

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D67/91

Profits tax – bad debts – whether company carrying on the business of the lending of money – whether the money lent was in the ordinary course of business – sections 16(1D) and 17(1C) of Inland Revenue Ordinance.

Panel: Ronny Wong QC (chairman), Ronny Tong Ka Wah QC and Peter W Willoughby.

Dates of hearing: 25, 26, 27, 28 and 29 November 1991.

Date of decision: 11 February 1992.

The taxpayer was a company in a larger group of companies which lent money to other group companies and suffered bad debt losses. The taxpayer sought to deduct the bad debts from its assessable income. The assessor refused to allow the bad debts to be taken into account as losses. The taxpayer argued that it was carrying on the business of lending of money within Hong Kong and that the bad debts had arisen in the ordinary course of the taxpayer's business and were not capital expenditure.

Held:

The debts in question were not made in the ordinary course of the business of lending money within Hong Kong. The transactions in question would not have been carried out by a moneylender in the ordinary course of the business of lending of money. Furthermore the taxpayer in question was not carrying on a moneylending business.

Appeal dismissed.

Cases referred to:

D38/89, IRBRD, vol 4, 433

Federal Commissioner of Taxation v Bivona Pty Ltd [1989] ATC 4183

CIR v Chinachem Finance Company Ltd [Inland Revenue Appeal No 7/90]

So Chau Chuen for the Commissioner of Inland Revenue.

Chua Guan Hock instructed by Johnson, Stokes & Master for the taxpayer.

Decision:

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I. THE EVIDENCE

- (1) This is an appeal against the Commissioner's determination dated 20 May 1991 whereby the Commissioner confirmed a profits tax assessment for the year of assessment 1987/88 dated 28 November 1988, showing net assessable profits of \$884,962 (after set off of loss brought forward of \$264,529) with tax payable thereon of \$159,293.
- (2) The Taxpayer, A Company, is a company incorporated in early 1975. Clause 3 of its memorandum provides:

‘The objects for which the company is established are:

 - (1) To carry on all or any of the business of ... borrowing, raising or taking up of money; lending or advancing of money, securities and properties on such terms as may be thought fit ...
 - (8) To carry on business as financiers ...
 - (9) To invest and deal with the moneys of the company not immediately required as may from time to time be determined.’
- (3) The holding company of A Company is B Company. Prior to 1983, B Company's principal activities consisted of the following:
 - (a) Holdings of shares in subsidiaries and other companies as capital investments.
 - (b) Holdings of land as long-term investment for rental income.
 - (c) Development of land for sale.
 - (d) Management of buildings developed by the company and acting as letting and rental collecting agents for other companies.
 - (e) Providing financing to group companies and generally acting as corporate treasurer for companies within the B Company group.
 - (f) Acting as project manager of property development projects developed by group companies and other companies.

B Company controls other subsidiary companies apart from A Company. B Company's group companies are hereinafter referred to collectively as the 'B Company group'.

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- (4) According to the minutes of a meeting of the board of directors of B Company held in January 1983, B Company resolved that it should limit its function to that of an investment holding company and the other functions be transferred to wholly owned subsidiaries of B Company. It was decided that A Company, which hitherto had been a dormant subsidiary should be activated to take over the functions of B Company in 'providing financing to group companies and generally acting as corporate treasurer of group companies'. The directors thought that this would facilitate the monitoring of the group's overall financing requirements, would enhance the group's ability to use different sources of funding and would increase the bargaining power of the group in negotiating financing arrangements with third parties.
- (5) At the same meeting, B Company further resolved to sell various of its properties at 'market value' to some of its subsidiaries. Paragraph 4b of the minutes of that meeting states that 'investment properties' of B Company should be sold to its subsidiaries 'at the respective prices set out below which in the opinion of the directors, represented the market value of the respective properties as at the date of the meeting. It was noted that such valuations were based on professional valuations made in August 1982 after taking into consideration the adverse change of market conditions since that date'. The valuation report was not produced to us. The sales included the following:

