

**Richfield International Land and Investment
Company Limited**

Appellant

v.

The Commissioner of Inland Revenue

Respondent

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE
3RD OCTOBER 1989

Present at the hearing:-

LORD ACKNER
LORD ROSKILL
LORD GOFF OF CHIEVELEY
LORD JAUNCEY OF TULLICHETTLE
LORD LOWRY

[Delivered by Lord Jauncey of Tullichettle]

This is an appeal by a taxpayer company ("the company") from a judgment dated 9th August 1988 of the Court of Appeal of Hong Kong (Clough and Hunter JJ.A. and MacDougall J.) allowing an appeal by the Commissioners of Inland Revenue ("the revenue") from an order dated 10th March 1988 by Sears J. which had allowed an appeal by the company by stated case from a decision of the Board of Review dated 12th August 1986 rejecting the taxpayer's appeal against an assessment to profits tax for the year 1979/80. That assessment related to substantial profits arising on the sale of a block of flats comprising fifteen units known as Gardena Court.

The assessment was made under section 14 of the Inland Revenue Ordinance which applied to the year of assessment and which provided (so far as material) that:-

"Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

Section 68(4) of the Inland Revenue Ordinance places upon an appellant the onus of proving that an assessment appealed against is incorrect. The issue between the parties has all along been whether, as the company contend, Gardena Court was at the time of the sale a capital asset in which event profits accruing on a sale thereof were not chargeable to profits tax or whether it was part of the company's trading stock in which event such profits were taxable.

There was presented to the Board of Review an agreed statement of facts together with a number of appendices containing relevant documents. The Court of Appeal set out the material facts as derived from the agreed statement and the appendices and their Lordships cannot do better than repeat their exposition albeit with slight adaptation and abbreviation:-

- "1. The company was incorporated on 22nd September 1972 as a private limited company.
2. On 9th October 1972 the company entered into three sale and purchase agreements to acquire by an issue of fully paid shares some seven properties at their then market value. These properties ranged in size from a small shop in Tai On Building which was unlet to Gardena Court and included a single unit in Lungcheong Villa and eight units in a block of flats known as Kellett Heights.
3. The company has acquired no other direct interest in properties in Hong Kong or elsewhere. Its later acquisitions were all indirect through subsidiaries, and in California.
4. At all material times, all of the said properties have been classified as Fixed Assets in the company's Balance Sheet. Throughout the years since 1972, the company has consistently made known in its annual statements its business of long term property investment.
5. (a) In November 1972 the company became a public company.
 (b) In December 1972 the company purchased all the share equity in the Wan Shang Overseas Investment Co. Ltd. This newly acquired subsidiary owned two properties in Los Angeles, Lucerne Towers and Orange Plaza. They were then fully let: were bought for long term investment and are still owned. Since that event all the company's new indirect property investment has occurred in California.
6. On 20th February 1973 the company sold the property in Tai On Building which was still

unlet realising a profit of HK\$42,000 which was shown in its 1972/73 accounts as a capital gain. This was not at first assessed for profits tax.

7. On 22nd August 1973 the company sold the property in Lungcheong Villa realising a profit of HK\$90,660 which was shown in its 1973/74 accounts as a capital gain. The Inland Revenue Department in correspondence with the company's auditors challenged the classification of profits realised on these two properties.
8. (a) In the end an additional assessment was made for 1972/73 in respect of the profit realised on Tai On Building and the profit realised on Lungcheong Villa was also assessed to profits tax for 1973/74 and 1974/75. The company did not lodge any objection against the said assessments. The profits tax totalled HK\$33,341.

(b) The assessments asserted 'property dealing' and the charged tax appears to be based upon the difference between original cost and the price realised.

...
 10. The company continued to claim and obtain capital allowances on the remaining five properties.
 11. From 1972 the rents receivable from the properties Kellett Heights and Gardena Court, until their respective dates of disposal, represented the bulk of the Company's rental income.
 12. (a) On 7th December 1976 the company sold one of the units of property in Kellett Heights. The remaining seven units of property were sold between May 1978 and November 1978. The profits of approximately HK\$2.5m realised on the sale of this property were included in the company's trading profits and assessed for profits tax. Up to the time of sale the property had been fully let out.

