Case No. D77/88

Profits tax – deductions- exchange losses incurred by moneylender – whether losses were of a revenue or capital nature – ss 16(1) and 17(1)(c) of the Inland Revenue Ordinance.

Panel: Robert Wei QC (chairman), Christopher Chan Cheuk and Lester Kwok Chi Hang.

Dates of hearing: 31 October, 1 and 2 November 1988.
Date of decision: 10 March 1989.

The taxpayer company was a licensed moneylender. Its paid-up capital was nominal. It borrowed significant funds in US$ and on-lent those funds principally to affiliated companies in HK$. Its US$ funds were borrowed from four unrelated entities and were repayable on demand. In fact, the funds were held by the taxpayer for terms which spanned between less than one year to nine and a half years. Ultimately, the taxpayer repaid all its US$ loans, having incurred significant exchange losses during the terms of those loans.

These loans had been properly shown as current liabilities in the taxpayer’s financial accounts, and the exchange losses were properly reflected for accounting purposes as revenue items in its profit and loss accounts as deriving from the ordinary activities of the taxpayer.

The taxpayer claimed deductions for these exchange losses. The IRD disallowed these deductions. It took the view that these losses were of a capital nature because, it asserted, the loans were not temporary financial facilities but rather formed part of the taxpayer’s capital base. The IRD also took the view that the taxpayer was not a true finance company but rather was a mere conduit between lenders to the taxpayer’s group and the affiliated end-users of those funds.

Held:

The exchange losses were incurred on revenue account and were therefore deductible.

(a) The rules relating to deductibility of exchange losses are different in both the UK and Australia. However, it was unnecessary to decide which country’s case law applies in Hong Kong because, under either test, the taxpayer’s exchange losses were deductible.

(b) Under UK case law, the test for deductibility is whether, so far as the taxpayer was concerned, the relevant loans (i) constitute fluctuating and temporary financial accommodation (in which case the exchange losses would be on revenue account) or (ii) were an accretion to the taxpayer's capital (in which case the exchange losses would be on capital account). This is a question of fact.

On the facts, the borrowing of funds by the taxpayer, which carried on a business of lending money, was an ordinary activity and an integral part of its business, and the exchange losses were a cost of this ordinary activity.

Also, the fact that the taxpayer's borrowings were repayable on demand meant that the loans by their nature could represent only temporary accommodation.

Irrelevant were the huge sizes of the loans compared to the taxpayer's nominal capital, the terms for which the loan funds were actually held and the replacement of these loans by another loan.

(c) Under Australian case law, exchange losses on funds borrowed by a person who carries on a business of borrowing and lending money or dealing in foreign exchange are on revenue account. Such funds are similar to trading stock. The borrowings are part of the process by which such a person obtains regular returns, and exchange losses on such loans are part of the price by which such a person obtains these funds. For other persons, exchange losses are prima facie on capital account.

Here, the taxpayer carried on the business of borrowing and lending money so that its exchange losses were on revenue account.

(d) The 'conduit' argument raised by the IRD was without merit. The taxpayer was a real finance company notwithstanding the fact that it lent principally to affiliated companies, and it therefore fell within the Australian criteria for deductibility.

Appeal allowed.

[Editor's note: This decision can usefully be read in conjunction with D8/89, reported elsewhere in this volume. It should also be noted that the case of Beauchamp v F W Woolworth plc which is referred to in the decision has subsequently been overturned by the House of Lords on appeal, although the principle to which this decision refers was upheld.]

Cases referred to:

D44/87, IRBRD, vol 2, 438
Avco Financial Services Ltd v FCT (1982) 13 ATR 63
Beauchamp v F W Woolworth plc [1988] STC 714
FCT v Hunter Douglas Ltd (1983) 14 ATR 629
Lombard Australia Ltd v FCT (1980) 10 ATR 743
Montreal Coke & Manufacturing Co v MNR [1944] AC 126
Scottish North American Trust Ltd v Farmer (1911) 5 TC 693
Tip Top Tailors Ltd v MNR (1957) 11 DLR(2d) 289

David Hinchen for the Commissioner of Inland Revenue.
Michael Flesch QC with R K Sujanani instructed by Ip, Ku & Stoppa for the taxpayer.

