

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D69/95

**Profits tax** – sale of property by private company – intention to redevelop and to hold long-term – government’s rejection of re-development plan – whether capital gain.

Panel: Robert Wei Wen Nam QC (chairman), Chen Yuan Chu and Kut Ying Hay.

Date of hearing: 5 July 1995.

Date of decision: 10 October 1995.

The taxpayer was a private limited company. The taxpayer acquired a property, and intended to redevelop it and to hold it on a long-term basis. The redevelopment plan was rejected by the government as the plan contravened a lease condition. The taxpayer therefore decided to renovate the property and then sell it unit by unit.

Held:

At any given time, an asset is either a trading asset or a long-term investment; it cannot be both; it cannot be neither. As for intention, it is idle to declare an intention unless one is financially able to carry out. Without such capability, it is not an intention which is ‘genuinely held, realistic and realisable’. The taxpayer failed to discharge its onus of proving intention of long-term investment.

**Appeal dismissed.**

Cases referred to:

Simmons v CIR STC 350

All Best Wishes Ltd v CIR 3 HKTC 750

Doris Lee for the Commissioner of Inland Revenue.

Kwan Yiu Kuen instructed by Messrs Wong Lam Leung & Kwok for the taxpayer.

**Decision:**

1. This is an appeal by a private limited company (the Taxpayer) against the second additional profits tax assessment for the year of assessment 1989/90, the third additional profits tax assessment for the year of assessment 1989/90 and the additional profits tax assessment for the year of assessment 1990/91, all raised on it and confirmed or

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revised, as the case may be, by the Commissioner of Inland Revenue in his determination dated 21 April 1994. The Taxpayer claims that the profits it derived from the sale of the units in the subject property are capital gains.

2. At the hearing, the Taxpayer was represented by Mr Kwan of a firm of tax consultants. Mr Y, a director of the Taxpayer, was also present. No witness was called.

3. From the documents produced by the Revenue, we find the following facts:

3.1 The Taxpayer was incorporated in Hong Kong on 23 September 1986.

3.2 During the period from its inception to 31 March 1987 the Taxpayer made a profit of \$3,160,000 on the sale of properties. The Taxpayer offered the profit for assessment.

3.3 On 20 March 1987 the Taxpayer acquired the subject property for \$3,300,000. The subject property was a 3-storey building with 4 flats on each storey and 9 carparking spaces on the ground floor.

3.4 After the acquisition of the subject property, the Taxpayer paid the following ex-gratia payments to the sitting tenants and obtained possession of the units:

<b>Year of Assessment</b>	<b>Amount Paid</b> \$
1987/88	55,767
1988/89	222,848
1989/90	80,000

3.5 On 10 April 1989 the Taxpayer's architect applied to the Buildings and Lands Department for approval of a general building plan for the redevelopment of the subject property by the erection of a building consisting of 3 storeys over carpark.

3.6 By letter dated 5 June 1989, the Buildings and Lands Department disapproved the general building plan. Paragraph 9 of the letter reads:

‘The District Lands Office/District A and Project Manager/District B commented that Special Conditions 2(b)(5) of the lease stipulated that the height of any building shall not exceed 25 feet nor shall any building exceed 2 storeys in height. Apparently, the proposed 3 storeys over carpark building contravenes the lease condition.’

3.7 By letter dated 15 June 1989 and addressed to the District Lands Office, District A, the Taxpayer's architect stated as follows:

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‘ ...

The effectiveness of the said condition appears unreliable as such will inevitably nullify the legality of ownership conveyance of the existing 4-storey building since 13 September 1974 or any earlier date. According to the assignment record in the Lands Department, a 4-storey high building was legally conveyed for at least 14 years and the assignment plans were certified by Mr ... (Chartered Engineer and Authorised Person) signifying the accuracy of its configuration and size as well as the legality of the premises. These legal documents obviously implying a modification of the above condition was established since the construction of the existing building and its subsequent legal conveyance.

...’

3.8 By letter dated 12 July 1989, the District Lands Office, District A, replied to the Taxpayer’s architect, stating:

‘ ...

