CACV 115/2017
[2018] HKCA 301

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL
CIVIL APPEAL NO. 115 OF 2017
(ON APPEAL FROM HCIA NO. 1 OF 2016)

BETWEEN

COMMISSIONER OF INLAND REVENUE — Appellant

and

PERFEKTA ENTERPRISES LIMITED — Respondent

Before : Hon Cheung, McWalters JJA and G Lam J in Court
Date of Hearing : 11 April 2018
Date of Judgment : 1 June 2018

J U D G M E N T

Hon Cheung JA :

I. Introduction

1.1 The issue in this appeal is whether the taxpayer was engaged in trade when it changed its intention in regard to a piece of its land from being held as capital asset to one for the purpose of trade, and as a result, income arising from the disposition of the land is chargeable to profits tax.

1.2 The respondent taxpayer was the owner of a piece of land ('the Lot') in Kwun Tong, Kowloon upon which a building was situated. In the 1960s and 70s, the taxpayer used the building as its base for manufacturing toys. Due to the relocation of the production work to the Mainland, by 1987 the taxpayer ceased its manufacturing operation locally in that building. It obtained permission to develop a composite industrial/office building on the Lot. It also entered into negotiation with a property developer Cheung Kong Holdings Limited ('Cheung Kong') to jointly redevelop the Lot. Eventually a Redevelopment Agreement dated 30 July 1994 was signed with Cheung Kong under which the latter agreed to pay the taxpayer $165,104,100 ('initial

payment'). The Commissioner of Inland Revenue ('Commissioner') was of the view that the initial payment paid to the taxpayer was trading profit and was liable to profits tax.

1.3 The taxpayer objected and appealed to the Board of Review ('the Board') on the ground that the initial payment was a capital receipt for which profits tax could not be charged. The Board by a majority allowed the appeal and remitted the assessment to the Commissioner for the purpose of giving effect to the decision of the Board. The Commissioner appealed by way of case stated to Chung J who allowed the Commissioner's appeal and set aside the Board's decision to remit the assessment to the Commissioner. The taxpayer now appeals against the decision.

II. Facts

2. The findings by the Board based on the agreed facts of the parties are as follows :

> '17. The appellant [the taxpayer] was incorporated on 9 April 1965. It has engaged in the business of toy manufacturing since its incorporation. Its first directors were Yeung Yun Tong (also known as Winston Yeung Wing Tong), Yeung Wing Yau, Yeung Wing Chai, Yeung Wing Tak and Yeung U Chung (also known as Yeung Wing Chung).
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> 18. By an Assignment dated 2 May 1969, the appellant [the taxpayer] acquired from Vanda Industrial Development Corporation Limited (in receivership at that time) at the price of $6,000,000 the Ground Floor, Mezzanine and the 1st, 2nd, 3rd, 4th, 8th, 9th & 10th Floors of Vanda Industrial Building at No. 25 Cheong Yip Street, Kwun Tong, Kowloon, representing 9 equal undivided 12th parts or shares of and in Kwun Tong Inland Lot No. 603 ("the Lot") and the building thereon. The appellant [the taxpayer] used the same as its manufacturing base in Hong Kong.
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> 19. In 1977, the appellant [the taxpayer] acquired the remaining equal undivided shares of and in the Lot and the building thereon. The appellant [the taxpayer] used the same as its manufacturing base in Hong Kong.
>
> 20. In 1978, the appellant [the taxpayer] entered into a processing arrangement with an entity in Mainland China and established the Guangzhou Bai Yun Perfekta Toys Factory in Guangzhou.
>
> 21. In 1985, the appellant [the taxpayer] relocated the Guangzhou Bai Yun Perfekta Toys Factory to Guanlan in Shenzhen and that led to the establishment of the Guanlan

Perfekta Toys Factory through entering into a new processing arrangement with another entity in Mainland China.

22. In 1987, the appellant [the taxpayer] ceased its manufacturing operations at the Tsuen Wan Factory and thereafter disposed of the same.

23. On 23 July 1991, Canaan Consultants Int'l Ltd made an application under section 16 of the Town Planning Ordinance (Cap. 131) ("TPO") to the Town Planning Board ("TPB") for permission to develop a composite industrial/office building at the Lot. TPB rejected the application and informed Canaan Consultants Int'l Ltd of the same on 18 October 1991.

24. On 10 June 1992, a second TPO section 16 application was submitted to TPB via City Planning Consultants Ltd ("CPC") again for a composite industrial/office building at the Lot. TPB approved the application (subject to conditions) at a meeting on 24 July 1992 and informed CPC of their approval on 28 August 1992.

25. On 2 October 1992, Larry HC Tam & Associates Ltd ("LHCT") on behalf of the appellant [the taxpayer] applied to the District Lands Office/Kowloon East ("DLO/KE") for modification of lease conditions for the redevelopment of the Lot by constructing a composite industrial/office building.

26. On 9 October 1992, Ronald Lu & Partners (HK) Ltd (RLP) submitted to the appellant [the taxpayer] a fee proposal for its consultancy services in relation to the redevelopment of a composite industrial/office building at the Lot for its consideration and acceptance. RLP stated in its proposal that their estimated construction cost for the project was approximately HK$180 million on the assumption of an adoption of medium to high quality industrial/office standard. The appellant [the taxpayer] accepted the fee proposal and confirmed with RLP of the same on 2 November 1992.

27. On 23 February 1993, CPC made a third TPO section 16 application to TPB in respect of a revised design of the proposed composite industrial/office building at the Lot.

28. TPB approved the third TPO section 16 application (subject to conditions) on 16 April 1993 and informed CPC of the same on 7 May 1993.

29. On 31 July 1993 the Buildings Department ("BD") disapproved certain general building plans submitted by RLP for the proposed composite industrial/office building at the Lot. RLP re-submitted certain general building plans for approval on 23 August 1993. BD approved the re-submitted plans and informed RLP of the same on 22 September 1993.

30. On 2 February 1994, the District Lands Office/Kowloon East told LHCT that he was prepared to recommend to the Government that a modification of the lease be granted to allow an industrial/office development by way of Surrender and Regrant subject to, *inter alia*, the payment of land premium in the sum of HK$61,420,000.

31. On 25 February 1994, LHCT replied to DLO/KE that the basic terms, including payment of land premium in the sum of HK$61,420,000, as indicated on 2 February 1994 were acceptable to the appellant [the taxpayer].

32. On 31 March 1994, RLP wrote to the appellant [the taxpayer] confirming the appellant [the taxpayer]'s instructions to appoint CY Leung & Co for valuation of the proposed composite industrial/office building at the Lot.