Decision:

1. This appeal concerns the deductibility under section 16(1) of the Inland Revenue Ordinance of foreign exchange losses incurred during the years of assessment 1981/82, 1982/83 and 1983/84 upon (a) the repayment of US dollar loans obtained by the Taxpayer for the purpose of on-lending (principally to its affiliated companies) and (b) the year and translation into Hong Kong dollars of outstanding US dollar loans.

2. The facts as found by the Commissioner of Inland Revenue and contained in paragraph 1 of his determination dated 12 June 1986 are not in dispute. Mr X, a director of the Taxpayer, gave evidence on behalf of the Taxpayer, which we accept.

Facts

3. The Taxpayer was incorporated in 1973. At all material times, its issued and paid-up capital was $20. It belongs to a group of companies comprising 150 to 200 companies (affiliates). Its activities include lending to affiliates, making mortgage loans to purchasers of property from affiliates, making personal loans and financing the purchase of motor cars through hire-purchase, its principal activities being the first two.

The group is controlled by Mr X and his wife. The main business of the group is property development, whilst the Taxpayer plays the role of financier to the group companies. In the years in question, about 60% of their borrowings were from the Taxpayer which was licensed to carry on the business of a money-lender.

In order to enable itself to make loans, the Taxpayer borrowed moneys, mostly in US dollars, which were converted into Hong Kong dollars and on-lent to the affiliates, the interest rates on the lendings being always higher than the rates payable on the borrowings. The Taxpayer derived its profits from the interest differential. The Taxpayer chose to borrow in US dollars because the interest rates were comparatively cheap and stable. The

Taxpayer was not connected or associated with any of the lenders who were four in number, and neither Mr X nor his wife had any interest in any of them.

4. The US dollar loans and advances made by the four lenders are briefly as follows:

(a) Loan from A Limited. This loan is evidenced by a mortgage dated 9 January 1980 and made between a third party as the mortgagor, the Taxpayer as the borrower and A Limited as the mortgagee, and by a further charge dated 9 July 1980 made between the same three parties. The maximum amount of the credit facilities secured was $60,000,000 which could be drawn in US dollars at the borrower's option. Any amount outstanding under the credit facilities was repayable on demand. The amount outstanding on 31 March 1981 was US$7.6 million which was repaid by part payments made in September 1981, January 1982 and finally in March 1982. This loan therefore lasted a little over two years. The repayments were all made in US dollars at exchange rates higher than the rate prevailing on 31 March 1981, thus resulting in an exchange loss of $4,500,000.

(b) Loan from B Limited. This loan was arranged orally, and is evidenced by an audit confirmation by B Limited dated 7 August 1981. The first drawdown was on 16 March 1981 and the amount outstanding as at 31 March 1981 was just under US$10.5 million, which was repaid on 14 January 1982. The loan therefore lasted for less than a year. The US dollar exchange rate on the day of repayment was higher than the rate at the previous year end and produced an exchange loss of $5,470,000. The loan was repayable on demand.

(c) Loan from C Limited. This loan is evidenced by a loan agreement dated 28 March 1975 which provided for a line of credit not exceeding US$15 million repayable on demand. The amount outstanding as at 31 March 1981 was US$11.25 million which was repaid on 22 October 1984. The loan lasted for nine and a half years. The unfavourable differences in US dollar exchange rates between the years ends of 1981 and 1982, 1982 and 1983, and 1983 and 1984 gave rise to exchange losses of $4,300,000, $10,000,000 and $12,700,000 respectively.