Apparently, the proposed redevelopment contravenes the lease conditions on the permitted 2 storeys and height of 25 feet.

The arguments in your above referenced letter are considered not acceptable. Future redevelopment of the captioned lot to a 3-storey over carport residential building would require modification of the lease condition.

Project Manager/District B would advise that he has no objection to the erection of a 3-storey building over carport on the subject lot.’

3.9 In about August 1989, the Taxpayer renovated the subject property.

3.10 During the period from January 1990 to November 1990, the Taxpayer sold all the 12 flats and 2 of the 9 carparks to purchasers solicited through estate agents. The sales grossed over \$11,000,000.

3.11 The Taxpayer did not object to the profits tax assessment for the year of assessment 1989/90, the additional profits tax assessment for the year of assessment 1989/90 or the profits tax assessment for the year of assessment 1990/91.

3.12 The Taxpayer objected to the second additional profits tax assessment for the year of assessment 1989/90 on the ground that it was excessive.

3.13 The Taxpayer’s accounts reported the following profits on the sale of the units in the subject property:

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Year ended 31 March 1990	\$3,100,000
Year ended 31 March 1991	\$3,640,000

The Taxpayer did not offer those profits for assessment.

3.14 The third additional profits tax assessment for the year of assessment 1989/90 and the additional profits tax assessment for the year of assessment 1990/91 were based on the above-mentioned profits. The Taxpayer objected to the assessments on the ground that the profits were capital gains on disposal of fixed assets and were not chargeable to profits tax.

3.15 In his determination the Commissioner of Inland Revenue confirmed the second additional profits tax assessment for the year of assessment 1989/90 and revised downwards the third additional profits tax assessments for the year of assessment 1989/90 and the additional profits tax assessment for the year of assessment 1990/91.

4. The Taxpayer's case is briefly this. At the time of acquisition, it intended to redevelop the subject property and retain it after redevelopment as a long-term investment. During the next three years the sitting tenants vacated the units one by one upon being paid ex-gratia payments. The Taxpayer then applied to the government for approval of its redevelopment plan. The government rejected the plan because it contravened a height restriction imposed by a lease condition. The government's rejection of the plan made it impossible for the Taxpayer to carry out its intention to redevelop and hold the redevelopment on a long-term basis. The Taxpayer therefore decided to renovate the subject property and then sell it unit by unit.

5. The question of whether a profit derived by a person from the sale of an asset is subject to profits tax turns on his intention at the time when he acquired it. If the intention was to dispose of it at a profit, the asset was a trading asset, and the profit is a trading profit and is taxable. If the intention was to hold it as a long-term investment, the asset was a capital asset, and the profit is a capital gain and is not taxable. At any given time, an asset is either a trading asset or a long-term investment; it cannot be both; it cannot be neither (see Simmons v CIR STC 350 at page 352). In this appeal, the onus is on the Taxpayer to prove that, at the time of acquisition, its intention was to hold the subject property for redevelopment and for long-term investment after redevelopment. On the question of intention, Mortimer J said in All Best Wishes Ltd v CIR 3 HKTC 750 at page 771:

*'The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in*

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*the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said actions speak louder than words...'*

6. The Taxpayer relied on two board minutes in support of its case. The first minute was dated 1 March 1987 and was in the following terms:

'Minutes of a directors' meeting held at the registered office of the company on 1 March 1987.

PRESENT : Mr X  
Mr Y  
Mr Z

CHAIRMAN : Mr X took the chair.

RESOLUTION : It was unanimously resolved to acquired (sic) the properties at ... (the subject property) at a consideration of \$3,300,000. Mr X or failing him, Mr Y is hereby authorized to deal with any documents relating to the acquisition of the property.

It was further resolved that the company should redevelop the property and hold for rental collection on completion of the redevelopment.

END OF MEETING : This concluded the business of the meeting.

X (signed)  
Chairman'

The second minute was dated 1 August 1989 and was as follows:

'Minutes of a directors' meeting held at the registered office of the company on 1 August 1989.

PRESENT : Mr X  
Mr Y

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Mr Z

CHAIRMAN : Mr X took the chair.