33. On 21 April 1994, the Board of the appellant [the taxpayer] held a meeting to discuss a proposal from Cheung Kong regarding the redevelopment of the Lot. The minutes of that meeting recorded, *inter alia*, as follows :

"Re: 25 Chong Yip Street, Kwun Tong, Redevelopment plan

The Chairman reported that discussions had taken place with representatives of Cheung Kong (Holdings) Limited who had approached [the appellant] [the taxpayer] with a suggestion of a joint development of the Company's industrial premises at 25 Chong Yip Street, Kwun Tong. As the premises were acquired 24 years ago (since May 1969) and were in need of upgrading it was recommended that the duscussions [sic] with Cheung Kong proceed. Consideration would have to be given to the leasing of alternative premises for the Company's manufacturing operation during the period of development if

such were to proceed. The proposal from Cheung Kong (Holdings) Limited envisaged the sale to third parties of the newly developed industrial & office building as the manufacturing business of [the appellant] [the taxpayer] was seen to be a 'sunset industry' in Hong Kong and with more production being carried out in PRC, the redevelopment of the site and subsequent sale would be an appropriate method for [the appellant] [the taxpayer] to realise its long term asset. It was agreed that any joint development program would have to provide for the appellant [the taxpayer] to have an entitlement to take up sufficient space for its own manufacturing requirements in the future. It was decided that for internal purposes any such joint development should be carried out in an entity separate from [the appellant] [the taxpayer] and that consideration be given to a sale of the property to a wholly owned subsidiary which would subsequently enter into a development venture with Cheung Kong."

34. On 23 April 1994, CY Leung & Co produced a Valuation Report in respect of the Lot valuing it at HK$4l8,000,000 reflecting its development potential for redevelopment in accordance with a preliminary scheme provided to them, with the benefit of immediate vacant possession, but without taking into account any premium payable, and sent the same to RLP.

35. On 25 April 1994, the appellant [the taxpayer] and Cheung Kong held a meeting.

36. On 4 May 1994, Cheung Kong proposed to the appellant [the taxpayer] a joint venture arrangement for the redevelopment of the Lot.

37. On 30 July 1994, the appellant [the taxpayer], Great Poka (a subsidiary of Cheung Kong) and Cheung Kong entered into the Redevelopment Agreement whereby it was agreed, *inter alia*, that:

"[Great Poka] shall pay to [the appellant] [the taxpayer] as consideration for [the appellant] [the taxpayer] granting to [Great Poka] the right to redevelop the Lot in accordance with the terms of this [Agreement] an Initial Payment totalling HK$165,104,100 [as follows ...]"

38. On 6 August 1994, the appellant [the taxpayer] and the Government entered into the Agreement and Conditions of Exchange in respect of the Lot.

39. By an Assignment dated 14 November 1994, the appellant [the taxpayer] assigned the Lot to its wholly owned subsidiary Prodes Company Limited ("Prodes") at the consideration of HK$314,315,900.

40. On 24 November 1994, Prodes, Great Poka and Cheung Kong entered into the New Agreement (a draft copy of which was annexed to the Redevelopment Agreement).

41. On 9 December 1994, the representatives of the appellant [the taxpayer] and Great Poka jointly inspected the Lot and confirmed the delivery of vacant possession of the same to Great Poka. Manufacturing operations of the appellant [the taxpayer] at the Lot also ceased in December 1994.

42. On 6 August 1997, the appellant [the taxpayer] notified Great Poka that it would like to reserve Units 2-4 on the 6th Floor and the whole of 7th and 8th Floors for its own use; and it would like to name the new building "Perfekta Building".

43. On 3 November 1998, Great Poka asked Prodes whether it would exercise its option under clause 11.04 of the New Agreement.

44. On 12 November 1998, the appellant [the taxpayer] replied to Great Poka that its Board of Director had decided not to exercise the option to purchase any of the units in the new development.

45. On 4 December 1998, Cheung Kong informed Prodes that it planned to start the marketing work in respect of the new development on 6 December 1998 at an average price of HK$1,300 per sq ft.

46. On 10 February 1999:-

    (i) Prodes, Great Poka and Winrise Limited ("Winrise") (another subsidiary of Cheung Kong) entered into an Agreement for Sale and Purchase of the Lot whereby Prodes sold the Lot to Winrise at a consideration of HK$332,661,000.

(ii) Prodes, Great Poka and Winrise entered into an Agreement relating to the Manner of Payment of Purchase Price whereby it was agreed that of the purchase price of HK$332,661,000:-

(a) HK$315,210,899.27 would be paid to Great Poka (as it was entitled under clause 12.03 of the New Agreement to reimbursement out of the sale proceeds for, *inter alia*, the land premium paid and construction costs incurred);

(b) HK$17,450,100.73 would be paid into the Stakeholders' Accounts and treated as the Sale Proceeds (as defined in the New Agreement).

(iii) Kanabell Corporation (the sole beneficial owner of Prodes at the time) sold Prodes to Unicenter Limited (another subsidiary of Cheung Kong) at a consideration of HK$10.

47. On 11 February 1999, the Board of the appellant [the taxpayer] ratified and approved, *inter alia*, an Assignment between the appellant [the taxpayer] and Prodes whereby:-

(i) Prodes assigned its rights, interests, benefits and entitlements under the New Agreement to the appellant [the taxpayer]; and

(ii) the appellant [the taxpayer] released and discharged Prodes from all its debts and liabilities and obligations owing to the appellant [the taxpayer] and all actions, proceedings, claims, demands, costs and expenses relating thereto and in respect thereof.

48. On 8 August 2007, the appellant [the taxpayer] received HK$386,223.21 (50% of the balance in the Stakeholders' Accounts).'

III. Decision of the Board

3.1 The Chairman of the Board (Mr Kenneth Kwok SC) who gave the minority decision, dismissed the taxpayer's appeal. He held the initial payment was chargeable to profits tax because there was a change of intention to trade :

> '123. Having considered all the circumstances urged on us, I find and hold that:
>
> (l) There was a change of intention from capital holding of the [old] Lot and the [old] building thereon to trading/business.
>
> (2) Consequent upon such change of intention:
>
> (a) the [old] Lot and the [old] building thereon ceased to be the appellant [the taxpayer]'s capital assets; and
>
> (b) the [old] Lot and the [old] building thereon became the appellant [the taxpayer]'s trading stock;
>
> (3) The change of intention took place on 30 July 1994 when the appellant [the taxpayer] entered into the Redevelopment Agreement.
>
> 124. The first ground of appeal fails.'

3.2 He further held that the initial payment was not a capital receipt in that *McClure v. Petre* [1988] 1 WLR 1386 which was cited by the taxpayer in support of its argument on capital receipt is distinguishable since it was based on a different charging provision. He further refused the taxpayer's application to amend its grounds of appeal in order to challenge the calculation of the trading profit.

3.3 The majority of the Board (Mr Nelson Miu and Mr Mark Sutherland) was of the view that, while there was a change of intention of the taxpayer on 30 July 1994, it was not for the purpose of trade :

> '168. The change of intention that took place on 30 July 1994 was therefore not simply that the appellant [the taxpayer] would thereupon embark on an adventure in the nature of trade. The intention of the appellant [the taxpayer] was to dispose of its capital asset, 'take home' part of its value (about 40%) in the form of cash (by way of Initial Payment), while reinvesting the balance (approximately 60%) in a joint venture with Cheung Kong with a view to earn more profit. The evidence of Mr. Yeung Senior should be understood in this context.'

3.4 Mr Miu did not regard the initial payment as a trading receipt but he considered *McClure* to be distinguishable. Mr Sutherland relied on *McClure* and held

that the initial payment was a capital asset. The majority, however, agreed with Mr Kwok that the amendment should not be allowed.

