to support the Commissioner's case was D3/86 which relates to the date of commencement of trading. This case has no application in the present case for the reasons stated above.

It is difficult to understand why the Commissioner has contested this appeal, accepting, as he does, the evidence as provided before and during this appeal by the Taxpayer. Had the Commissioner challenged the material evidence, it would have been easier to understand his case.

For the reasons given we allow this appeal and direct that the assessments appealed against be annulled.