<u>DESCRIPTION OF PROPERTY</u>	<u>NAME OF SUBSIDIARY THAT PURCHASED THE PROPERTY</u>	<u>PRICE</u> \$
Property W (with one carparking space)	C Company	3,800,000
Property X (with one carparking space)	D Company	3,300,000
Property Y	E Company	3,500,000
Property Z	F Company	3,500,000

- (6) The sales by B Company to C Company, D Company, E Company and F Company were all effected in early 1983. The sales of Properties Y and Z were for the respective sums of \$3,585,618 and \$3,585,619. The sales of Properties W and X were at the consideration depicted in the minutes of 12 January 1983.
- (7) In early 1983 A Company borrowed in US dollars and lent in US dollars to each of C Company, D Company, E Company and F Company. As a result of proposed changes to the Inland Revenue Ordinance announced in the 1984 budget speech, the activities of A Company was suspended in late 1984

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pending clarification of the possible effect of the proposed new section 16(2) on the B Company group. In late 1984, four separate loan agreements in analogous terms were entered into between B Company as lender and C Company, D Company, E Company and F Company as borrowers for the following amounts:

<u>DATE OF AGREEMENT</u>	<u>BORROWER</u>	<u>AMOUNT</u> \$
[Date Specified]	(C Company	4,829,880.48
	(
	(D Company	4,335,898.21
	(
	(E Company	4,409,487.50
	(
	(F Company	4,465,523.42

All these loans were for 'ten years' with option to the borrower to 'pre-pay at any time without penalty'. Interest was to be 'payable at such rate and upon such terms, if any, as shall have been agreed from time to time'. What actually happened was that the four companies used these loans to discharge their loans then outstanding to A Company. In other words B Company stepped into the shoes of A Company as the provider of the loans.

- (8) The proposed legislative changes did not eventually materialise as had been anticipated and A Company resumed its activities in early 1985 whereupon the same loan amounts were lent by A Company to the subsidiaries who in turn repaid B Company. In other words, the transactions in late 1984 were reversed. Because of the depreciation of the HK dollar as against the US dollar, the respective amounts of the loans to C Company, D Company, E Company and F Company exceeded the respective purchase prices of the properties paid in 1983. No evidence was adduced that property values had appreciated since 1983. On the contrary, we think we are entitled to take notice that property values had in reality depreciated since 1983. Even so, the various loans to C Company, D Company, E Company and F Company were advanced without security and for twelve years on renewable terms.
- (9) In the final quarter of 1984, B Company entered into discussions with its banker ['the bank'] for the restructuring of banking facilities. B Company requested that all existing loans granted by the bank to B Company be cancelled and replaced by loans to A company. The loans to A Company were to be secured by a mortgage over a building owned by a fellow company within the B Company group. A Company was to pay interest based on Best Lending Rate or Hong Kong Inter Bank Offer Rate. The request was said to be in line with B Company's proposal to use A Company 'as our group treasurer'.

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- (10) At a meeting of the directors of A Company held in early 1985, those directors resolved to accept facilities in the sum of \$1,588,131,158.27 offered by B Company. The directors of A Company further resolved to offer to various companies including C Company, D Company, E Company and F Company loans 'in the terms similar to those offered to [A Company] by [B Company]'.
- (11) Four loan agreements made in early 1985 were entered into between A Company as lender and C Company, D Company, E Company and F Company as borrowers for loans of the following amounts:

<u>DATE OF LOAN AGREEMENT</u>	<u>BORROWER</u>	<u>AMOUNT</u>
		\$
	(C Company	4,829,880.48
	(
	(D Company	4,355,898.21
	(
[Date Specified]	(E Company	4,409,587.50
	(
	(F Company	4,465,523.42

Save for the identity of the borrowers and the amount of the loans, the loan agreements were in identical terms. The loans were for a term of twelve years with an option to each of the borrower 'to pre-pay at any time without penalty'. Interest was to be payable 'at such rate and upon such terms, if any, as shall have been agreed from time to time'. The loans were wholly unsecured. This is said to be due to the close relationship between the parties and the income generating properties held by each of the borrowers.

