HCIA 1/99

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE

Inland Revenue Appeal No. 1 of 1999

BETWEEN:

WONG NING INVESTMENT CO. LTD. Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon. Yuen, J. in Court
Dates of hearing: 22-23 November 1999
Date of Judgment: 3 July 2000

JUDGMENT

This is an appeal by Wong Ning Investment Co. Ltd ("the Taxpayer") from a decision of the Inland Revenue Board of Review by way of Case Stated.

The Assessments

The assessments relevant to the present appeal were made for the year 1986/87. There were 3 assessments:-

- an estimated assessment of profits of $2,000,000 ("Assessment (i)");

- an additional assessment of profits of $1,641,562 ("Assessment (ii)");

- and a second additional assessment of profits, initially of $95,950,000, later reduced by the Commissioner to $60,950,000 ("Assessment (iii)").

Events

These assessments arose from the sale by the Taxpayer of a property in Pokfulam to an associated company on 28 January 1986.

The Taxpayer had acquired the property 9 years before, on 21 January 1977, when the property was still an undeveloped site. The property was transferred to the Taxpayer from its parent company Hoi Tung Investment Co. Ltd. for a consideration of $1.

Development of the site did not commence for more than 1 year, because the Building Authority was of the view that the site was subject to height and other restrictions. The Taxpayer challenged the Building Authority's view. Development of the site commenced in 1979 and the plans underwent a series of changes, with the Taxpayer finally succeeding in getting approval for plans for a 32-storey residential building over 4 storeys of car parking spaces.

On 28 January 1986, before the development was completed, the Taxpayer sold the property by way of an Agreement for Sale and Purchase to Istril Ltd. ("Istril"), an associated company, for $29,050,000. The assignment was executed 3 years later, in 1989.

Meanwhile, Istril took over the development of the property. In 1988, Istril completed the development, which was named Victoria Gardens. Immediately after the issue of the Occupation Permit in May 1988, Istril rented out the apartments in Victoria Gardens, mainly to expatriates, and that has remained the position since then.

The Taxpayer, Hoi Tung and Istril were all part of what has been called, in the Case Stated, the Chinachem group of companies, although that group was not defined or its members identified.

Assessment (i)

The assessor considered that the sale by the Taxpayer of the property to Istril in 1986 was in the nature of trade and hence subject to profits tax. In April 1987, the Taxpayer was required to file a profits tax return for the year 1986/87.

No return had been filed by July 1987, whereupon the assessor issued an estimated assessment, i.e. Assessment (i)

Assessment (ii)

In August 1987, the Taxpayer filed its 1986/87 profits tax return. Profits for the year comprised profits from the sale of 2 units in an industrial property owned by the Taxpayer *and* from the transfer of the property by the Taxpayer to Istril. It would appear that the latter profits were based on the difference between $29,050,000 (the consideration on the transfer) and $27,385,232.84 (the costs of the property).

In December 1987, on the basis of the Taxpayer's August 1987 return, the assessor issued an additional assessment of profits i.e. Assessment (ii).

No appeal was lodged by the Taxpayer within time against either Assessment (i) or (ii).

Assessment (iii)

In July 1988, the assessor issued a second additional assessment of profits of $95,950,000 i.e. Assessment (iii). This was computed by assessing the open market value of the property as at the date of sale (assessed at $125,000,000), and deducting from that the price at which the property was sold by the Taxpayer to Istril ($29,050,000).

Taxpayer's challenge to assessments

Within the same month, the Taxpayer filed a notice of objection to this assessment.

It also sought to challenge Assessments (i) and (ii) under s.70A of the Inland Revenue Ordinance. Section 70A provides that if, upon application made within 6 years after the end of a year of assessment, it is established to the satisfaction of an assessor that the tax charged is excessive by reason of an *error* or omission in any return or statement submitted in respect thereof, the assessor shall correct such assessment.