(d) Loan from D Limited. This loan is evidenced by a loan agreement dated 9 February 1981 providing for advances of up to US$200 million. It lasted for less than four years. The outstanding balances as at 31 March 1982, 1983 and 1984 were the same, that is, US$120 million. The unfavourable US dollar exchange rates produced exchange losses of $47,800,000, $107,000,000 and $124,000,000 for the years 1981/82, 1982/83 and 1983/84 respectively. The loan was repayable on demand.

5. The US dollar loans after conversion were used to fund lendings in Hong Kong dollars, of which 93% or more were made to affiliates. They were short-term loans.

6. In the year 1984/85, to avoid any further possible exchange losses, the Taxpayer repaid the US dollar loans mentioned in paragraph 4(c) and (d) and replaced them with a long-term Hong Kong dollar loan of $988,000,000 (which was repayable on demand) from an affiliate, E Limited, who had obtained the necessary funds or at least a substantial proportion thereof from other affiliates in the group.

Accounting practice

7. The Taxpayer called Mr Y, a partner of a firm of certified public accountants, to address the question whether the accounting policy on foreign currency balances, as set out in the audited accounts of the Taxpayer for the years ended 31 March 1982, 1983 and 1984, is consistent with generally accepted accounting practice in Hong Kong. His evidence may be summarised as follows.

8. Mr Y had considered and reviewed the audited accounts and also read the Commissioner's determination. Having considered the essential terms of the four loans, he is of the opinion that these loans are properly included as current liabilities in the audited accounts. He was informed that the purpose of the loans was to enable the taxpayer to lend money to affiliated companies. The accounting policy on foreign currency balances as set out in the audited accounts is as follows:

> 'Foreign currency assets and liabilities as at 31 March are translated into Hong Kong dollars at the approximate market rates of exchange ruling at the balance sheet date. Foreign currency transactions during the year are converted at the rates ruling at the dates of transactions. All exchange differences are included in the determination of profits.'

The exchange losses arising from the repayments and translation into Hong Kong dollars of the US dollar loans were recognised in the profit and loss account in the relevant audited accounts of the Taxpayer.

9. There are Statements of Standard Accounting Practice that describe methods of accounting approved by the Council of the Hong Kong Society of Accountants (HKSA) for application to all financial statements and which are intended to give a true and fair view of financial position and profit and loss. A Statement of Standard Accounting Practice on Foreign Currency Translation (SSAP 11) was issued in January 1985 by the HKSA. It simply codifies the generally accepted accounting practice with respect to foreign currencies which has existed in Hong Kong for a number of years.

10. Under paragraph 19 of SSAP 11, each asset, liability, revenue or cost arising from a transaction denominated in a foreign currency is to be translated into the reporting (that is, Hong Kong) currency at the exchange rate in operation on the date on which the

translation occurred. Under paragraph 21 of SSAP 11, at each balance sheet date, monetary assets and liabilities denominated in a foreign currency are to be translated using the closing rate or, where appropriate, the rate of exchange fixed under the terms of the relevant transactions. Paragraph 22 of SSAP 11 states that an exchange gain or loss will result during an accounting period if a business transaction is settled at an exchange rate which differs from that used when the transaction was initially recorded or, where appropriate, that used at the last balance sheet date. An exchange gain or loss will also arise on unsettled transactions if the rate of exchange used at the balance sheet date differs from that used previously. Such exchange gains and losses should be included in the profit or loss as arising from ordinary activities unless they arise from events which themselves fall to be treated as extra-ordinary items, in which case they should be included as part of such items. An extraordinary item, Mr Y explained, is an item that does not arise in the ordinary conduct of the business.

11. The accounting treatment of exchange losses adopted by the Taxpayer is, in Mr Y opinion, consistent with the requirements of paragraph 19, 21 and 22 of SSAP 11 mentioned above. In his opinion, these exchange losses are properly included as revenue items in the profit and loss account deriving, as they do, from the ordinary activities of the Taxpayer. We accept Y's evidence, which was unchallenged.