IV. Decision of Chung J

1) The seven questions

4.1 Both the Commissioner and taxpayer appealed. The Board submitted the following seven questions to Chung J for determination. The first three questions were submitted by the Commissioner while the fourth to seventh questions were submitted by the taxpayer.

Question 1) Whether there is any evidence or any sufficient evidence on which the Board can find, or draw inference as to, the following :

(1) 'Where a joint venture agreement provides for profit to be shared equally, the assumption must be that the perceived value of the parties' contributions should/would also be equal';

(2) 'What the appellant [the taxpayer] has done here was to sell the Property for HK$418 million';

(3) 'The change of intention that took place on 30 July 1994 was ... not simply that the appellant [the taxpayer] would thereupon embark on an adventure in the nature of trade. The intention of the appellant [the taxpayer] was to dispose of its capital asset, 'take home' part of its value (about 40%) in the form of cash (by way of Initial Payment), while reinvesting the balance (approximately 60%) in a joint venture with Cheung Kong with a view to earn more profit.' [This is described by Chung J as the reinvestment finding.]

Question 2) Whether, bearing in mind that the onus of proof was on the taxpayer and subject to obtaining and reviewing the transcripts of the hearing before the Board, the majority of the Board misdirected itself and/or erred in law in relying on the matters as found under question 1(1), (2) and/or (3) in circumstances where :

(1) the Taxpayer did not conduct the appeal, whether before or at the hearing before the Board, by alleging and proving those matters; and/or

(2) the Commissioner of Inland Revenue was not alerted to the possibility of a finding of any of those matters, whether before or at the hearing before the Board, and given the opportunity to address the Board on the same.

Question 3) Whether on the true construction of the *Inland Revenue Ordinance* (Cap. 112) and having regard to all the facts as found by the Board, in particular the finding that there was a change of intention :

(1) the majority of the Board was correct in law in holding that the initial payment constituted profits arising from the sale of a capital asset and capital receipt not chargeable to tax;

(2) the true and only reasonable conclusion is that as stated by the minority of the Board in paragraph 139 of the decision.

Question 4) *Whether* :

(1) on the facts found by the Board, the Board (at paragraph 168 of the decision) erred in law in concluding that there was a change of intention on the part of the appellant [the taxpayer] ; and

(2) there is any evidence in support of such finding;

having regard to, *inter alia*, the Board's findings that :

(i) the joint venture was to be carried out by a subsidiary company, Newco (Prodes) (paragraph 166 of the Decision);

(ii) the intention of the appellant [the taxpayer] was that the adventure in the nature of trade should be carried on by Prodes (paragraph 167 of the Decision); and

(iii) the Redevelopment Agreement contained provisions for the appellant [the taxpayer] to

step in and take up responsibilities which were to be assumed by its subsidiary (Prodes) (paragraph 167 of the Decision), but only if the subsidiary failed to enter into the new agreement.

Question 5) Whether the Board erred in law (at paragraph 168 of the Decision) by taking into account the activities and intention of the appellant [the taxpayer]'s subsidiary (Prodes) in ascertaining the intention of the appellant [the taxpayer];

Question 6) Whether the Board erred in law (at paragraph 173 of the Decision) in holding that the sale of the right to redevelop land was not a realisation of part of the capital value of the Lot, such that the initial payment constituted a capital receipt;

Question 7) Whether the Board erred in law in refusing to allow the appellant [the taxpayer]'s application to add a new ground of appeal, having regard to the fact that :

(1) the appellant [the taxpayer] had already contended in the Third and Fourth Grounds of Appeal (as set out in paragraphs 15 and 20 to 21 of the letter dated 16 June 2011 from Pang & Associates to the Board) that the amount of chargeable profits is nil as the appellant [the taxpayer] did not make any profits;

(2) the appellant [the taxpayer] had submitted to the Board that the new ground of appeal was raised out of an abundance of caution to amplify the aforementioned point; and

(3) even if there had been a change of intention, the appellant [the taxpayer] did not make any profits in 1994, taking into account the disposal of the Lot as trading stock to Prodes.

2) Chung J's decision

4.2 Chung J summarised the questions from the Commissioner and the taxpayer as follows :

> '4. Different questions of law, respectively submitted by the parties, have been posed by the Board in the case stated. In gist, those submitted by the Commissioner are:
>
> (a) was there sufficient evidence for the Board's conclusions reached in para 154, 166 and 168, Board's decision (set out in more details in para 20 below);
>
> (b) bearing in mind the burden of proof rested with the taxpayer, did the Board err to reach the conclusions mentioned in sub-para (a) above, when they have not been so put forth by the taxpayer, and were unknown to the Commissioner beforehand;
>
> (c) on the true construction of Cap 112, and the Board's finding that there was a change of intention on the taxpayer's part, did the Board err to hold the initial payment (defined in para 12 below) was not chargeable to profits tax (rather than as that found by the Board's minority).
>
> 5. The questions submitted by the taxpayer are (in summary):
>
> (1) did the Board err to find that there has been a change of intention on the taxpayer's part (and whether there was evidence in support thereof), especially when the transaction was to be implemented by one of the taxpayer's subsidiary companies;
>
> (2) did the Board err to take into account the said subsidiary company's activities and intention when ascertaining the taxpayer's intention;
>
> (3) did the Board err in its conclusion at para 173, the Oct 2015 decision;
>
> (4) did the Board err to refuse the taxpayer's application to add an additional ground of appeal.'

4.3 Based on the questions as framed by Chung J, the following is a summary of what he was required to address and his answers to the questions. Although the term 'the Board' is used both in the questions and in the answers, I think it is more precise at this stage to identify specifically whether it was a majority or minority decision. But as pointed out in paragraph 6.23 of this judgment, the affirmation by Chung J of the minority view on change of intention does not, in the context of this case, mean the minority decision has any less force than a decision of the Board.

1) Was there sufficient evidence for the Board (the majority) to come to the reinvestment finding?

Answer : There was insufficient evidence for the majority to make its reinvestment finding.

2) Did the Board (the majority) err on the reinvestment finding when the matter was not put forward by the taxpayer?

Answer : The majority erred.

3) Did the Board (the majority) err in finding the initial payment was not chargeable to profits tax?

Answer : The majority erred.

4) Did the Board (the minority) err in finding there was a change of intention to trade?

Answer : The minority did not err.

5) Did the Board (the minority) err to take into account Prodes' activities and intention when ascertaining the taxpayer's intention?

Answer : The minority did not err.

6) Did the Board (the majority) err in holding the initial payment was a capital receipt?

Answer : The majority did not err.

7) Did the Board (unanimous) err to refuse the taxpayer's application to add an additional ground of appeal?

Answer : The Board did not err.