(b) In a minute dated 28th October 1976 the Board resolved to sell a unit in Kellett Heights. The profit on this of HK\$196,233 apparently calculated on the difference between cost and re-sale price appeared in the company's profit and loss account for the year ending 31st March 1977.

- (c) In a minute dated 18th October 1978 the Board resolved to sell the remaining seven units at Kellett Heights. The profit on these sales of HK\$2,446,233, also apparently calculated on the difference between cost and re-sale price, appears in the company's profit and loss account for the year ending 31st March 1979.
- (d) The company and group Accounts for the year ending 31st March 1979 were accompanied by Chairman's Statements dated 9th August 1979. Both were written after the decision to sell Gardena Court referred to in paragraph 14 below. The Statement accompanying the Group Accounts included the following:-

'While your group will continue to sell a further portion of its Hong Kong properties if favourable terms are obtained, investments in real estate in Los Angeles USA will be increased through the group's subsidiary.'

13. On 3rd June 1979 the company revalued its remaining properties to reflect their then estimated market value and credited to capital reserve a total revaluation surplus of HK\$14,905,707 including a surplus of HK\$12,567,865 in respect of Gardena Court.
14. On 12th July 1979 the company's board of directors resolved to sell Gardena Court at HK\$24,500,000. The sale was completed on 31st January 1980. The book profit realised of HK\$6,395,800 was shown in the Company's 1979/80 accounts as surplus on disposal of capital assets. The company had let out the property for rental income from the time of its acquisition in 1972 up to the date of sale."

To the above exposition it is only necessary to add the following paragraph from the judgment of the Court of Appeal:-

"Until his death in February 1981 Mr. Y.M. Wong was the Chairman, the only executive director, and the governing mind of the company. The three witnesses who were called before the Board, his daughter, Mrs. Shum, Mr. Chan and Mr. Chuang had, as the Board concluded, very second-hand knowledge of the material events. The auditors who had some direct knowledge were not called. The Board were we think very conscious of this position and anxious not to be unfair to the deceased."

Upon the foregoing facts the Board concluded that it was the initial intention of the company to purchase and retain the seven Hong Kong properties as long term investments but they further concluded that at least by April 1978 Mr. Y.M. Wong looked upon the Hong Kong properties of the company as trading stock. In reaching this latter conclusion the Board expressed the belief that:-

"... at sometime during the passage of time culminating in a Minute of the 18th April 1978 (which clearly indicated a willingness to sell other flats in Kellett Heights), Mr. Y.M. Wong - who was the policy maker - had lost his resolve to so restrict the company's affairs and was quite willing to sell the Company's properties. But, we had to ask ourselves, was he merely procuring the company to realize its investments or had he embarked the company into trading? Were it not for the submission to profits tax on the sales of the Tai On, Lungcheong & Kellett Heights, the answer would on balance have been in favour of realization."

The Court of Appeal expressed the view that in the passage which their Lordships have emphasised the Board were addressing themselves to the crucial issue in the case. Their Lordships would respectfully agree with that view. The Board then went on to consider when the conversion from investment to stock-in-trade took place and said:-

"We were tempted to think the first sale in February 1973 of the Tai On unit at a profit of \$42,000 (tax at 15% = HK\$6,300) was nothing more than the realization of an investment which should not have been there in the first place: with reluctance however we did not believe that the second-hand explanations we received - plausible though they were - can outweigh the undoubted fact that the company did submit to profits tax on that transaction and when to that fact is added the subsequent submission to tax on the profitable sales of Lungcheong Villa and the Kellett properties we did not think it was open to us to treat Tai On as a case apart.

We therefore reached the conclusion that by the time of the Tai On sale Mr. Y.M. Wong was treating all the Hong Kong properties as trading stock."

Sears J. had difficulty in discovering from the stated case what were the facts which were found and what were the opinions which the Board came to on those facts. He considered that the Board's reasoning was illogical and that they had not addressed their minds to the real issue. He decided that the sale of Gardena Court was simply the realisation of capital assets. The Court of Appeal found some difficulty in understanding

the basis of the judge's decision and their Lordships share their dilemma. The Court of Appeal, after a careful analysis of the facts and the relevant principles of law, concluded that it could not be said that the Board's factual conclusions and inferences were either unreasonable or insupportable.