Commissioner's determination

In March 1992, the Commissioner confirmed Assessments (i) and (ii). However he accepted a re-valuation of the property downwards by $35,000,000, and so reduced Assessment (iii) to an assessment of profits of $60,950,000.

Appeal to Board of Review

In April 1992, the Taxpayer lodged an appeal to the Inland Revenue Board of Review. A hearing was originally set down for July 1992 but was adjourned.

The hearing did not take place until March 1996. The appeal in respect of Assessment (i) was abandoned. Accordingly, the issues before the Board of Review were:-

(a) whether s.70A applied to Assessment (ii); and

(b) whether the property had been acquired by the Taxpayer in 1977 as trading stock or as an investment. It was held in *Lionel Simmons Properties Ltd v CIR* 53 TC 461 that an asset cannot be acquired as *both* trading stock and an investment, and what matters is the Taxpayer's intention at the time of acquisition (subject to changes of intention).

At the hearing, the Taxpayer called oral evidence from Mr Tong Pui Chung, formerly the chief accountant of the Chinachem group, and Mr Peter Siu, formerly the assistant to Mr & Mrs Wang who controlled the Chinachem group.

Mr Tong and Mr Siu were questioned on their evidence by counsel for the Commissioner and by the Board of Review, but, as will be seen later, questions about certain matters relied upon by the Board of Review in its decision were *not* put to these witnesses.

There was also a statement from Mr C.C. Ko, another former employee, who had been one of the two first directors of the Taxpayer, but who since 1990 had lived in the United States. Mr Ko was not available to be questioned.

In August 1996, the Board of Review dismissed the Taxpayer's appeal and confirmed the assessments. The Board of Review's findings of fact and its conclusions were contained in a written decision.

On 12 September 1996, the Taxpayer required the Board of Review to state a case pursuant to s.69 of the Inland Revenue Ordinance.

Case Stated

The Case Stated was not signed off until 5 January 1999. It is not entirely clear what the reasons for the delay were, although it would appear that some time was taken before the Taxpayer and the Commissioner could agree over the drafting of parts of the Case Stated.

The questions of law stated for the opinion of the Court are:-

(a) whether on the facts, the only true and reasonable conclusion contradicts the Board of Review's conclusion that the property had not been purchased as a long term investment asset but had been acquired as trading stock;

(b) whether the Board of Review misdirected itself in law and/or erred in law in relying on and/or giving undue weight to evidentiary matters referred to in the Decision and Judgments in *Chinachem Investment Co Ltd v CIR*, which was founded on its own particular facts, which facts were not put to any of the witnesses called by the Taxpayer;

(c) whether, as a matter of law, and on the facts, it was open to the Board of Review to conclude that the property had been purchased as trading stock;

(d) whether the Board of Review was correct in law by reaching a decision consistent with the principles established in the judgments in *Sharkey v Werhner* 36 TC 275 and *Petrotim Securities v Ayres* 41 TC 389.

Question (b) raises question of error of law

Questions (a) and (c) in the Case Stated are predicated "on the facts", which must mean those facts found by the Board of Review. Those findings of fact are, however, themselves challenged in question (b).

To what extent can findings of fact be challenged on appeal by way of case stated?

Section 69(1) of the Inland Revenue Ordinance provides that the decision of the Board shall be final: Provided that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the High Court.

Section 69(5) provides that any judge of the High Court shall hear and determine any question of law arising on the stated case and may in accordance with the decision of the court upon such question confirm, reduce, increase or annul the assessment determined by the Board, or may remit the case to the Board with the opinion of the court thereon. Where a case

is so remitted by the court, the Board of Review shall revise the assessment as the opinion of the court may require.

An error of law has been held in *Edwards v Bairstow* [1956] AC 14 to arise, not only where the case contains anything *ex facie* which is bad law and which bears upon the determination, but also where the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal.

In the present case, the Taxpayer has contended that the Board of Review relied on and/or gave undue weight to evidentiary matters referred to in the Decision and Judgments in *Chinachem Investment Co Ltd v CIR* ("the CICL case"), which were not put to the Taxpayer's witnesses.