The law

12. Section 17(1) of the Ordinance provides that, for the purpose of ascertaining profits, no deduction shall be allowed in respect of, among other things, any expenditure of a capital nature or any loss or withdrawal of capital. In his determination, the Commissioner took the view that the exchange losses were capital expenditure within the meaning of section 17(1) because the loans did not represent temporary financial facilities but in fact formed part of the capital base of the Taxpayer. He also rejected the argument that, because the money obtained from the loans was used as working capital (as opposed to fixed capital), the loans themselves should not be regarded as capital liability.

13. Both in the statement of grounds of appeal and at the hearing, the Taxpayer's case was based on the central point that the exchange losses were expenditure of a revenue nature and therefore allowable deductions. However, towards the end of his final submission, Mr Hinchen for the Revenue advanced the argument that the Taxpayer was merely a convenient conduit pipe to a group of affiliates who were property developers and was not a standard finance company such as those one finds in the Australian cases. He therefore submitted that this appeal must fail.

Were the exchange losses capital or revenue?

We shall deal with the question of capital expenditure first.

14. There are two streams of case law on the subject, English and Australian. Each of these will be considered separately.

English case-law

The latest English case is Beauchamp v F W Woolworth plc [1988] STC 714, where it was agreed that the outcome of the question whether exchange losses incurred upon repayment of foreign currency loans are deductible in computing profits for corporation tax purposes depended on whether the loans were part of the Taxpayer's revenue transactions or accretion to its capital. This is a matter of general principle not turning on any particular legislation (see 718). The question is one of fact (see 718).

The basic principle is that, if the loans are a means of fluctuating and temporary accommodation, they are to be regarded as revenue transactions and not accretions to capital. The principle was first propounded in Scottish North American Trust Ltd v Farmer (1911) 5 TC 693 (HL) (see 719).

In the Woolworth case, there were two loans of 50m Swiss francs each repayable after 5 years. Counsel for the Crown submitted that there was only one relevant consideration, namely, that the loans, far from being fluctuating and temporary accommodation, were fixed in amount and were repayable over a fixed long-term period of five years. Norse LJ said at 720:

> ' In my judgment, it is not open to the court to hold that there was only one relevant consideration in the case. The Commissioners were entitled both to think that there was at least one other such consideration and to give it more weight than the terms of the loan pure and simple. That consideration was the taxpayer's purpose in raising the loans, namely to provide them with cash for the general purposes of their trade over the five-year periods when they would be repaid out of profits generated in the course of their business.'

Again, at 721 he has this to say: '[The Commissioners] weighed one relevant consideration against another and found that the taxpayers' purpose in raising the loans outweighed the terms of the loans pure and simple.' The Commissioners had concluded that the arrangements for providing cash for the general purposes of the taxpayers' trade over the five-year periods were within the ordinary activities of running the business. He concluded his judgment at 722 by saying:

> ' On a view of the case as a whole, I find it impossible to say that the facts found by the Commissioners were such that no person acting judicially and properly instructed as to the relevant law could have come to the determination that the loans were revenue transactions and not accretions to capital.'

15. In the present case, the Taxpayer's business consisted of borrowing and lending money, thereby making a profit out of the interest differential. The borrowing of money to enable the Taxpayer to lend money is in our view an ordinary activity of running the business and indeed an integral part of the business, and the exchange losses are part of the

cost of the borrowings. Furthermore, the US dollar loans in question were demand loans and therefore by nature can only be a means of temporary accommodation. It is true that the Taxpayer was at all times in need of cash but such need was satisfied by arrangements which were liable to be terminated at any time and therefore were temporary accommodation. In our view, these considerations outweigh the considerations relied on by the Revenue, such as the size of the loans as measured against the Taxpayer's own capital (that is $20), the length of time the loans had been outstanding (that is, 3½ years in the case of D Limited and 9¼ years in the case of C Limited) and the fact that the loans appeared to be replaced by a long-term loan in 1984/85, that is, the year next following the accounting period.