4.4 Question 6 above is based on Question 7 as framed by the taxpayer and Question (3) as framed by Chung J in paragraph 5 of his judgment. Both questions referred to paragraph 173 of the decision of the Board. Paragraph 173 is the view of Mr Miu of the majority on the *McClure* capital receipt argument. Although Chung J held the majority did not err, my view is that he had made a typographical error and he actually intended to say the majority had erred and the minority did not err on this issue. This can be demonstrated by paragraph 61 of his judgment when he said :

> '61. An issue has also been raised as to whether the disposal of the right of redevelopment is a disposal of a capital nature (para 173, the Oct 2015 decision (para 5(3) above)). The taxpayer contends it is, relying on *McClure v Petre* [1988] 1 WLR 1386. It contends that a redevelopment right represents a "once-and-for-all realization of the capital value of the part of the asset". I agree with the Commissioner that the minority has given the correct reason for distinguishing the *McClure* decision: it dealt with a different tax charging provision (s 67(1), Income and Corporation Taxes Act 1970, as opposed to s 14, Cap 112) (para 132-139, the Oct 2015 decision).' (emphasis added)

V. The ambit of the present appeal

5.1 The taxpayer did not appeal against Chung J's decision that the majority erred in the manner submitted by the Commissioner under questions 1 to 3. In other words the taxpayer did not defend the reinvestment finding. The three grounds of appeal relied upon by the taxpayer are derived from questions 4 to 7.

5.2 The three grounds are as follows :

1) Chung J was wrong in holding that the minority did not err in finding that the taxpayer changed its intention to trade in respect of the Lot where

   (1) there is no evidence to support such a finding; and

   (2) the taxpayer all along intended to use and did use its subsidiary, Prodes, to carry out the joint venture with Cheung Kong to redevelop the Lot.

2) Chung J was wrong in holding (in agreement with the minority) that the alleged disposal by the taxpayer of its 'right of development' was not a disposal of a capital nature (in which case the initial payment would not be subject to profits tax).

3) Chung J was wrong in affirming the unanimous decision of the Board not to exercise its discretion to permit the taxpayer to pursue a new ground of appeal thereby upholding the decision to charge tax on the entirety of the initial payment.

VI. First ground of appeal

1) Change of intention

6.1 As explained by Fok PJ of the Court of Final Appeal in *Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue* (2016) 19 HKCFAR at 54, profits tax is chargeable only on profits arising in or derived from the carrying on by a taxpayer of 'a trade, profession or business' in Hong Kong and profits arising from the sale of capital assets are excluded from such charge: section 14(1) of *Inland Revenue Ordinance* ('*IRO*') (Cap. 112) (paragraph 43). It follows from this statutory charging provision that a landowner may sell his land at an enhanced price above his acquisition cost but not be subject to tax on the profits thereby generated unless in doing so he is embarking on a trade or business of selling land. The material issue of fact to be decided is whether the taxpayers were carrying on a trade or business when they made the profits sought to be taxed, or whether those profits arose from the sale of a capital asset (paragraph 44). The question of whether an activity amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the relevant fact-finding body on a consideration of all the circumstances (paragraph 45). An intention to trade is essential (paragraph 46).

6.2 Tang PJ held :

> '18. Since it was common ground that the Old Lots were acquired and held by HKSKH not for the purpose of trading but as it were as an investment or a capital asset, they would remain "an investment unless the owner changes his intention to that of trading. If findings of this kind are to be made, precision is required. There must be evidence which establishes that change of intention. An investment does not turn into trading stock because it is sold." '

2) <u>The Chairman's reasons on change of intention</u>

6.3 Mr Kwok came to the view that the intention of the taxpayer which was originally holding the Lot as capital changed when it entered into the Redevelopment Agreement with Cheung Kong for the following reasons :

1) [Paragraph 108] The steps taken by the taxpayer from 1991 to 1994 in retaining professional advisers and experts to seek and obtain the Town Planning Board's permission to develop an industrial/office building at the Lot; the District Lands Office/Kowloon East's agreement for modification of the leasehold conditions; the Buildings Department's approval of building plans regarding the proposed industrial/office building at the Lot and valuation of the proposed composite industrial/office building at the Lot.

2) [Paragraph 109] The taxpayer incurred fees, costs and expenses.

3) [Paragraph 110] The minutes of the taxpayer dated 21 April 1994 recorded the decision 'for internal purposes' to carry out 'in an entity separate from [the taxpayer]' any such development and that 'consideration be given to a sale of the property to a wholly owned subsidiary which would subsequently enter into a development venture with Cheung Kong'.

4) [Paragraph 111] Cheung Kong held a meeting with the taxpayer on 25 April 1994 and proposed to the taxpayer on 4 May 1994 a joint venture arrangement for the redevelopment of the Lot.

5) [Paragraph 112] The Redevelopment Agreement dated 30 July 1994 entered into by the taxpayer, Great Poka and Cheung Kong contained, *inter alia*, the following terms :

Recital (3) : [The taxpayer] has resolved to grant permission to the [Great Poka] to redevelop the Lot by constructing thereon the development (as hereinafter defined) in accordance with the conditions (as hereinafter defined), and to sell and assign undivided shares of and in the Lot and the development to purchasers of the units (as hereinafter defined) upon completion of the development.

Recital (6) : Subsequent to the surrender and regrant of the Lot but prior to redevelopment, [the taxpayer] intends to transfer the registered and beneficial ownership of the Lot to its wholly owned subsidiary ('Newco').

Clause 3.02 : [Great Poka] shall pay to [the taxpayer] as consideration for [the taxpayer] granting to [Great Poka] the right to redevelop the Lot in accordance with the terms of this [agreement] an initial payment totalling HK$165,104,100 as follows :

(1) the sum of HK$30,000,000 forthwith upon the signing of this agreement;

(2) a further sum of HK$70,000,000 within seven (7) business days after written confirmation from Government being received by [Great Poka] that the

conditions have been duly executed by all parties;

(3) a further sum of HK$65,104,100 upon vacant possession of the Lot together with any buildings thereupon being delivered to [Great Poka] free from encumbrances or rights which are capable of preventing the development. Vacant possession shall mean the handing over of the Lot to [Great Poka] free from any occupant(s) as ascertained by joint inspection of Newco and [Great Poka]. Newco shall give to [Great Poka] seven (7) business days prior notice of the date vacant possession will be given to [Great Poka].

Clause 5.01 : Within four (4) months after the date of issue of the conditions [the taxpayer] shall at its sole cost and expense transfer the registered and beneficial ownership of the Lot to Newco subject to Newco executing the new agreement referred to in Clause 5.02 below.

Clause 5.02 : [The taxpayer] hereby agrees and undertakes with [Great Poka] to procure that Newco shall simultaneous with but immediately after the execution of an assignment of the Lot in its favour enter into a new agreement ('the New Agreement') with [Great Poka] and [Cheung Kong] in the form as set out in Appendix II. [Great Poka] and [Cheung Kong] agree and undertake with [the taxpayer] that they shall enter into the New Agreement with Newco. Should Newco fail to execute as contemplated in this clause, the assignment of the Lot to it shall not take effect and shall become null and void and [the taxpayer] shall be deemed to have replaced Newco in its position and continue as the registered and beneficial owner of the Lot under the New Agreement.

Clause 8 : 8. *JOINT VENTURE*

8.01 This agreement is in the nature of a joint venture and sale and purchase of interest in property.

6) (1) [Paragraphs 113-117] The consideration stated in the assignment of the Lot dated 14 November 1994 by the taxpayer to its wholly owned subsidiary, Prodes, was $314,315,900. As a matter of arithmetic, $314,315,900 + $165,104,100 − $61,420,000 = $418,000,000.