- (12) One witness gave evidence before us. He has been a director of B Company since mid-1984 and became its Executive Director in 1979. He has been a director of A Company since early 1985 and continues to hold that office. He was also one of the directors of C Company, D Company, E Company and F Company. The witness gave evidence that:

'It was thought important that there should be sufficient flexibility in these arrangements so that the borrower companies could repay the entire principal or any part thereof at any time without penalty. No rate of interest was stipulated because it was desired to make A Company a commercial and profitable undertaking. Therefore, a margin was charged to cover A Company's expenses and a certain amount of flexibility was maintained so as to ensure that A Company was in fact a profitable company.'

- (13) The witness further gave evidence that the rate of interest was decided by him 'on behalf of both borrower and lender in March 1985 to be 5% above the

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interest costs of the company. Such interest was to be paid at the end of each financial year being 31 March'. There is, however, nothing in writing reflecting this 'agreement' or 'decision'.

- (14) A Company had no employees or staff other than its directors. The accounting functions of all companies within the B Company group and the collecting of rentals on behalf of each of the subsidiary companies which owned property was performed by G Company, another dormant company within the B Company group activated as a result of B Company's board meeting in January 1983. G Company collected rent on behalf of C Company, D Company, E Company and F Company. After deducting outgoings including G Company's fees, surplus rentals were periodically transferred to A Company as payments on accounts of C Company, D Company, E Company and F Company. The amounts so paid are as follows:

<u>DATE OF REPAYMENT</u>	<u>C Company</u> \$	<u>E Company</u> \$	<u>F Company</u> \$	<u>D Company</u> \$
[various dates in 1985 specified]	(350,000 ((90,000 ((150,000	100,000 90,000 150,000	150,000 70,000 160,000	250,000 160,000 100,000
<u>[Total for 1985]</u>	<u>[590,000]</u>	<u>[340,000]</u>	<u>[380,000]</u>	<u>[510,000]</u>
[various dates in 1986 specified]	(30,000 ((86,000	100,000 131,000	50,000 89,000	30,000 0
<u>[Total for 1986]</u>	<u>[116,000]</u>	<u>[231,000]</u>	<u>[139,000]</u>	<u>[30,000]</u>
[various dates in 1987 specified]	(90,000 ((335,000 ((3,015,000 ((200,000 ((0 ((0 ((0	70,000 0 0 30,000 0 360,000 3,240,000	0 0 0 0 0 360,000 3,240,000	0 0 0 0 600,000 0 0

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	(
	(0	0	0	2,400,000
	(0	0	0	12,719
[Total for 1987]		[3,640,000]	[3,700,000]	[3,600,000]	[3,012,719]
[Total repaid for 3 years]		4,346,000 =====	4,271,000 =====	4,119,000 =====	3,552,719 =====

(15) By 31 March 1987, the indebtedness of C Company, D Company, E Company and F Company to A Company stood as follows:

<u>DATE OF ADVANCE/ DEBIT OF INTEREST</u>	<u>C Company</u> \$	<u>E Company</u> \$	<u>F Company</u> \$	<u>D Company</u> \$
Loan in early 1985 [See (10) above]	4,829,880.48	4,409,587.50	4,465,523.42	4,355,898.21
Loan in late 1986	0	0	0	57,000.00
Interest charged for year ended 31-3-1985	10,304.93	9,913.02	9,927.78	9,440.26
Adjustment	143.97	134.66	157.44	45.05
Interest charged for year ended 31-3-1986	27,261.85	25,960.88	26,251.65	24,605.79
Interest charged for year ended 31-3-1987	23,807.40	22,350.80	23,050.50	22,198.52
Total indebted-	\$4,891,398.63 =====	\$4,467,946.86 =====	\$4,524,910.79 =====	\$4,469,187.83 =====

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ness as at
31-3-1987

The interest amounts 'paid' were debit entries in accounts maintained by A Company for each of C Company, D Company, E Company and F Company thereby increasing the indebtedness of each company. The adjustments are said to be attributable to 'the interest charged by B Company to A Company'.