The Taxpayer carried on its business by borrowing money for the purpose of on-lending. Some of these borrowings were not repaid for long periods only because the lenders did not exercise their right to demand repayment. But that does not in our view change the character of these loans, which were temporary accommodation on the dates when they were respectively made, and remained so until they were repaid.

As for the replacement of the loans by a long-term loan in Hong Kong dollars in 1984/85, which was funded in whole or in part by the affiliates, this is an occurrence outside the accounting period and in any event cannot change the character of the US dollar loans. So we do not attach any great significance to this consideration either. In our view, these US dollar loans were revenue transactions and not accretions to capital.

Australian case-law

16. The leading Australian case is Avco Financial Services Ltd v Federal Commissioner of Taxation (1982) 13 ATR 63, an appeal case decided by the High Court of Australia consisting of five judges. Avco was a wholly-owned subsidiary of an American corporation and was engaged in the provision of consumer credit in the form of personal loans, hire-purchase sales and similar transactions.

Until 1967, Avco's parent company lent funds to Avco. Since 1967, Avco raised funds by borrowing in the USA and Australia. Some of the loan agreements ranged from one to five years. Avco's borrowing programme was so arranged as to meet the requirement for funds for lending to the customers and the requirement for funds to meet accruing obligations for repayment of earlier loans both in Australia and in the USA. Owing to fluctuations in the exchange rate, exchange gains or losses were realised upon repayment of US dollars borrowings.

It was held that, where a finance company borrows money overseas in the ordinary course of its business and not for some special purpose, exchange gains made in the course of making repayments are assessable income and exchange losses are allowable deductions.

> ' The gains which resulted from variations in the rate of exchange will be assessable if they can be regarded as income in accordance with ordinary usages and concepts ...

> The losses will be deductible if they fall within section 51(1) of the Act [that is, the Income Tax Assessment Act 1936, as amended] ... The sole question in the present case is whether the gains and losses were of a revenue or of a capital nature' (per Gibbs, CJ at 66).

17. Deductions for losses and outgoings are governed by section 51(1) of the Australian Act, which reads as follows:

> 'All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature ...'

18. Gibbs CJ went on to say (at 68):

> 'Where a taxpayer carries on the business of borrowing and lending money, the moneys used for that purpose are analogous to trading stock – the taxpayer in effect deals in the money. Exchange ... losses, regularly and frequently made and incurred, in the course of making repayments of borrowed money which is used by the taxpayer in making loans on the course of its finance business are outgoings made in the day to day conduct of the business and for the purpose of carrying on the business as a going concern. The first matter to be considered, in deciding whether a payment is of a capital or of a revenue nature, is what was the character of the advantage sought by the payment ... The question has to be considered from a practical and business point of view ... From that point of view, the additional moneys paid as a result of the unfavourable exchange variations – the exchange losses – were part of the price by which the appellant obtained the money which it used to make a profit – part of the process by which the appellant obtained regular returns ... The exchange losses were in my opinion losses on revenue account, and of course the gains have the same character ...'

19. The joint judgment of Mason, Aickin and Wilson JJ (the joint judgment) at page 74 refers to the dissenting judgment of Cartwright J in <u>Tip Top Tailors Ltd v Minister of National Revenue</u> (1957) 11 DLR (2d) 289 where the learned judge said at 300:

> 'in the case of a taxpayer carrying on a commercial undertaking such as that of the appellant, whose business is not that of dealing in foreign exchange or borrowing and lending money, a gain or loss related to dealings between borrower and lender is prima facie one of capital and not of income.'

The joint judgment then refers to the remarks of Lord Macmillan in <u>Montreal Coke & Manufacturing Co v Minister of National Revenue</u> [1944] AC 126 at 134:

> ' It is not the business of either of the appellants to engage in financial operations ... Of course, like other business people, they must have capital to enable them to conduct their enterprises, but their financial arrangements are quite distinct from the activities by which they earn their income.'

