HCIA 7/2001

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

INLAND REVENUE APPEAL NO. 7 OF 2001

BETWEEN

WAH HING FAT REALTY COMPANY LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVENUE Respondent

Before: Deputy High Court Judge Poon in Court
Date of Hearing: 26 November 2002
Date of Judgment: 26 November 2002
Date of Reasons for Judgment: 10 December 2002

REASONS FOR JUDGMENT

Introduction

1. The appellant and one Italy Land Investment Limited ("Italy Land") were at all material times one of the two joint owners of Ground Floor, Wayson Commercial House, 68-70 Lockhart Road, Wanchai, Hong Kong ("the Property"). On 1 May 1994, the Property was sold at HK$17,500,000. In its profits tax return for the year 1995/96, the appellant only declared the assessable profits as HK$725,784, and sought to exclude HK$6,682,000, the profits derived from disposal of the Property, as capital gain. But the assessor did not make the exclusion and assessed the assessable profits at HK$6,739,585. By the determination dated 17 March 1999, the Deputy Commissioner confirmed the assessor's decision. The appellant appealed to the Board of Review on 13 April 1999.

2. On 11 November 2001, the Board confirmed the Deputy Commissioner's determination. Dissatisfied, the appellant brought this appeal against the Board's decision pursuant to section 69 of the Inland Revenue Ordinance, Cap. 112 ("the Ordinance"). The appeal first came before Kwan J on 6 March 2002 whereupon the appellant applied to amend the Case Stated. Kwan J remitted the Case Stated to the Board for consideration of amendments with costs of the appeal up to and including the hearing before her against the appellant. The Case Stated was subsequently amended on 16 May 2002.

3. On 26 November 2002, after hearing the parties, I dismissed the appeal and ordered that subject to the costs order of Kwan J, the respondent shall have the costs of this appeal. I had indicated that I would give the reasons for my decision in writing, which I now do.

Agreed facts

4. Before the Board, the following facts were agreed:

(1) The appellant was incorporated in September 1978. It commenced its business in March 1979. In that year, it together with Italy Land bought old landed properties and redeveloped them for resale. Most of the redeveloped properties were sold before 1984 except the Property. Unsold units on G/F, 1/F and 22/F of Wayson Commercial House were then assigned to the appellant and Italy Land jointly. Those on 4/F was assigned to the appellant solely. In the appellant's accounts for the year ended 30 June 1984, the unsold units were classified under current assets and described as "stock in trade, at the lower of cost and net realizable value as estimated by director". The figure given was HK$1,099,582.50.

(2) The units on 1/F, 2/F and 22/F were subsequently sold in the years of assessment 1986/86, 1989/90 and 1992/93 respectively. Profits/loss on disposal of these properties were reported by the appellant as trading profits/loss in its profits tax returns and were assessed accordingly. The appellant took no objection against these assessments.

(3) The appellant had changed its accounting year-end date to 30 April since the year of assessment 1993/94. In its accounts for the year ended 30 June 1992, 30 April 1993 and 30 April 1994, the Property was shown as "properties held for sale". The notes to the financial statements stated:

> " Properties held for sale are shown as current assets and are stated at the lower of cost and net realizable value. Cost includes cost of purchase of land and buildings and other direct cost attributable to such properties. Net realizable value represents the estimated selling price less cost to be incurred in selling. Credit is taken for the profits on sale of properties when the sales agreement is completed."

(4) The appellant changed auditors over the years. For the years between 1979/80 and 1983/84, the auditors were Lui & Mak, CPA. For the years between 1984/85 and 1989/90, it was SK Luk & Co, CPA. Then it was Tsui Pui Ling, CPA ("Tsui") for the years between 1990/91 and 1994/95. Finally, for the year 1995/96, it was PY Ng & Co, CPA.

(5) In the audited accounts for the year ended 30 April 1994, the appellant claimed deduction for valuation fee of HK$11,750 paid to the valuer for valuing the Property. The assessor disallowed the deduction and added the fee back to the returned profit. The appellant through Tsui objected on the ground that the valuation fee was actually of revenue nature instead of capital nature and was therefore taxable, the Property being held for sale of the appellant. The assessor then revised the 1994/95 assessment and allowed the deduction.