- (16) Messrs Jones Lang Wootton valued the properties held by each of C Company, D Company, E Company and F Company as at 31 March 1987 as follows:

<u>VALUE DATE</u>	<u>PROPERTY</u>	<u>OWNER</u>	<u>VALUE</u> \$
31-3-1987	Property W	C Company	3,300,000
31-3-1987	Property X	D Company	2,700,000
31-3-1987	Property Y	E Company	3,400,000
31-3-1987	Property Z	F Company	3,400,000

- (17) According to the witness:

'In general, from A Company's viewpoint having made a loan or advance to a particular company, it would examine the accounts of the borrower company to ascertain whether it was capable of repaying the loan taking into account the net asset value of the borrower. If the net asset value was less than the amount outstanding, then ... the deficiency in the net asset value was provided as bad or doubtful debts.'

- (18) Based on the year-end net asset values of each of C Company, D Company, E Company and F Company after taking into account the valuation by Jones Lang & Wootton outlined in (16) above, A Company made various provisions for bad debts in the year of assessment 1986/87 in respect of the loans it extended to C Company, D Company, E Company and F Company. The provisions are as follows:

<u>DEBTOR 1986/87</u>	<u>PROVISIONS</u> \$
C Company	758,000
D Company	947,000
E Company	440,000

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F Company 694,000

TOTAL: 2,839,000
=====

- (19) After 31 March 1987, each of C Company, D Company, E Company and F Company disposed of its sole asset to parties unrelated to the B Company group at the then market price. These disposals were made because of the wish of the B Company group to concentrate on commercial as opposed to residential properties. The properties sold were all residential.

<u>DATE OF DISPOSAL</u>	<u>SELLER</u>	<u>PROPERTY</u>	<u>CONSIDERATION</u> \$
August 1987 [Date Specified]	C Company	Property W	3,350,000
September 1987 [Date Specified]	(D Company	Property X	3,000,000
	(E Company	Property Y	3,600,000
	(F Company	Property Z	3,600,000

The proceeds of sale obtained by C Company, D Company, E Company and F Company were used to make the repayments referred to in paragraph (14) above. A Company in turn used the proceeds to repay its overdraft from the bank.

- (20) Following the repayments consequential upon the disposals, various sums were written back into the accounts of A Company for the year of assessment 1987/88 in respect of the indebtedness of the four companies.

<u>BORROWER</u> <u>1986/87</u>	<u>PROVISIONS AS PER</u> <u>PARAGRAPH 17 ABOVE</u> \$	<u>1987/88 WRITTEN</u> <u>BACK</u> \$	<u>ACTUAL BAD</u> <u>DEBTS</u> \$
C Company	758,000.00	212,601.37	545,398.63
D Company	947,000.00	30,531.17	916,468.83
E Company	440,000.00	243,053.14	196,946.86
F Company	<u>694,000.00</u>	<u>288,089.13</u>	<u>405,910.87</u>
TOTAL:	2,839,000.00 =====	774,274.81 =====	2,064,725.19 =====

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- (21) The figure of \$2,064,725.19 is in effect the difference between the total amounts outstanding of the four companies referred to in paragraph (15) above less the repayment by the four companies referred to in paragraph (14) above.
- (22) By special resolutions dated 17 June 1988, each of C Company, D Company, E Company and F Company resolved to commence members voluntary winding up under section 228 of the Companies Ordinance. No 'proof of debts' or other recovery documents were produced by A Company because they considered these to be unnecessary 'in view of the debtors being in the same group of companies'.
- (23) For the years ending 31 March 1987 and 31 March 1988, A Company obtained its funds from three sources:
- (a) the bank;
 - (b) its holding company, B Company; and
 - (c) its fellow subsidiary companies.
- (24) The extent of fundings under each of these heads can be seen from the following figures extracted from the accounts of A Company:

<u>YEAR ENDED</u>	<u>LOANS FROM HOLDING COMPANY B COMPANY</u> \$	<u>LOANS FROM FELLOW SUBSIDIARY COMPANIES</u> \$	<u>BANK LOAN</u> \$	<u>BANKING FACILITIES AVAILABLE</u> \$	<u>BANKING FACILITIES UTILIZED</u> \$
31-3-1986	1,453,345,000	No evidence	60,000,000	96,250,000	73,924,000
31-3-1987	1,423,872,288	73,433,620	Nil	81,250,000	36,337,000
31-3-1988	1,487,106,046	77,266,415	60,000,000	200,000,000	100,256,000

A Company paid the bank interest on the bank loan and on the bank overdraft. In respect of loans from fellow subsidiary or associated companies or individuals, some of those companies were inactive and interest was not paid by A Company on accounts which were inactive or dormant. The loans from B Company was virtually interest free.