(2) This gives the impression that the disposal of the Lot by the taxpayer to its subsidiary, Prodes, was at CY Leung & Co's valuation.

(3) However, the amount which the taxpayer and its subsidiary, Prodes, put as the sale and purchase price was of no concern to (i) Great Poka and Cheung Kong; and (ii) the taxpayer and its subsidiary, Prodes. As Lord Hoffmann NPJ said in paragraph 26 in *Tai Hing Cotton Mill Ltd v CIR* :

'But these parties were plainly not dealing at arms' length. They were parent and subsidiary; in economic terms the same enterprise under the same direction. The notion that each was trying to get the best deal it could is quite unreal. The land was simply being passed from one pocket to the other. It did not matter to the parties what the terms of sale were. In economic terms, the result would have been exactly the same whatever the taxpayer agreed to pay.'

(4) It did not matter to the taxpayer and Prodes what the consideration of the sale of the Lot by the taxpayer to Prodes was. In economic terms, the result would have been exactly the same whatever the consideration was. There was no real purpose of seeking or obtaining CY Leung & Co's valuation.

7) [Paragraphs 116-122] The taxpayer's ownership of the Lot comprised ownership of the land and ownership of the old building thereon. However the old lot was to be surrendered, the proposed re-grant may be *in situ*, but it is nevertheless a new grant. The old building was to be demolished. The proposed joint development was a substitution, not an enhancement, of the old lot and the old

building as explained in *Crawford Realty Ltd*. The signposts pointed not to mere realisation but rather a profit making scheme amounting to an adventure in the nature of trade.

8) When Mr Yeung Senior of the taxpayer was cross-examined on why the transaction did not go the route of an outright sale instead of a joint development, he gave what Mr Shieh described as a forthright answer - Mr Yeung Senior wanted to make more money as the price might go up after redevelopment.

9) The nature of a joint venture involves a commercial, business or trade purpose. Cheung Kong, Great Poka and the taxpayer entered into the Redevelopment Agreement to engage in trade with a view to making a profit. Mr Kwok did not accept that Cheung Kong and Great Poka joined hands with the taxpayer to merely enhance the old property for the benefit of the taxpayer.

10) By the time the taxpayer had entered into the Redevelopment Agreement, the activities had gone beyond mere enhancement for the purpose of realising the old property for its maximum profit. The Redevelopment Agreement was in express terms binding on the taxpayer. The taxpayer was then engaged in trade.

3) <u>Burden of proof</u>

6.4 The first ground of appeal advanced by Mr Smith SC (together with Mr Justin Lam) for the taxpayer has two parts. First, it is not disputed that the Lot was acquired as capital and that there had to be a change of intention before profits tax implications can arise. Thus the starting point is that no profits tax is chargeable and the burden rests on the Commissioner to demonstrate a change of intention to trade.

6.5 This point on burden of proof can be dealt with shortly. The Commissioner, of course, had to show that the initial payment was subject to profits tax in that there was a trading activity which occurred when the taxpayer entered into the joint venture agreement and the Redevelopment Agreement. But the Commissioner having assessed the profits tax on that basis, the burden is on the taxpayer to show that the assessment is incorrect. Section 68(4) of the *IRO* expressly provides that :

'(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

6.6 As Bokhary and Chan PJJ observed in *Real Estate Investments (NT) Limited v Commissioner of Inland Revenue* (2008) 11 HKCFAR 433 :

> 'It is natural and appropriate to strive to decide on something more satisfying than the onus of proof. And it should generally be possible to do so. But tax appeals do begin on the basis that, as s. 68(4) of the Inland Revenue Ordinance provides, "[t]he onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant". And it is possible although rare for such an appeal to end – and be disposed of – on that basis, at paragraph 32.
>
> As for the notion of a shifting onus, such a notion is seldom if ever helpful. Certainly it cannot shift the onus of proof from where s. 68(4) of the Inland Revenue Ordinance places it, namely on a taxpayer who appeals against an assessment to show that it is excessive or incorrect, at paragraph 35.' (emphasis added)

4) Separate legal entity

6.7 Second, on the merits of the finding of change of intention, Mr Smith relied on the separate legal entity point. He argued that there was no change of intention to trade on the part of the taxpayer because all along, its intention was for an entity separate from itself, i.e. Prodes, its subsidiary, to undertake the joint venture with Cheung Kong. Any trade was intended to be undertaken by Prodes and not the taxpayer. This is embodied in the Board Minutes, the Redevelopment Agreement and the New Agreement.

6.8 He argued that the principle of separate legal personality must be observed to distinguish between the taxpayer and Prodes as two separate legal entities. Reliance is made to the well-established cases such as *Adams v Cape Industries plc* [1990] Ch 433 at 536 and *Prest v Petrodel Resources Ltd* [2013] 2 AC 415 at 489. Specifically in the taxation context, he relied on what Lord Millett NPJ explained in *ING Baring Securities (Hong Kong) Ltd v Commissioner of Inland Revenue* (2007) 10 HKCFAR 417 at paragraph 134 :

> '…But for tax purposes in this jurisdiction a business which is carried on in Hong Kong is the business of the company which carries it on and not of the group of which it is a member; the profits which are potentially chargeable to tax are the profits of the business of the company which carries it on; and the source of those profits must be attributed to the operations of the company which produced them and not to the operations of other members of the group.'

6.9 He submitted that the only exception is where the Commissioner relies upon (which he has not done in the present case) Section 60 and/or 61A of the *IRO* to demonstrate that the transactions are artificial, fictitious or designed to avoid liability for tax. In the context of those provisions, it might have been open to the Commissioner to argue that the interposition of a subsidiary to carry out the joint venture was fact designed to avoid tax liability by the taxpayer.

6.10 He further referred to Lord Hoffmann NPJ's judgment in *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd* (2007) 10 HKCFAR 704 :

> '6. ..... For the purpose of carrying the agreement into effect, both Tai Hing and Hang Lung used special purpose subsidiaries. This is a perfectly normal procedure. It has the advantage of isolating the assets and liabilities of a particular venture from the rest of the parent company's business. ......'

5) <u>Challenge on findings of fact : the proper approach</u>

6.11 In deciding whether the taxpayer had been engaged in trade, it is important to bear in mind that, first, it is the Board which has been given the task to make findings of fact based on all the facts and circumstances of the case. As Fok PJ in *Church Body of Hong Kong Sheng Kung Hui* held :

> '50. As indicated above, in determining whether an activity amounts to trading, the fact-finding tribunal must consider all the circumstances involved in the activity. It will then have to make a "value judgment" as to whether this constitutes trading and whether the requisite intention to trade can be inferred. Regardless of what is claimed to be the intention subjectively, the question falls to be determined objectively having regard to all the surrounding circumstances.
>
> .....
>
> 61. It was not in dispute that the taxpayers acquired the land as a long term capital asset. It was the Commissioner's contention that the taxpayers had changed their intention in relation to the land so that, in disposing of it, they were carrying on a trade. This involved the proposition that, as a matter of fact, there was a change of intention on the part of the taxpayers. The question is whether this change of intention could properly be inferred from the primary facts found by the Board of Review. In this respect, it must be borne in mind that it is a requirement of drawing an inference that: (1) the inference must be grounded on clear findings of primary fact; and (2) the inference must be a logical consequence of those facts.'