(6) Since 1982, the Property had been leased out by the appellant and Italy Land to generate rental income. The first tenant was Standard Chartered Bank between 15 March 1982 and 27 February 1985 at the monthly rent of HK$48,000 to HK$60,000. It was a eight years' lease but was terminated before its expiry upon the tenant's request. The Property was not leased out until 16 December 1985 to Tai Ka Loi Food Centre Restaurant for three years up to 15 December 1988. The 1/F was also leased out to this tenant at the same time. The rental ranged from HK$39,000 to HK$44,850. The next tenant was Singapore Club Catering & Fast Food for three years between 1 March 1987 and 28 February 1990. Then Firm Client Ltd took up the tenancy since 25 September 1990 initially for three years up to 24 September 1993 for monthly rental of HK$75,000. Upon expiry, the tenancy was renewed and the rent was revised to HK$100,000. On 1 May 1994, the

Property was sold together with tenancy at HK$17,500,000. The appellant derived a profit of HK$7,911,585 from the sale.

(7) For the year ended 30 April 1996, the appellant distributed dividends of HK$5,500,000.

(8) The appellant filed its 1995/96 profits tax return, declaring assessable profits of HK$725,784, which was arrived at after excluding HK$6,682,000 being part of the profits on disposal of the Property. The sum was alleged to be capital gain on disposal of the Property.

As noted above, the purported exclusion was in the event disallowed by the assessor.

The Board's reasoning and finding

5. The appellant's primary case before the Board was that initially the Property was held for trading purpose but the appellant subsequently changed its intention to that of capital investment. I will summarise below the appellant's case and the Board's reasoning insofar as they are relevant for present purposes.

6. The appellant put forward four different dates when the alleged change of intention took place, namely, (1) 15 March 1982 when the tenancy with Standard Chartered Bank commenced, (2) sometime in 1985 when the appellant carried out a valuation and compared it with the rental received, (3) 1 March 1987 when the appellant claimed that deduction from the profits tax assessment (subject matter of this appeal) should have been made to take into account the market value of the Property on the change of intention; and (4) 15 April 1987 when the appellant passes a board resolution resolving that "the purpose of [the Property and 1/F of Wayson Commercial House] be changed to a long terms rental properties investment basis and that an independent valuation on these properties be conducted" ("the 1987 Minutes"). The Board doubted if there was any change of intention when the appellant was not sure when exactly the change took place.

7. Mr Choy Wai Bor ("Mr Choy"), a director and the chairman of the appellant, gave evidence before the Board. He stressed that all along the appellant had held the Property for capital investment purpose. But he was unable to explain the reason why it was then necessary to record in the 1987 Minutes the alleged changed of intention. Accordingly, the Board disregarded it as having no evidential value.

8. Mr Choy further explained that errors had been made on the accounting and tax documents over the years by Tsui and the appellant's own employees. The Property was accordingly described as stock in trade or being held of sale purpose. He however was unable to explain satisfactorily to the Board how Tsui and the employees could have made such mistakes. In

particular, in Tsui's case, her predecessors had made the same description of the Property and she was just adopting the same in the documents that she had dealt with. The Board took the view that the accounting and tax documents, which were contemporaneous records, were highly relevant in the absence of any other reliable contemporaneous evidence.

9. The appellant also sought to rely on a letter dated 19 October 1987 from Knight Frank Kan & Baillieu as evidence of the valuation conducted pursuant to the 1987 Minutes. This letter was however just a quotation of fee on the proposed valuation. It did suggest that the Property was worth HK$4,000,000. But it expressly stated that it was "nothing more than an informal desk-basis approximate indication and can in no way be read as a valuation for any purpose". The Board did not accept the appellant's contention.

10. The Board identified in paragraph 25 of the Amended Case Stated the fact that the Property had been leased out for over 12 years as the strongest factor in favour of the appellant. However it observed that merely leasing out the Property did not necessarily involve a change of intention as it could be sold with tenants, as it transpired later in May 1994.

11. The appellant sought to contend that the Revenue had treated the sale proceeds Italy Land earned from the disposal of the Property as capital gain. The Board rejected that submission. For the correspondence between Italy and the Revenue clearly established the contrary. The appellant did not seek to pursue this line of argument before me.

12. In the end, the Board found that the appellant had not changed its intention as alleged. It had failed to prove that that was indeed the case.