It is clear that a tribunal cannot extract *facts* from another case (referred to for the *law*) and use them against a party. If the tribunal did so, it would be taking into account matters extraneous to the hearing, and such a misdirection on the evidence is an error in law. In not giving the witnesses an opportunity to address the matters arising from that case that the tribunal considered relevant to its assessment of their credibility, the tribunal would be acting unjudicially as well.

Therefore if the Taxpayer can show that the Board of Review has relied, to a material extent, on matters which were not adduced as evidence and which had not been put to the Taxpayer's witnesses at the hearing, then that reliance would be, in my view, an error in law.

No judicial review

It has been suggested by Miss Gladys Li SC, counsel for the Commissioner, that the issue raised in question (b) of the Case Stated ought to have been taken by way of judicial review. In my view, however, as stated above, question (b) is capable of being raised as a question of law by way of Case Stated and since it has been so raised, convenience and the avoidance of multiplicity of proceedings justify the continuation of the present appeal. This is particularly since the Commissioner has not hitherto raised the subject of an application for judicial review (and indeed has agreed to the inclusion of question (b) in the Case Stated), and when the time limit for an application for judicial review has long elapsed.

Issue on appeal

In this appeal, question (b) is of primary importance. The issue for this court is whether the Board of Review has placed emphasis on extraneous matters to such a material extent as to vitiate its determination of the facts relevant to its decision.

At the hearing, the Taxpayer sought to substantiate its case that the property had been acquired as an investment by making one important point through the evidence of Mr Siu and two important points through the evidence of Mr Tong. However, the Board of Review rejected these points after comparing their evidence with matters disclosed in the CICL case, without giving these witnesses the opportunity to address these matters.

Siu's evidence - residential properties would not be let before sale

Before I set out Mr Siu's evidence, I should note that the Board of Review had considered it relevant to its decision to see how Istril dealt with the property after completion, as well as to examine the accounts, not only of the Taxpayer, but also Istril, Hoi Tung and Yue Heung, another company in the group to whom the Taxpayer referred.

The point that Mr Siu emphasised in his evidence was that the "group" never rented out residential properties before sale. Therefore, since Istril had rented out the property immediately after completion, and indeed continued to hold the property for letting, the inference was that this property was acquired as an investment.

Mr Siu's evidence as recounted by the Board of Review in the Case was that "the group had occasionally developed property then let it out and then sold the units subject to the tenancies, however he emphasised that that was never done with domestic flats". This piece of evidence was described by the Board of Review as important.

However, the Board of Review then noted that "this *important* piece of evidence conflicts with the evidence in the CICL case where <u>all</u> the properties concerned were let when sold and some of them were domestic premises" (emphasis added).

The evidence in the CICL case was never adduced as evidence in the present case.

Further, when one examines the CICL case, it would appear that whilst some of the properties sold in that case were indeed flats which had been held for 7-8 years as fixed assets for rental income, these sales had been made by CICL to its associated or subsidiary companies shortly before the cessation of its (CICL's) business.

Therefore if the parties here had been made aware of the Board of Review's intention to take into account the evidence in the CICL case, Mr Siu may well have been questioned on the particular facts in that case.

Miss Li, counsel for the Commissioner, accepted that apart from the reference to the CICL case, there was *no* evidence that contradicted Mr Siu's evidence in this aspect, which the Board of Review itself had described as important.

It is clear from the decision that the Board of Review's comparison of Mr Siu's evidence with the evidence in the CICL case played a large part in its decision to reject (or at least substantially doubt) his evidence. It said that it had "some strong reservations concerning Mr Siu's evidence. ... He was quite emphatic about the group never selling domestic flats that had been let, *yet the CICL report show* [sic] *he was quite wrong*".