- (25) With the funds so obtained, A Company lent to fellow subsidiaries within the B Company group. The loans are said to be short, medium and long-term. Apart from the loans to C Company, D Company, E Company and F Company, there is no evidence as to the detailed terms of the other loans to other members of the B Company group. The amounts so lent and the interest obtained are as follows:

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<u>YEAR ENDING</u>	<u>NO OF BORROWING BY FELLOW SUBSIDIARIES</u>	<u>TOTAL AMOUNT OF LOANS</u> \$	<u>AMOUNT OF INTEREST OBTAINED</u> \$
31-3-1987	14	1,519,123,223	8,896,809
31-3-1988	8	1,608,019,995	10,108,811
31-3-1989	7	1,606,696,967	36,697,431

Apart from interest on the above loans, A Company also obtained interest in years ending 31 March 1988 and 31 March 1989 on current accounts maintained by other companies within the B Company group. The advances of A Company were confined to companies within the B Company group. A Company did not lend to members of the public.

- (26) A Company's other source of interest income came from deposits with banks. This source produced interest in the following amounts.

<u>YEAR ENDING</u>	<u>NO OF DEPOSITS</u>	<u>INTEREST GENERATED</u> \$
31-3-1987	1	760
31-3-1988	32	280,465
31-3-1989	[No evidence]	1,783,536

According to the witness, deposits were placed with the bank whenever A Company had surplus funds and were placed on over-night deposit or for a period of one week to facilitate the easier management and lending of A Company's money in the ordinary course of its business. The amount of such deposits ranged from \$500,000 to tens of millions of dollars.

This source of income is comparatively minor when compared with interest that A Company received from its fellow companies. For the years ended 31 March 1987 and 1988, 99.99% and 97.55% of A Company's interest income came from its fellow companies within the B Company group.

- (27) A Company's profit (or loss) is the difference between the loan interest it paid to the bank, B Company and its fellow subsidiary companies and the interest that A Company received from borrowing companies within the B Company group and from the bank.
- (28) For the years of assessment 1986/87 and 1987/88 the assessor issued the following statements of loss and profits tax assessment:

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1986/87

Basis period: Year ended 31 March 1987

Date of Issue: 23 December 1987

	\$
Loss per return	3,103,529
Less: Provision for doubtful loan [See paragraph (18) above]	<u>2,839,000</u>
Loss carried forward	\$264,529 =====

1987/88

Basis period: Year ended 31 March 1988

Date of Issue: 28 November 1988

	\$
Profit per Accounts	1,149,491
Less: Loss set-off	<u>264,529</u>
Assessable profit	\$884,962 =====

STATEMENT OF LOSS

	\$
Loss brought forward	264,529
Less: Set-off	<u>264,529</u>
Less carried forward	Nil =====

- (29) The issue before us centres on the sum of \$2,839,000. A Company claims that the same should be deductible under section 16(10)(e) of the Inland Revenue Ordinance (chapter 112).

II. THE ISSUES

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- (30) We are grateful to both Mr Chua for A Company and to Mr So for the Revenue for their written submissions.
- (31) A Company relies on section 16(1)(d) of the Inland Revenue Ordinance which is in the following terms:

‘16 Ascertainment of chargeable profits

- (1) In ascertaining the profits in respect of which a person is chargeable to tax under this part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this part for any period, including-

...

- (d) bad debts incurred in any trade, business or profession, proved to the satisfaction of the assessor to have become bad during the basis period for the year of assessment.

...

Provided that-

- (i) deductions under this paragraph shall be limited to ... debts in respect of money lent, in the ordinary course of the business of the lending of money within Hong Kong, by a person who carries on that business;
- (ii) ...’