Questions of law

13. The following questions of law are raised for my determination:

(1) Whether, as a matter of law and on the facts found, it was open to the Board to conclude that part of the gain on disposal of the Property of $6,682,000 was properly assessable on the Appellant to profits tax for the year of assessment 1995/96 ("Question 1").

(2) Whether as a matter of law, and on the facts found, it was open to the Board to find that there had not been a change of intention from holding the Property for the purpose of sale to long term holding for rental income purpose having regard to the facts found by the Board including the following:

(a) that the Property continued to be leased out since 1st March 1987, the date of alleged change of intention, to the date of sale;

(b) that the Appellant did not dispose of the Property during the various periods when the Property was vacant; and

(c) that structural alterations were made to the Property in 1985 and 1986 ("Question 2").

(3) Whether there was any evidence to support the following findings of fact made by the Board:

(a) that the Appellant was unable to pinpoint with any degree of accuracy the date of change of intention;

(b) that the Former Representatives had not wrongly classified the Property in the accounts under 'Stoke-in-trade' or 'Property held for sale';

(c) that the board minutes dated 15th April 1987 were of no evidential value;

(ca) that Mr Choy's answer in the hearing in respect of the date when the minutes were signed were evasive;

(d) that the KFKB fee proposal was no evidence at all of any valuation of the Property or of any attempt by the Appellant to have sought a valuation because of a change of intention; and

(e) that the Appellant, not being able to immediately dispose of the Property prior to or shortly after the completion of the redevelopment, decided to rent the Property out and to wait for an opportune time to sell the Property ("Question 3").

14. Mr Cheung, for the appellant, abandoned Question 2(c) or 3(b) for the purpose of this appeal.

Main issue

15. The main issue before me, as it was before the Board, is whether there was a change of intention on the part of the appellant relating to the Property whereby it was held no longer for the original purpose of trade but rather for capital investment. The main thrust of the appellant's submissions, as I understand Mr Cheung, is that the evidence before the Board clearly established that there was such a change of intention and the Board ought to have found so. In my view, once this fundamental issue is determined, the answers to the questions of law will become apparent. I

will therefore first examine if the Board was entitled to come to its finding that there was no change of intention as alleged. I will then deal with the questions of law in turn.

No change of intention

16. Change of intention is a question of facts to be determined by looking at all the circumstances of the case, including things said and done at the time, before and after: *All Best Ltd v. CIR* 3 HKTC 750, *per* Mortimer J (as he then was) at p.771. Intention may change in the course of time. "What was first an investment may be put into the trading stock and, I suppose, vice versa. If findings of this kind are to be made, precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and possibly, a liability to tax": *Sharkey v. Werner* [1956] AC 58, *per* Lord Wilberforce at p.1199.

17. Mr Cheung placed heavy reliance on the 1987 Minutes. He contended that it properly recorded the change of intention and is indeed prima facie evidence of the transaction under section 119 of the Companies Ordinance, Cap. 32. The Board ought to have given weight to it accordingly.

18. Section 119 provided:

> " **119. Minutes of proceedings of meetings and directors**
>
> (1) Every company shall cause minutes of all proceedings at general meetings and at meetings of its directors to be entered in books kept for that purpose.
>
> (2) Any such minute if purporting to be signed by the chairman of the meeting at which the proceedings were had, or by the chairman of the next succeeding meeting, shall be evidence of the proceedings.
>
> (3) Where minutes have been made in accordance with the provisions of this section of the proceedings at any general meeting of the company or meeting of directors or managers, then, until the contrary is proved, the meeting shall be deemed to have been duly held and convened, and all proceedings had thereat to have been duly had, and all appointments of directors, managers, or liquidators, shall be deemed to be valid.
>
> (4) If a company fails to comply with subsection (1), the company and every officer of the company who is in default shall be liable to a fine and, for continued default, to a daily default fine."

19. There is no evidence before the Board to suggest that the statutory requirements under section 119(1) had been fully complied with. Mr Choy did not give details in this regard. The best Mr Choy was able to say was that he thought the staff ought to have kept the company's minutes book. They should know what to do, he said. The appellant would have no difficulty to call the responsible officer to address this point. But it did not do so. In the circumstances, I am unable to accept that the appellant is entitled to invoke section 119 in order to attach to the 1987 Minutes the evidential weight that it now seeks to place on it.