The Board of Review had thus dismissed this part of Mr Siu's evidence - on the non-sale of rented residential property - largely (if not solely) on the basis of the CICL case. That piece of evidence was, in the Board of Review's own estimation, "important" to the Taxpayer's case. It is therefore clear, in my judgment, that in referring to the evidence in the CICL case, the Board of Review misdirected itself in a material respect.

Tong's evidence

As for Mr Tong, there were two aspects of his evidence which were rejected by the Board of Review after comparing it with matters in the CICL case.

Classification of assets

The first concerned the group companies' accounting practice. His evidence was that after acquisition of a site, the asset would, during development but before completion, be entered into a company's books as "Leasehold Properties at Cost" or "Leasehold Properties under Development". On completion, the asset would be classified as "Fixed Assets" if it was intended for renting out or "Current Assets" if it was intended to be sold.

As far as this property was concerned, the property had, during development, been categorised in the Taxpayer's accounts and Istril's accounts, as "Leasehold Property at Cost" and "Leasehold Property under Development". After completion, Istril had categorised it as "Fixed Asset". Therefore, the point advanced by the Taxpayer was that it could therefore be inferred that the property had been acquired as a fixed asset or investment.

The fact that different properties belonging to the same company were classified as "fixed assets" or "current assets" was supported by evidence of the accounts of Istril, Hoi Tung and Yue Heung.

This piece of evidence was however rejected by the Board of Review as "Mr Tong's evidence as to group practice is not entirely in keeping with the classification to be found in the CICL Stated Case".

Such evidence as there was on this aspect in CICL comprised of a letter from the company's tax representatives to the Commissioner which sought to explain why the properties there had been categorised as "Current Assets". In a letter, the tax representatives said that the accountant of the company "had never seriously attempted to make a proper classification of the units in the balance sheet". It was said that everything was put under current assets to avoid the "tedious work of segregating those rental units from those held for resale". The accountant did not however give evidence at the CICL hearing.

Further, the property here had been re-classified as "fixed assets" in 1988, i.e. *after the decision* of the Board of Review in CICL in 1985 (CICL having ceased business in 1979). If the Board of Review were to test Mr Tong's evidence against the "evidence" in CICL, he should have been allowed to address the matter before his evidence was rejected as "not entirely in keeping with the classification to be found in the CICL Stated Case".

The Board of Review rejected the "classification" point by reference to the perceived inconsistency with the "evidence" in CICL. In dealing with the submissions of counsel for the Taxpayer, the Board of Review said:

> " Group accounts classification was consistent progressing from 'under development' to 'current assets' to 'fixed assets' on completion depending on whether the asset was for sale or leasing out. We accept that such is the case with the accounts of Istril, Hoi Tung, Yue Heung and of course the Site was transferred before the need for post-completion classification arose. We also accept that when the property was completed in Istril's hands it was re-classified as 'Fixed Assets' at least in the 31.3.1986 [sic] accounts and no longer appears in Istril's 31.3.1989 [sic] accounts as 'Property under development' (the intervening accounts and balance sheets are missing). *Nevertheless* the findings in the CICL case suggest that such classification was not consistent throughout the group" (emphasis added).

Although the Board of Review said that this was "not of particular significance", it expressed the view that it was "another indication of laxity by the group's accounts department and its auditors, so where [the Board of Review] was invited to draw inferences from classifications the suggested inference is diluted, because of the unexplained exceptions to the claimed consistency". The reference to "unexplained" exceptions is unfortunate - the witness was *not given the opportunity* to offer an explanation, if any, at the hearing.

The Board of Review's rejection of this piece of evidence clearly tainted its assessment of Mr Tong's credibility. In the section of the decision headed "CICL Case", it said:

> " The first thing we found striking about the CICL Stated Case Report is that what was said there about the classification of assets and mortgaging of them is contrary to the evidence given by Mr Tong. Certainly the findings in that case are disconcerting, leading us to wonder how far the testimony before us was dictated by expediency rather than frankness".