6.12 Second, it is important to bear in mind the restraint imposed on the appellate Court from such appeals. As Bokhary PJ held in *Kwong Mile Services Ltd v Commissioner of Inland Revenue* (2004) 7 HKCFAR 275 that :

> '37. In an appeal on law only the appellate court must bear in mind what scope the circumstances provide for reasonable minds to differ as to the conclusion to be drawn from the primary facts found. If the fact-finding tribunal's conclusion is a reasonable one, the appellate court cannot disturb that conclusion even if its own preference is for a contrary conclusion. But if the appellate court regards the contrary conclusion as the true and only reasonable one, the appellate court is duty-bound to substitute the contrary conclusion for the one reached by the fact-finding tribunal. The correct approach for the appellate court is composed essentially of the foregoing three propositions. These propositions complement each other, although the understandable tendency is for those attacking the fact-finding tribunal's conclusion to stress the third one while those defending that conclusion stress the first two.'

6.13 The complaint by the taxpayer that the Board and Chung J had ignored the separate legal entities, in fact, had been raised below. Mr Kwok dealt with this argument as follows :

> '126. I have decided … that the change of intention took place on 30 July 1994 when the [taxpayer] entered into the Redevelopment Agreement. The change took place before Prodes came into existence or the picture. Hence the reference to 'Newco'. Chargeability arose before Prodes came into existence or the picture.
>
> 127. In any event, the facts, including:
>
> - the fact that the Redevelopment Agreement purported to bind 'Newco' before it came into existence or the picture; and
>
> - the facts stated in paragraphs 47 and 48 above [namely,
>
> > 47. On 11 February 1999, the Board of the [taxpayer] ratified and approved, *inter alia*, an assignment between the [taxpayer] and Prodes whereby:-

(i) Prodes assigned its rights, interests, benefits and entitlements under the New Agreement to the [taxpayer]; and

(ii) the [taxpayer] released and discharged Prodes from all its debts and liabilities and obligations owing to the [taxpayer] and all actions, proceedings, claims, demands, costs and expenses relating thereto and in respect thereof.

48. On 8 August 2007, the [taxpayer] received HK$386,223.21 (50% of the balance in the Stakeholders' Accounts).]

showed that Prodes was the [taxpayer's] alter ego.'

6.14 Chung J's view on separate legal identity is as follows :

'46. Secondly, the use of another legal entity to carry out the redevelopment was meant to be an 'internal' arrangement (hence the phrase 'for internal purposes').

...

52. As regards the taxpayer's argument that the redevelopment was carried out by a subsidiary (Prodes), para 46 above is repeated. In this connection, it should be noted the taxpayer's obligations under the subject agreement did not necessarily end with the transfer of the subject land to Prodes. In the event Prodes should fail to enter into a "new agreement" with the developer (and Great Poka), clause 5.02 stipulated:

> '… the assignment of the [subject land] to [Prodes] shall not take effect and shall become null and void and [the taxpayer] shall be deemed to have replaced [Prodes] in its position and continue as the registered and beneficial owner of the [subject land] under the New Agreement … At the request of the Developer, [the taxpayer] shall execute the New Agreement …'.

Further, clause 8.01 made clear that the joint venture mentioned therein was between the taxpayer on the one part and the developer and Great Poka on the other.'

6.15 In my view, Mr Kwok had certainly taken into consideration all the relevant factors which I had summarised on the finding of change of intention. I really cannot see how the conclusion he reached from the primary facts can be regarded in any sense as being unreasonable, illogical or plainly wrong which allows this Court to intervene. The same applies to the conclusion reached by Chung J.

6.16 In my view the taxpayer has completely missed the point on its separate legal entity challenge. Mr Kwok's finding is that by July 1994 the taxpayer was engaged in trade by reason of the change of intention from holding the Lot as a capital asset to that of a trading stock. The use of Prodes is only relevant to the method of carrying out the trade, namely the taxpayer assigning the Lot to Prodes to carry out the joint venture. By confusing these two distinct features, the taxpayer had proceeded with its arguments on a false premise. Once this distinction is recognised, the argument that the Board and Chung J had erred on the separate legal entity point falls apart because the intention to trade is that of the taxpayer and nobody else. Prodes was not even a party to the Redevelopment Agreement. It was the taxpayer who received the initial payment and not Prodes. As Mr Shieh SC (together with Mr Mike Lui) for the Commissioner pointed out Prodes might have also engaged in trading activities but it does not mean that the taxpayer had not engaged in trade when it changed its intention from holding the Lot as capital to that of trade. In the context of this type of case, it is the change of intention of the taxpayer that is crucial. By the terms of the Redevelopment Agreement together with the receipt of the initial payment, the Board cannot be faulted from forming the view that the only true and reasonable inference is that taxpayer had engaged in trade.

6.17 Mr Smith criticised Chung J's brief reasoning in holding that there was a change of intention in that he erred in construing clause 5.02 and clause 8.01 of the Redevelopment Agreement. It also criticised Chung J's description that the use of another legal entity to carry out the redevelopment was meant to be an 'internal arrangement' and he was wrong to rely on Mr Yeung's evidence to support a change of intention by the taxpayer.

6.18 It has to be pointed out that the focus of Chung J's judgment was on the reinvestment finding by the majority. I do not consider Chung J had misconstrued the terms of the Redevelopment Agreement.

6.19 Mr Smith submitted that Clause 5.02 is inconsistent with the finding that it changed its intention at the time of entering into the Redevelopment Agreement, because 'no relevant change of intention would or could occur unless and until' it decided to substitute itself for Prodes as a party to the New Agreement. I disagree. As Mr Shieh rightly pointed out clause 5.02 must be relevant to the issue of change of intention on the part of the taxpayer. Under that clause, if it did not procure Prodes to sign the New Agreement, it would be deemed to replace Prodes's position in the New Agreement and itself come under an obligation to sign it. By this clause, it even gave advanced authorisation to Cheung Kong to execute the New Agreement as its attorney. While no doubt the latter is intended to confer a guarantee on Cheung Kong that the Redevelopment Agreement will be carried through, the overall structure of the Redevelopment Agreement points towards the clear view that the taxpayer was the party

who had decided to carry out the trading activity as a property developer with Cheung Kong and upon which an inference was drawn of a change of intention on the part of the taxpayer.

6.20 Mr Smith further referred to the provision in clause 6.02 relating to the refund of the initial payment by the taxpayer. The refund will operate in the event, amongst other things, Cheung Kong decided to terminate the agreement when 'Newco refuses or fails for whatever reason to execute the New Agreement'. This refund provision does not detract from the finding on the taxpayer's change of intention.

6.21 As to the purpose of clause 8.01, it was to pre-empt any suggestion that the joint venture between these parties was in the nature of a partnership. It does not advance the taxpayer's case on change of intention.