The joint judgment then goes on at the same page as follows:

> ' The majority judgments, as well as the dissenting judgment in Tip Top Tailors, and the speech of Lord Macmillan in Montreal Coke recognise, rightly in our opinion, that the borrowing of money and the repayment of loans by a finance company in the ordinary course of its business stand in a different situation from borrowings by a company not undertaken in the ordinary course of its income-earning business. The essence of the business of a finance company as carried on by the taxpayer is the borrowing and lending of money, the rates of interest payable on money lent being significantly higher than the rates payable on the money borrowed, for it is from the difference in the rates that the company generates its profit ... A finance company usually borrows in order to increase its working capital which is then turned over at a profit; the manufacturing or trading company frequently borrows to strengthen its permanent capital.'

Then, at 76 to 78, the joint judgment says:

> ' The true principle is that in the case of a finance company which borrows money overseas in the ordinary course of its business and not for some special purpose, the added cost of repayment in foreign currency caused by the devaluation or depreciation of the Australian dollar is an additional cost of the borrowing and, like other costs of the borrowing, is an allowable deduction under section 51(1). Conversely, a saving in the amount of foreign currency needed to repay an overseas loan due to a revaluation or an appreciation in the value of the Australian dollar is to be considered as income arising directly out of the finance company's ordinary business ... Like the borrowing transactions with which they are associated, the foreign exchange transactions are entered into by the taxpayer in the ordinary course of its business and form an integral part of that business ... the gains and losses are an ordinary incident of transactions of this kind ... In the argument emphasis was given to the notion that the money stock of a finance company is similar to the trading stock of a trading company. There are some obvious similarities. However, there are some differences. Money is not dealt with in specie as a commodity and money is not included in the definition of 'trading stock' for the purposes of the Act ... Despite these differences, what is of immediate importance is the strong similarity between the getting in and the turning over of a trading stock by a trading company and the borrowing and on-lending of money by a finance company. This similarity is so strong as to suggest that just as exchange gains and losses on the acquisition of trading stock are to be included in the assessable income of a trading company, like gains and losses in connexion with the borrowing and repayment of loans by a finance company are also to be included in its assessable income ... Avco's borrowings to obtain funds to finance its lending and hire-purchase

> business bear a sufficiently close resemblance to the borrowing of funds to purchase stock-in-trade and the deferring of payments due to suppliers of such stock to require exchange gains and losses to be treated in the same way, that is, as being on revenue account ...'

The joint judgment then draws a distinction between moneys borrowed by a finance company in the ordinary course of its business and moneys borrowed for some special purpose, naming, as an instance of borrowing for a special purpose, such as a company undertaking not to use the funds for on-lending and to employ them in such a way that they could be regarded as part of the permanent capital structure of the business.

20. The case of Lombard Australia Ltd v Federal Commissioner of Taxation (1980) 10 ATR 743, although decided earlier than the Avco case, went on the same principles. The decision of the appeal judge was in favour of the taxpayer. At 769 he said:

> ' It is, in this situation, necessary, in my view, to go further than labelling the taxpayer a 'financier', 'money lender' or 'currency trader': what one must do, in my opinion, is to determine how this particular taxpayer carried on its business. It is clear, at the outset, that substantial though the subscribed capital and shareholders' funds of the taxpayer may have been, they, at no relevant time, were sufficient to enable the taxpayer to carry on business on the scale which it did: it was at all relevant times essential for the taxpayer's business that it have access to substantial borrowed funds to on-lend to its customers ... the application of those funds by on-lending them was an integral part of the process by which the taxpayer earned its income ... borrowing overseas was an integral part of the process by which not only the taxpayer but most, if not all, major financiers in Australia funded their lending activities.'