- (32) Mr Chua, Counsel for the Taxpayer, also sought to rely on the opening words of section 16(1) as distinct from section 16(1)(d)(i) towards the close of his submissions. We do not, however, think there is any merit in this argument. A bad debt incurred in respect of money lent must, by reason of the language and structure of section 16, come within section 16(1)(d)(i) which restricts or limits the ambit of the opening words of section 16(1).
- (33) Apart from this argument, Mr Chua identified two broad issues. These he set out in his written submissions as:

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- ‘(A) Whether [A Company] carried on “the business of the lending of money within Hong Kong” within the meaning of section 16(1)(d), Inland Revenue Ordinance, chapter 112;
- (B) Whether the monies in question were lent “in the ordinary course of “A Company’s business, and did not involve any “expenditure of a capital nature of any loss or withdrawal of capital” within the meaning of section 17(1)(c), Inland Revenue Ordinance.’
- (34) Issue (B) was expressively disavowed by Mr So for the Revenue during argument. The only remaining issue is, therefore, issue (A) which turns on the proper construction of section 16(1)(d) and the application of the subsection to the facts.
- (35) There is no doubt that A Company did carry on a business during the years of assessment in question. Equally, there is no dispute that A Company did lend money to C Company, D Company, E Company and F Company.
- (36) Mr Chua seeks to argue, however, that A Company is entitled to claim deductions under section 16(1)(d)(i). He, of course, accepts that the burden is on him to show that the bad debts come within the subsection. In order to succeed, he must show that the bad debts in question were debts incurred ‘in respect of money lent, in the ordinary course of the business of the lending of money within Hong Kong, by a person who carries on that business’. (emphasis added)
- (37) We are of the view that issue (A) formulated by Mr Chua is overly simplistic and does not identify sufficiently the relevant considerations we should bear in mind. In our view, in order to succeed, A Company must satisfy the Commissioner that a bad debt has been incurred:
- (i) in respect of money lent;
 - (ii) in the ordinary course of the business of the lending of money within Hong Kong; and
 - (iii) by a person who carries on that business.
- (38) Condition (i) is satisfied on the facts. The questions we have to decide in this appeal are whether conditions (ii) and (iii) are also satisfied on the facts before us.

III. ORDINARY COURSE OF THE BUSINESS OF THE LENDING OF MONEY

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- (39) We need not be detained by the phrase ‘within Hong Kong’. Undoubtedly A Company’s business was conducted ‘within Hong Kong’ and any money-lending business relevant to this appeal, if carried on, must be carried on ‘within Hong Kong’.
- (40) We are of the view, however, that paragraph (d) postulates a reference to the ordinary course of the business of the lending of money by a money-lender objectively ascertained. Hence the rather cumbersome language of the paragraph first referring to the business of the lending of money within Hong Kong and the requirement that the Taxpayer carries on that business. Otherwise, the legislature could easily have simply provided that the debts should be ‘incurred by the taxpayer in the ordinary course of its business of the lending of money within Hong Kong’.
- (41) It follows that before we consider whether A Company had been carrying on the business of that of a money-lender, we must first consider whether the debts in question were debts incurred ‘in the ordinary course of the business of the lending of money within Hong Kong’.
- (42) We think the answer is ‘no’.
- (43) First, there was never any separate and independent request from any of the borrowers for a loan nor any independent consideration by A Company as to whether or not a loan should be made and if so in what amounts and on what terms. B Company decided, for reasons of its own, that it should sell all its properties to its subsidiaries at a price and at a time solely determined by it and no other. Money was then lent to these subsidiaries through A Company to buy the properties. When the fiscal advantage of this arrangement became doubtful, the arrangement was promptly reversed so that the money was owed to B Company directly instead of through A Company. Subsequently, when the legislative threat had gone, the arrangement was promptly reinstated. There is no evidence that any of the borrowers ever considered whether a loan from A Company as opposed to some other form of financing was appropriate or indeed needed. There was no independent evaluation of the commercial implications, if any, of obtaining a loan. These loans were in reality simply ‘given’ to the borrowers.
- (44) Secondly, the loans were lent to enable the subsidiaries which had no financial resources of their own to buy the properties. In other words, each loan constituted 100% of the purchase price of each property. Indeed, since the loans were advanced in US dollars eventually the loans far exceeded the purchase price of the properties and quite probably the then valuation of the properties. This is confirmed by the subsequent sale of the properties which gave rise to the bad debts. And yet no security was ever furnished by the borrowers. Moreover, the borrowers did not consult A Company at the time as

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to whether or not the properties should be sold at a loss. A Company was, therefore, taking all the risks and the borrowers none.