RESOLUTION : The Board was informed by ... (the architect) that the redevelopment project of the company's properties at ... (the subject property) was rejected by the Government. Rental value of the properties under the present situation would be little and are not worthwhile for holding for long term. It was unanimously resolved to sell the properties in order to retain the financial resources for alternative projects.

It was informed (sic) by Mr Y that the properties are not sellable under the present situation. It was further resolved to renovate the properties before sales. Mr Y is hereby authorized to look for suitable contractors for the renovation work.

END OF MEETING : This concluded the business of the meeting.

X (signed)  
Chairman'

7. Both minutes contain a mistake about a director's gender. It is common ground that the third director was a lady, that is, a Ms Z, but in both minutes she was described as 'Mr Z'. The repeated mistake indicates a degree of carelessness in the preparation of the minutes. It may or may not be that the two minutes were prepared in close proximity in time. However, the misnomers cannot in our view lead to the conclusion that the board meetings were not held or that the resolutions were not passed. The two minutes purport to bear the signature of the chairman. Section 119 of the Companies Ordinances provides that a minute purporting to be signed by the chairman of the meeting shall be evidence of the proceedings. There being no evidence to the contrary, the right approach, in our view, is to treat the minutes as the genuine records of the board meetings and the resolutions.

8. The board resolution dated 1 March 1987 declared an intention to redevelop the subject property and hold the redevelopment for long-term investment. However, to

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prove that it acquired the subject property as a long-term investment, the Taxpayer must go on to prove that it had the financial resources not only to carry out the redevelopment but also to retain it for long-term investment. It is idle to declare an intention unless one is financially able to carry it out. Without such capability, it is not in our view an intention which is 'genuinely held, realistic and realisable' (see paragraph 5 above). In a letter addressed to the Clerk to the Board of Review, the Taxpayer's tax representatives stated that the Taxpayer could have obtained loans from financial institutions or shareholders to fund the redevelopment. No evidence was adduced to support that statement, which we therefore decline to accept. Further, even assuming (without finding) that the Taxpayer was able to raise loans for the building cost, there is no evidence to demonstrate, by projections, estimates or otherwise, that the Taxpayer could have repaid the loans without having to sell the redeveloped subject property. In our view, the Taxpayer failed to discharge its onus of proving that in acquiring the subject property, it was making a long-term investment. That disposes of this appeal.

9. Before we conclude this decision, there are the following matters we should like to mention. Mr Kwan stated that the proceeds of sale of the subject property were mainly invested in the acquisition of another long-term investment as a replacement for the subject property. He did not refer us to any evidence in support; the statement, as a bare assertion, is unacceptable. Even assuming (without finding) that the other property was acquired as a long-term investment, and that the acquisition was mainly funded by the proceeds of sale of the subject property, we fail to see how that can carry one way or the other the issue of whether the subject property was acquired as a long-term investment.

10. In April 1991, the then tax representatives of the Taxpayer lodged an objection on behalf of the Taxpayer to the years of assessment 1987/88 and 1988/89 on the ground that the ex-gratia payments to tenants should be allowed as a deductible expense. The letter of objection stated:

' ...

The properties at ... (the subject property) were acquired with existing tenancies which were subjected to the jurisdiction of Landlord and Tenant (Consolidation) Ordinance. For commercial reason, it is a common practice for the Company to compensate the tenants for earlier surrender of the protected tenancies and moved out as soon as possible; and the whole block of properties could be disposed under 'vacant possession' condition to estate developer at a much higher price. This is the background for the payment of the ex-gratia payments and compensation.

...'

In short, the explanation was that the ex-gratia payments were expenses incurred in preparing the subject property for sale with vacant possession to an estate developer. Mr Kwan attacked the letter, stating that it was inconsistent with the fact that the Taxpayer itself applied for redevelopment. That is an arguable point. Mr Kwan further stated that the letter

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had been written without the Taxpayer's consent and without asking for any information; that is a bare assertion which we decline to accept. However, in view of the apparent inconsistency mentioned above, we have decided to give no weight to the letter.

11. This appeal is dismissed. The assessments in question as confirmed or revised, as the case may be, by the Commissioner of Inland Revenue are hereby confirmed.