It is clear from that that the Board of Review's review of Mr Tong's evidence was materially influenced by the comparison with the CICL case, to the Taxpayer's detriment.

Mortgage of property

Mr Tong also gave evidence that the intention to hold the subject property for investment could be seen from the fact that the property had been mortgaged. He said in evidence that "group companies" did not mortgage properties which were trading stock.

In support of that piece of evidence, he referred to the Taxpayer's accounts which showed that this property had been mortgaged, but another property held by the Taxpayer (Hung Mou Industrial Building), which was undisputed trading stock, was not. This was also the case with the Taxpayer's parent company Hoi Tung where University Heights was mortgaged, but its trading properties were not. It was also the case with Yue Heung, where trading stock was mortgaged and other properties were not.

Miss Li has also accepted that there was no evidence to contradict Mr Tong's evidence on this point.

However, again by reference to the CICL case, this piece of evidence was rejected by the Board of Review. I have set out above the passage in which the Board of Review said that what was said in the CICL case about classification of assets *and mortgaging* of them was contrary to the evidence of Mr Tong and that the findings in that case were disconcerting, leading the Board of Review to doubt the veracity of the evidence.

It is not clear from the Case Stated what material in the CICL case about mortgages had caused the Board of Review to arrive at that conclusion adverse to the Taxpayer. In the CICL Case Stated, it had been submitted by the taxpayer that that company had largely *self-financed* its developments and it was contended that that was one of the features pointing to an intention to hold the property for investment.

However the Board of Review in the CICL case doubted whether the *evidence* of the witnesses in that case fully substantiated all of those features.

Thus, it was not known to the Board of Review here what was the evidence in the CICL case, if any, pertaining to mortgages. If the Board of Review were intending to draw

any inferences from the material referred to in the report of the CICL Case Stated adverse to the Taxpayer, it ought to have given the witness an opportunity to address the point.

Further, the Board in CICL found that the properties were not held for investment but were *trading stock*. So if anything is to be gained from such evidence as there might have been in the CICL case, it was to the effect that the trading stock was self-financed. If that is to be taken into account at all, it would seem to support, not contradict, Mr Tong's evidence that as the subject property here *was* mortgaged, the Taxpayer's intention here was to hold the property for investment.

Materiality

Whilst there were other materials before the Board of Review which could have influenced its decision to reject the Taxpayer's case, the written decision itself showed that the Board was heavily influenced by its references to the CICL case.

A section was devoted to the CICL case under "Deliberations and Conclusions". More importantly, the Board of Review attached significance to the "evidence" in the CICL case in its deliberations over both the issues before it, i.e. the error issue under s70A and the intention issue.

The CICL case clearly affected the Board of Review's assessment of the credibility of the two witnesses who gave evidence for the Taxpayer and led it to reject Mr Siu's evidence on a point which the Board of Review itself had described as "important".

In the light of the emphasis placed on the CICL case by the Board of Review, I cannot say that the Board of Review *would* have still come to the same conclusion if it had not been so influenced.

Order

In the circumstances, the matter has to be reconsidered by a tribunal correctly directing itself on the evidence adduced before it. I have considered whether the correct order for this court to make is to annul the assessment determined by the Board of Review or to remit the case to the Board with the opinion of the court thereon.

In my view, given the nature of the error here, the more appropriate order has to be to annul the assessment. This is not a case where there has been a discrete error of law which can be rectified by the Board in accordance with the correct interpretation of the relevant legal principle which is then applied to its assessment. The Board of Review's error has affected its perception of the witnesses and its decision on both the main issues. I therefore annul the

assessment determined by the Board and further give an order nisi that the costs of the appeal be to the Taxpayer.

(MARIA YUEN)
Judge of the Court of First Instance
High Court

Mr Denis Chang SC and Mr RK Sujanani instructed by Ford Kwan & Co for the Appellant

Miss Gladys Li SC instructed by Secretary for Justice for the Respondent