- (45) Thirdly, there never was any independent agreement as to the interest rates to be charged by A Company. The rate of 5% above costs of funding was arbitrarily imposed by the witness without consultation with any of his co-directors in any of the companies including A Company. Further, there was no written or indeed any formal agreement as to the periodical payment of interest or periodical repayment of capital. In form, there might be an arrangement for the payment of interest but we doubt whether any action would have been taken by the lender if the interest payments had not been made or not been made punctually. Again, A Company was taking all the risks and the borrowers none.
- (46) Fourthly, the term of repayment was said to be twelve years renewable by agreement but repayable at anytime by the borrowers without penalty. The borrowers therefore enjoyed all the benefits of a flexible arrangement but on the other hand, A Company could not plan and make use of its working capital in any systematic way to exploit a profitable business. Indeed, it would have been very surprising in the circumstances if it made any profit at all!
- (47) Finally, when all the above considerations are taken together it seems clear to us that these transactions were not transactions which would be carried out by a money-lender in the ordinary course of the business of the lending of money, and we so find.
- (48) This should be sufficient to dispose of the appeal but in case we are wrong, we will consider the next issue, namely, whether A Company carried on the business of money-lending.

IV. THE CARRYING ON OF THE BUSINESS OF THE LENDING OF MONEY:

Indicia of a Money Lending Business

- (49) The question whether A Company carries on a money-lending business is a question of fact. All relevant circumstances must be taken into consideration.
- (50) We are guided by D38/89, IRBRD, vol 4, 433 which outlined some of the indicia of a money-lending business (although we would emphasize that none of the indicia by themselves are conclusive) namely:
- (a) that the person is willing to lend to all and sundry, provided they are from the lender's point of view eligible. We are of the view that Federal Commissioner of Taxation v Bivona Pty Ltd [1989] ATC 4183, heavily relied upon by Mr Chua, does not displace this as a relevant indicia;

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- (b) that there must be frequent turnover of money in the course of the business – a long period of time allowed for repayment is an indication of an investment business rather than a money-lending business. Mr Chua does not accept this as relevant on the basis of CIR v Chinachem Finance Company Ltd [Inland Revenue Appeal No. 7/90]. However, we do not share his view that CIR v Chinachem negatives this factor as one of the relevant indicia. The status of the taxpayer as a money-lender was not in issue in the High Court in the Chinachem case. The only question was whether the borrowing of the taxpayer in that case was on capital or revenue account;
- (c) that the money-lender requires not only regular and frequent payments by way of interest on account of his loans but also regular repayments on account of principal;
- (d) that it is not sufficient to prove that money has been lent occasionally at a remunerative rate of interest. It is necessary to prove some degree of system and continuity in money-lending transactions and loans to something more than friends, relatives, or group of associated companies;
- (e) that in considering whether a person is carrying on a business of money-lending all loans made must be taken into account; and
- (f) that interest a not, of itself, conclusive evidence of a money-lending business being carried on.

Mr Chua accepts (c) to (f) above.

- (51) We will consider the presence or absence of these indicia in the light of the evidence.

Nature of Lending

- (52) A Company has not at any time held a money-lending licence. Loans were never advanced to members of the public. The lending activities of A Company were confined exclusively to members of the B Company group. The business of A Company is in reality that of a group treasurer or financial controller rather than a money-lender: its role is not simply to lend money to borrowers in order to make a profit but collectively to borrow money on behalf of the B Company group from the bank and the majority shareholder and then to distribute these funds to various companies in the B Company group according to their needs or the needs of the B Company group as a whole. This is confirmed by the minutes of the board of directors of B Company dated 12 January 1983 especially at paragraph 5. Moreover, in writing to the banker of

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B Company group in a letter dated 14 December 1984, the witness, on behalf of B Company repeatedly referred to A Company as the 'group treasurer'.