20. Further, the evidential value of the 1987 Minutes, if any, must be reduced to minimal by Mr Choy's oral testimony. He said in effect that from the outset it had always been the intention of the appellant as a developer to hold the Property as capital investment as it was the most valuable property, being situated on the ground level. One wonders, as the Board did, why it was then necessary to record the alleged change of intention in the 1987 Minutes. Mr Choy was unable to give a satisfactory answer. Further, the 1987 Minutes referred to the change of intention of both the Property and the 1/F of Wayson Commercial House. But when later the 1/F was disposed of, the sale proceeds were treated as trading profits and assessed as such. The appellant did not take any objection to the assessment. Why were the sale proceeds of the 1/F treated as trading profits in stark contradiction of the alleged change of intention as recorded in the 1987 Minutes? No explanation had been given. Mr Cheung complained that Mr Choy was not cross-examined on the veracity of the 1987 Minutes. He was thus deprived of the opportunity to answer the query. But the Board is not obliged to put questions to Mr Choy on those matters: *Kaifull Investment Ltd v. CIR* [2002] 2 HKLR 40. Mr Reyes, SC, sitting as a deputy judge, said at paragraph 60 of the judgment at pp.875-876:

> " It was not for the Board to debate with Mr Wan the weight to be attached to the surveyor's letter. Nor was it for the Board to point out to Kaifull or its witnesses precisely where and why the documentary evidence tendered by Kaifull in support of its case was unconvincing. The rule in *Browne v Dunn* (1893) 6 R 67 does not import an obligation on a tribunal to tell a party in what respects documents adduced as evidence support or undermine a witness' assertions."

I respectfully agree.

21. Further, the alleged change of intention in April 1987 is flatly contradicted by the appellant's own subsequent conduct by asserting for the purpose of the 1994 audited accounts that the fee of valuation for the Property was of revenue nature instead of capital nature: see paragraph 4(5) above.

22. The Board's observed at paragraph 24 of the Amended Case Stated that Mr Choy was evasive as to when he exactly signed the 1987 Minutes. According to the transcript of proceedings, it was after repeated questioning that Mr Choy said he signed it on the date when the meeting was held. Mr Cheung submitted that the date at which Mr Choy signed the minutes was of

no relevance under section 119 of the Companies Ordinance. He referred to subsection (2) in this regard. The Board had thus taken into consideration irrelevant consideration. I am unable to accept this submission for two reasons. First, section 119(2) refers to any such minute in section 119(1). Subsection (2) will apply only if the minute in question is entered in books kept for that purpose. As I have demonstrated in paragraph 18 above, there is no evidence to suggest that the requirements in subsection (1) were fully complied with. In the circumstances, the appellant cannot invoke subsection (2). Second, the Board made the observation in the context of dealing with the allegation that the change of intention took place on 15 April 1987, the date on which the meeting was held. If Mr Choy was evasive as to when he signed the 1987 Minutes, it would obviously have an impact on the appellant's case that the alleged change of intention took place on 15 April 1987. It was legitimate for the Board to make that observation and have proper regard to it.

23. In my view, the Board is entitled to disregard the 1987 Minutes after taking into account all the circumstances. This disposed of the main contention of Mr Cheung. He next submitted that the Board should have given weight to the KFKB letter. It was either a valuation or an attempt to value the Property. The letter is on its face certainly not a valuation. It is hardly an attempt to value either. It is only a quotation of fee for valuation to be conducted. The Board is entitled to conclude that no valuation had been made pursuant to the 1987 Minutes.

24. The Board is in my view entitled to have regard to the accounting and tax documents at the material times and reject Mr Choy's explanations. These documents are not conclusive evidence. The Board was aware of that: see paragraph 14 of the Amended Case Stated. But as rightly observed by the Board, they may amount to important evidence. The Board derived support from the following passages in *Chinachem Investment Co. Ltd v. CIR* 2 HKTC 261:

> " I entirely accept that the matter (whether an item is held as capital or as stock-in-trade) is not concluded by the way in which it has been treated in the taxpayer's books of account, but it seems to me that the way in which the properties have been treated in the accounts is by no means an insignificant factor to be taken into consideration, particularly where there has also been no attempt to claim depreciation in respect of those properties"

(*per* Macdougall J at p.302.)