21. The principles of the Avco case were summarized by Lockhart, J in Federal Commissioner of Taxation v Hunter Douglas Ltd (1983) 14 ATR 629. At 643 he said:

> ' Borrowings by finance companies in the ordinary course of their business or borrowings by trading companies to purchase trading stock are examples of expenditure incurred in the earning of a taxpayer's income and not for the purpose of enhancing the business or organisation of the taxpayer as an income earning entity. It is well established that such borrowings are revenue items.'

22. In the present case, we have found that the Taxpayer carried on the business of borrowing and lending money, making its profit out of the interest differential. Applying the principles of the Avco case, we are of the view that the borrowings were made in the ordinary course of the taxpayer's business and that, like the borrowings, the exchange losses incurred upon their repayment are revenue items.

As for the exchange losses incurred upon translation at the balance sheet dates, they were a consequence of complying with the established accounting practice mentioned in paragraphs 8 to 10 hereof and in particular the requirements of paragraph 22 of SSAP 11.

We accept the accounting expert's opinion that they are properly included as revenue items in the profit and loss accounts of the years in question.

English law or Australian law

23. Mr Flesch, counsel for the Taxpayer, submitted that, if it was necessary to choose between the two streams of case law, we should prefer the Australian law to the English law because the relevant Australian statutory provisions are similar to ours and because the Australian cases deal with the special situation of a finance company or a company whose business is that of borrowing and lending of money. The argument is interesting and persuasive, but in the present case there is no occasion for making any choice as our conclusion is the same whichever law we apply.

Finance company status: the 'conduit' argument

24. Mr Hinchen submitted that the Taxpayer was not the sort of 'standard' finance company one finds in the Australian cases but a mere conduit pipe, and that therefore the Avco principles did not apply. He cited a Board of Review case D44/87 (IRBRD, vol 2, 438) as an illustration. Like what the learned judge did in the Lombard case, we think it is necessary to go further than labelling and see how the Taxpayer carried on its business. It borrowed US dollars from lenders with whom it was not connected or associated in any way, and on-lent the money after conversion, principally to companies with whom it was affiliated, and made its profit out of the interest differential.

On the evidence we find (and indeed it is not disputed) that each of these three steps, that is, the borrowing, the lending and the earning of the interest differential as its income, was truly carried out. That, in our view, is enough to attract the application of the Avco principles.

Case D44/87 was decided on its own facts. In that case, prior to August 1979, the taxpayer's principal activities in that case were related to the shipping business. However, in the two years prior to the year of assessment in question, the nature of the taxpayer's business, as declared in the profits tax returns, was 'property investment'. The major shareholders of the taxpayer company, the Singapore lender and each of the borrowers were the same, that is, a Mr Z and members of his family. The Taxpayer lent to no one except these affiliated companies. In relation to two of the loans, they were recorded in the ledgers as having been made some months before the companies were incorporated. Eventually, the advances to the affiliated companies were written off. Not a scrap of evidence was put before the Board as regards the nature of the taxpayer's obligation owed to the Singapore lender. These facts make that case distinguishable. We do not think it is necessary to enumerate the facts of this case by way of comparison. Nor do we think that, if a company lends principally to its affiliates, it cannot be a finance company.

25. The Taxpayer in this case was incorporated as a finance company. As the Commissioner found, its principal activities have been 'mortgage financing and lending to

affiliated companies'. In his determination, the Commissioner did not question the status of the Taxpayer as a finance company but reached his decision on other grounds. It is not disputed that in previous years the Taxpayer's exchange losses were allowed as deductions and that, in the past, the status of the Taxpayer as a finance company was accepted by the Revenue.

26. On the totality of the evidence, we find that, in the years 1981/82 to 1983/84, the Taxpayer's status as a finance company remained unchanged.

Conclusion

27. In our view, the exchange losses in question are allowable deductions under section 16(1) of the Inland Revenue Ordinance. This appeal is therefore allowed and the assessments in question are hereby annulled.