It is quite clear from the decision of the Board that if it had not been for the submission to profits tax on the sales of the Tai On shop, Lungcheong Villa and Kellett Heights they would have treated the sale of Gardena Court as a realisation of a capital asset. The sole question therefore in this appeal is whether they were entitled to draw the inference from the circumstances of these sales that Gardena Court had become part of the trading stock prior to its sale. A finding of fact by tax commissioners or other similar bodies charged with the hearing of appeals against assessment to tax will only be set aside by an appellate court, whose jurisdiction is restricted to matters of law, if it appears that the body in question has acted without any evidence or upon a view of the facts which could not reasonably be supported (*Edwards v. Bairstow* [1956] A.C. 14, Viscount Simonds at page 29). These principles apply not only to primary facts but to inferences drawn therefrom (*Furniss v. Dawson* [1984] A.C. 474, Lord Brightman at pages 527-8). Furthermore if the primary facts as found are capable of supporting two alternative inferences it is no function of the appellate court to substitute its preferred inference for that legitimately drawn by the body in question (*Furniss v. Dawson supra* per Lord Brightman at page 528, *Lim Foo Yong Sdn. Bhd. v. Comptroller-General of Inland Revenue* (1986) S.T.C. 255, Lord Oliver of Aylmerton at page 259a).

Their Lordships turn to consider the facts from which the Board drew the crucial inferences. In the first place the Tai On shop was sold some four months after acquisition without being let and although it appeared in the company's assets as a capital transaction no challenge was made to the subsequent assessment to tax on the profits of sale. In the second place Lungcheong Villa was sold some ten months after acquisition and again although the sale was treated by the company as a capital transaction no challenge was made to the assessment to tax of a substantial amount. In the third place one unit at Kellett Heights was sold in December 1976 and the profit accruing on that sale appeared in the company's profit and loss account for the year ending 31st March 1977 thereby attracting an assessment of profits tax. In the fourth place the remaining seven units at Kellett Heights were sold between May and November 1978. Again the profit accruing on the sales appeared in the company's profit and loss account for the year ending 31st March 1979 thereby attracting an assessment to profits tax. Kellett Heights was the company's second most valuable

property in Hong Kong and a very substantial amount of tax was paid in respect of its sale. There was no evidence before the Board to suggest that Kellett Heights had been sold for the purpose of re-investing the proceeds in real property in the USA. Indeed the accounting treatment of the sale of the property with a consequent tax liability points strongly against those in charge of the company having treated Kellett Heights as a fixed asset. As the Court of Appeal pointed out the company had no business to submit to a substantial assessment to profits tax if such assessment was on the facts unjustified. In their Lordships' view the inescapable inference from the way in which the company treated the sale of the units in Kellett Heights is that it regarded them as trading stock.

There was no finding by the Board that the company had sought to treat any of the seven Hong Kong properties acquired by them in a different manner so far as investment was concerned. In these circumstances, having concluded that the company was content to be taxed on the profits accruing from the sales of the Tai On shop and Lungcheong Villa as on the sale of trading stock and that the company had effectively invited taxation on that basis in relation to the profits accruing from the sale of Kellett Heights, it was but a short step to reach the conclusion that the sale of Gardena Court was undertaken on the same basis. It could not in these circumstances be said that the Board drew an inference for which there was no foundation in fact or which could not reasonably be sustained by the facts which were found.

The only remaining question is to consider whether the Board were entitled to conclude that Gardena Court and the other Hong Kong properties had become trading stock prior to the sale of the Tai On shop. The Board had some hesitation in reaching this conclusion but having regard to the lack of direct evidence as to the circumstances surrounding this sale they concluded that such evidence as there was was outweighed by the fact of submission to the assessment. Their Lordships do not consider that they could be criticised for reaching this conclusion particularly when regard is had to subsequent events.

Their Lordships will accordingly humbly advise Her Majesty that the appeal ought to be dismissed. The appellants must pay the respondents' costs.