> " It is accepted by the Commissioner that the accounts are not conclusive evidence of the matter in issue ... Nevertheless the accounts must remain important and call for credible explanation, because they are contemporaneous evidence of the Company's intention ... I agree with the judge that the way in which the properties have been treated in the accounts is by no means an insignificant factor"

(*per* Sir Alan Huggins, VP at p.308.)

The Board's approach to those documents and its conclusion, in my view, cannot be flawed.

25. Mr Cheung further submitted that the Board had failed in paragraph 25 of the Amended Case Stated to make any findings on the appellant's circumstances in holding the Property for a substantial period. He argued that the Board was wrong in applying *Chinachem Investment Co. Ltd v. CIR* to the present case without making a finding what the appellant's intention was. With respect, counsel must have misread this particular paragraph. Its effect is set out in paragraph 10 above. The Board did refer to the observations made by the Court of Appeal in *Chinachem Investment Co. Ltd v. CIR*. But it did not stop there. It went on to make the finding that the appellant, not being able to immediately dispose of the Property prior to or shortly after the completion of the redevelopment, decided not to rent the Property out and to wait for an opportune time to sell it. Mr Cheung then took two further points. He first complained that there was no evidence before the Board to enable it to make this finding. But in my view, there was ample evidence before the Board, including Mr Choy's oral testimony that the appellant would hold the Property for investment but might sell it when the market was bad, and how the Property was described in the appellant's accounts and tax documents, to enable it to draw such an inference. Mr Cheung next complained that the Board did not have proper regard to the fact that the Property was continuously leased out since 1 March 1987 to the date of sale and that the appellant did not dispose of it during the intervals when the Property was vacant. The Board must consider all the circumstances of the case before it. These facts are no more than factors that the Board had to take into account. They are not conclusive evidence and should be evaluated against all the circumstances and given weight, if any, accordingly. It is wrong, as Mr Cheung was apparently suggesting, to isolate them from the circumstances and to give them specific weight. The Board did consider all the circumstances before making the said finding. Indeed, it did recognise the renting of the Property since 1 March 1987 as the strongest factor in favour of the appellant. Mr Fung for the Commissioner pointed out that the only periods which the Property was not subject to a lease were from 28 February to 15 December 1985 and from 1 March to 24 September 1990. The vacancy for ten months in 1985 plainly did not indicate the appellant's change of intention, which alleged took place in 1987 in this context. The vacancy in 1990 did not assist the appellant for it was never its case that it changed its intention in 1990. I agree.

26. For the above reasons, I am of the view that the Board is right in coming to the finding that there was no change of intention as alleged.

Answers to the Questions

27. I will now turn to the questions of law and answer them as follows.

28. The answer to Question 1 is "yes".

29. The answer to Question 2 is "yes" as well.

30. Question 3, couched in its terms, is not a proper question of law. It is trite that under section 69 of the Ordinance, the Board's decision can only be impugned if (1) it has misdirected itself in law, for example, upon the burden of proof, or by misinterpretation of a statute; (2) it has drawn inferences or come to conclusions which cannot stand because the primary facts found by it do not admit of such inferences or conclusions; or (3) where there was no evidence on which the primary facts themselves could be based or where the Board should have made findings of other relevant primary facts: see *CIR v. Inland Revenue Board of Review* [1989] 2 HKLR 40, at 57E-H. The various matters referred to in Questions 3(a), (c), (ca) and (d) are not findings of facts. They are observations, comments or part of the reasoning process of the Board. The appellant is in law not permissible to mount an attack of such nature. In any event, the Board is well justified in coming to those conclusions. The matters referred to in Question 3(e) may arguably be described as inference drawn from primary facts. This is accepted to be so by Mr Cheung. I agree with Mr Fung that if it is an attack on inference, the proper way to frame the question is: whether on the facts found, it was open to the Board to find or infer and so on. Question 3(e) is therefore improper and should not be entertained. In any event, as I have demonstrated in paragraph 25 above, the Board was entitled to draw such an inference on the evidence before it.

31. The Board had taken the initiative to derive two further questions of law from Question 3. As the appellant is not relying on them, I do not propose to deal with them here.

32. For the above reasons, I dismiss the appeal with costs against the appellant.

(J. Poon)
Deputy High Court Judge

Representation:

Mr Ivan Cheung, instructed by Messrs P.T. Yeung & Tang, for the Appellant.

Mr Eugene Fung, instructed by Department of Justice, for the Respondent.