6.22 The description by Chung J that it was an internal arrangement was neither here nor there. The use of 'internal arrangement' does not have a 'sinister' connotation. It is consistent with *Tai Hing Cotton Mill* and certainly not contrary to the views expressed in *ING Baring Securities (Hong Kong) Ltd*. Indeed Dr Lu of the taxpayer frankly admitted in cross-examination that it was simply the usual practice and normal in a property development transaction such as that between the taxpayer and Cheung Kong to use subsidiaries because it would look 'more independent' and the liabilities would also be limited to the subsidiaries alone. Again it has to be emphasised that the use of Prodes was only a method or mechanics of implementing the taxpayer's intention to trade. Chung J did not uphold the change of intention solely by reference to Mr Yeung's evidence.

6) A minority decision or the Board's decision?

6.23 A point was raised at the hearing on the legal effect of the Board's decision after the majority's view on change of intention was rejected and when Mr Kwok's view which was being upheld was only a minority view. Mr Smith had certainly not asked either before Chung J or before us for the case to be remitted to the Board to determine afresh the issue of change of intention merely because the decision that was upheld was a minority decision. In fact this is clearly not permissible because of the wording of Question 3 of the Case Stated. What Chung J was asked by this question was to decide whether the majority's view or the minority's view on change of intention was the correct view. He decided in favour of the minority's view. That was the scope of the appeal before Chung J and this Court. There is no room for argument that a minority decision in such circumstances is not sufficient to be regarded as a decision of the Board.

VII. Second ground of appeal

1) Capital receipt

7.1 As to the second ground, Mr Smith argued that under section 14(1) of the *IRO*, profits arising from the sale of capital assets are not subject to

profits tax. Properly analysed, the taxpayer sold off the right to redevelop the Lot to Great Poka, separately from the Lot itself. Mr Smith conceded that if he failed in his argument on change of intention then this argument on capital receipt will not assist the taxpayer. As such it is strictly not necessary to address this point, but, nonetheless, I would deal with it because I do not regard this argument to be a matter of substance.

7.2 The taxpayer relied on *Commissioner of Inland Revenue v Far East Exchange Ltd* [1979] HKLR 76 to illustrate the distinction between capital receipt and receipt of income. I think a more useful exposition can be found again in the *Church Body of Hong Kong Sheng Kung Hui* where Fok PJ held :

> '48. It is well settled that an owner of land may dispose of his land at a higher price than that for which he acquired it and not be liable for profits tax on the gain, since his gain is "a mere enhancement of value" which may simply be the result of market forces. Moreover, he may expend money improving the property in advance of such disposal without being held to have embarked on an adventure in the nature of trade.'

7.3 The taxpayer relied on the judgment of Sir Nicolas Browne-Wilkinson VC in *McClure* at 1393 :

> '... where the value of an asset is attributable to a number of different characteristics, the consideration received for a transaction which realises once and for all the capital value of one of those characteristics (thereby diminishing the remaining value of the whole asset) is capable of constituting capital, not income, and that is so notwithstanding that the asset itself and all the rights in it remain throughout the property of the taxpayer. In my judgment, therefore, there is no such absolute distinction as Mr. Moses contended for between receipts for the disposal of the asset and receipts for the use of the asset. If the receipt represents the once-and-for-all realisation of the capital value of part of the asset - in this case land it can be, and indeed normally will be, itself a capital receipt. The mere fact that the taxpayer remains the unfettered owner of the same area of land, with the same interest, does not preclude a finding that the receipt is a capital receipt. It seems to me to be established that the receipt of money representing consideration for the once-and-for-all disposal of a right or valuable advantage which is incapable of again being realised is capable of constituting a capital receipt.' (emphasis added)

7.4 *McClure* was concerned with a Schedule A charge under section 67(1)(c) of the *United Kingdom Income and Corporation Taxes Act* 1970:

> 'Tax under this Schedule shall be charged on the annual profits or gains arising in respect of any such rents or receipts as follow, that is

> to say - (a) —, (b) —, and (c) other receipts arising to a person from, or by virtue of, his ownership of an estate or interest in or right over such land or any incorporeal hereditament or incorporeal heritable subject in the United Kingdom.' (emphasis added)

7.5 In *Inland Revenue Commissioner* v. *John Lewis Properties Plc* [2003] Ch. 513, Arden LJ grouped the *McClure* line of cases as cases illustrating the realisation principle. Although she said that 'Sterilisation' might have been a better word (paragraph 16(1)).

7.6 Dyson LJ, however, stated that :

> '84 The fact that the diminution is not permanent is not fatal to the classification of the payment as capital. Clearly, if the diminution is permanent, that will suggest strongly that the payment is capital. But the converse is not true.'

7.7 In *Able (UK) Ltd v Revenue and Customs Commissioners* [2008] STC 136, Moses LJ attempted to summarise the principle as follows :

> '[10] The principle to be derived from such cases as *Glenboig* and *Earl Haig's Trustees* is that consideration received for the once and for all realisation of the capital value of an asset is capable of being a capital receipt, notwithstanding that the asset remains in existence and is the property of the recipient (see the proposition enunciated by Sir Nicolas Browne-Wilkinson V-C in *McClure (Inspector of Taxes) v Petre* [1988] STC 749 at 754, [1988] 1 WLR 1386 at 1393). That principle may be applied to cases where an asset has the capacity to provide a number of distinct sources of income and the capital value of the asset reflects each of those sources. If one particular source is exhausted or realised, then consideration or compensation paid therefor may constitute a capital receipt if the value of the asset, which had hitherto reflected all those sources of profit to be derived from that asset, is diminished.' (emphasis added)

7.8 Mr Smith argued that by selling the right to redevelop the Lot to Cheung Kong, the taxpayer has lost such right and can no longer grant such right to another developer or party. It is bound by contract to permit Cheung Kong, and no one else, to redevelop the Lot. This is a valuable right concerning the Lot which was given up in consideration of the initial payment. On these principles, it follows that the initial payment should be characterised as a capital receipt or profit arising from the sale of a capital asset, which would not be subject to profits tax.

7.9 Mr Kwok had observed that *McClure* was concerned with a different charge than our section 14. His reasoning that there was not a sale of capital assets are as follows :

> '139. Under our section 14, only "profits arising from the sale of capital assets" are excluded. I have already concluded in paragraph 123 above that there was a change of intention from capital holding of the [old] Lot and the [old] building thereon to trading/business and that consequent upon such change of intention, the [old] Lot and the [old] building thereon ceased to be the appellant [the taxpayer]'s capital assets and became the appellant [the taxpayer]'s trading stock.' (emphasis added)

7.10 Chung J agreed with this view.

2) My view

7.11 First of all, I agree with Mr Kwok's approach. Further, the question whether the payment was a capital receipt requires the Court to take an approach which is of practical and business reality. As the Privy Council held in *Comr of Inland Revenue v Wattie* [1999] 1 WLR 873, 880, the answer to the question whether the item in issue (in that case expenditure) is of a capital or revenue nature 'depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process'.