- (53) As mentioned above there was no security offered by the four companies. The rate of interest was set arbitrarily without reference to commercial needs or to the situation after the loans had been advanced. It is inconceivable that loans on these terms would have been advanced to anyone other than wholly owned subsidiaries of B Company.

Turnover of Capital and Regularity of Repayments

- (54) A Company has only a paid-up capital of \$20. It relies solely on its principal shareholder, B Company, in providing it with working capital. B Company did this by both itself advancing money to A Company and by arranging finance with the banker of the B Company group. Without the intervention of B Company and in particular, the provision of security by B Company, A Company would not be able to obtain any finance from any financial institution.
- (55) Furthermore, A Company did not lend money to any one outside the B Company group in order to make money in accordance with the normal business of a money-lender. The evidence showed that the identities of its 'clients', the timing of the loans, the amount of the loans, the repayment terms and rate of interest were all determined by the B Company group or by B Company according to the financial needs of the B Company group as a whole and its individual members.
- (56) The loans from A Company to C Company, D Company, E Company and F Company were all for twelve years renewable by agreement. The agreements did not include the usual provision imposed by a money-lender whereby A Company could demand repayment on change of circumstances from any of the borrowers. This is particularly significant bearing in mind that the properties held by the four companies fell in value and the amount of the loan rose by virtue of the appreciation of the US dollar against the HK dollar.
- (57) There were no fixed repayment schedules. The repayments by each of the borrowers were fortuitous in the sense that the amounts and time of repayments were irregular depending solely on whether there was surplus rental after paying G Company for their management charges. There was simply no turnover of the working capital. In reality, A Company was making a long-term investment in the four companies. Its only chance of recovering its loan in full depended solely on the success of the borrowers. As events turned out, the companies were not successful and a considerable portion of the loans advanced by A Company were irrecoverable.

System and Continuity

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- (58) A Company had no existence apart from its Board. It had no office. It had no staff. Its business was managed by G Company. There was no system or continuity in A Company's business transactions. It lent money whenever the interest of the B Company group demanded; but equally, it was prepared to cease lending activities if the interest of the B Company group, which included fiscal requirements, no longer required them as happened in 1984.
- (59) Had B Company retained the properties and not sold them to its subsidiaries, there would have been no need for the commencement of the lending activities of A Company. If B Company had then sold the properties at a loss, B Company would not have been able to claim any deduction for the loss because the properties would have been 'investment properties' and their sale would then have been of a capital nature. By selling the properties to its subsidiaries at prices solely determined by B Company and by interposing A Company in the chain under the guise of a money-lender, B Company and the B Company group sought to transform what would otherwise have been a capital loss into a 'bad debt'. It was said that interest payments were made by the borrowers and tax was paid by A Company on those interest payments. But the fixing of the interest and the timing of the repayments of interest was entirely arbitrary. In effect, the B Company group simply transferred part of the surplus rental income of the borrowers to A Company.
- (60) In our view, the transactions involving the lending of money by A Company to the four companies were not a true trading operation, nor did it involve any real business of a commercial kind. For that reason it was not a true money-lending trade or business.

Interest

- (61) The interest earned by A Company in relation to its overall lending portfolio was minimal. Mr So, who appeared for the Revenue, helpfully set out in his written submissions the overall interest charged by A company over its entire lending portfolio to members of the B Company group. These figures showed that in the year of assessment 1986/87, A Company received 0.5% interest income from its lending transactions. In the year of assessment 1987/88, A Company received 0.73% interest income from its lending transactions. This was largely due to the fact, as admitted by the witness in cross examination, that substantial amounts were on-lent by A Company without interest.

Conclusion

- (62) On the facts, A Company was not carrying on the business of the lending of money in the two years in question and we so find. We, therefore, dismiss the appeal and confirm the Commissioner's determination.

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