7.12 The distinct facts of *McClure* as identified in the headnote of the reported judgment must be recognised :

> 'The taxpayer owned freehold land adjacent to a proposed motorway route that was subject to an agricultural tenancy. In 1983 he entered into an agreement with the contractors constructing the new road granting them a licence to deposit subsoil on part of his land in consideration for payment to him of sums exceeding £72,000. The permitted depth of deposited soil was limited by a contour line that was specified in the agreement. Throughout the period that dumping took place the tenant continued to pay the full rent to the taxpayer for the land and it was probable that after completion of the work the filled and restored land was of greater value than it had been prior to dumping taking place. The land so filled could not be used for any further dumping. The taxpayer was assessed to income tax under schedule A in respect of the receipt of the payments. An appeal against it was upheld by the general commissioners who concluded that the receipt of the moneys represented "one-off" payments that were of a capital and not a revenue nature and as such were outside the Schedule A charge as provided for by section 67(1) of the Income and Corporation Taxes

> Act 1970. The appeal by the Crown was dismissed by Sir Nicolas Browne-Wilkinson VC.'

7.13 In order to fully understand the argument it is necessary to refer to a further passage from the judgment of Sir Nicolas Browne-Wilkinson at page 1393 :

> 'The substance of the present matter is that the payments were received by the taxpayer as consideration for a once-and-for-all disposal of a right or advantage appurtenant to the land—namely, the right or advantage of using it for dumping. Immediately before the licence was granted the value of the land itself included the value of the right to turn it to advantage by using it for dumping. After the licence that right or advantage had gone for ever in return for a lump sum. True the acreage of the land and the taxpayer's interest remained the same, but it was shorn of this valuable advantage. It was in truth a realisation of part of the value of the freehold. That strikes me as a disposal of a capital nature, ...'

7.14 Applying judicial common sense one can see immediately that the present case is so far removed from the facts of *McClure*. In truth and in fact the taxpayer here was not simply disposing its capital asset, namely the Lot by selling it to Cheung Kong. Neither was it disposing a characteristic of the Lot, namely the redevelopment right while retaining the Lot itself. As Mr Shieh had submitted, the use of the term 'redevelopment right' in the Redevelopment Agreement is only a commercial jargon adopted to describe the mutual rights and obligations arising out of a contractual relationship. Simply giving a label of 'right to redevelopment' to the initial payment did not put the present case within the ambit of cases concerning sale of 'one of the characteristics of the land' mentioned in *McClure*. The initial payment was only a 'commercially negotiated figure' arrived at not by reference to valuation of any particular 'right' or interest in the Lot. This was confirmed by Dr Lu of the taxpayer. It was only a label placed by the parties on a set of contractual commitments to which the taxpayer agreed by entering into the Redevelopment Agreement.

VIII. Third ground of appeal

1) Application to amend

8.1 On 11 May 2012, i.e. the last day of the hearing of the appeal, the taxpayer applied for leave to add the following ground of appeal :

> '5. If there was a change of intention so that the land became trading stock, the calculation of the trading profit must take into account all expenses and outgoings of any nature, including the value of the land which the company disposed of in the relevant year and, after deducting the value of the land, the company made no profit.'

8.2 The Board (unanimous) refused to allow the amendment. In summary, Mr Kwok gave the following reasons for refusing to allow the amendment to add an additional ground of appeal :

1) The taxpayer claimed that all expenses and outgoings of any nature must be taken into account is unsustainable and contrary to section 16 of the *IRO* which imposes the following restrictions on the deductibility :

   (1) The outgoings and expenses must be incurred by the taxpayer during the basis period for that year of assessment; and

   (2) The outgoings and expenses must be incurred in the production of profits in respect of which the taxpayer is chargeable to tax under Part IV of the *IRO* for any period.

2) This is a fact sensitive issue. The amendment lacks particulars, namely,

   (1) the amount or nature of the alleged expenses;

   (2) the amount or nature of the alleged outgoings;

   (3) the amount or time of the value of the land;

   (4) the year which is said to be the 'relevant year';

   (5) the disposal which is referred to;

   (6) the subject matter of the disposal; and

   (7) the incurrence said to be in the production of profit.

3) The contention that the taxpayer 'made no profit', is untrue based on the taxpayer's own tax computation for the year of assessment 1994/95 where the total gains amounted to $474,580,664. In its profits tax return for that year of assessment, the taxpayer reported an exceptional item in its tax computation. Schedule 13 gave the following particulars of what the taxpayer claimed to be capital gains :

	$
Cost of Perfekta Building, No. 25 Chong Yip Street, Kwun Tong	18,116,554
Less: Accumulated depreciation	15,601,318
Net book value	2,515,236
Less: Sale proceeds	314,315,900
Gain on transfer	311,800,664
Add: Gain on granting redevelopment right	162,780,000
Total gains	474,580,664

8.3 Mr Kwok then relied on what Lord Millett NPJ said in *Commissioner of Inland Revenue v Secan Ltd and another* (2000) 3 HKCFAR 411 at 419, about the argument whether the Commissioner is entitled to act on the appellant's computation :

> 'Both profits and losses therefore must be ascertained in accordance with the ordinary principles of commercial accounting as modified to conform with the Ordinance. Where the taxpayer's financial statements are correctly drawn in accordance with the ordinary principles of commercial accounting and in conformity with the Ordinance, no further modifications are required or permitted. Where the taxpayer may properly draw its financial statements on either of two alternative bases, the Commissioner is both entitled and bound to ascertain the assessable profits on whichever basis the taxpayer has chosen to adopt. He is bound to do so because he has no power to alter the basis on which the taxpayer has drawn its financial statements unless it is inconsistent with a provision of the Ordinance. But he is also entitled to do so, with the result that the taxpayer is effectively bound by its own choice, not because of any estoppel, but because it is the Commissioner's function to make the assessment and for the taxpayer to show that it is wrong.' (emphasis added)

2) The complaint

8.4 Mr Smith submitted that he was not concerned so much about the deduction of expenses and outgoings but rather the proper valuation of the Lot for the purpose of assessing the correct amount of tax. He submitted, among other things, that the taxpayer's case on valuation had already been advanced in its letter of 16 June 2011 to the Board which set out the grounds of appeal to the assessment by the Commissioner and Mr Kwok himself had raised the issue of valuation at the beginning of the hearing. The application to amend was done out of an abundance of caution. But by its decision

which was only given three and a half years after the hearing, the Board refused to allow the taxpayer to raise this point. I note that the taxpayer's case before the Board was that the initial payment or the assignment proceeds should only be recognised as revenue as at 10 February 1999. On that date the taxpayer through Prodes and the developer sold the redeveloped property to Winrise at $332,661,000. As apparent from the decision of the Board, the contention that valuation should be done only in 1999 was, in fact, not pursued.

3) <u>My view</u>

8.5 First, I would like to point out that when a judge expressed some views in the course of a hearing, such views are at best tentative in nature and what really counts is the views he expressed in the judgment itself. Hence the practice of referring to the transcripts of what the judge had tentatively suggested is not helpful at all. Second, in order to deal with the substantial argument, it is important to remind oneself the role and function of the Board. As Lord Walker of Gestingthorpe NPJ observed in the Court of Final Appeal judgment of *Shui On Credit Company Limited v Commissioner of Inland Revenue* (2009) 12 HKCFAR 392 (paragraphs 29 and 30) the Board's function is both original and administrative. In my view the exercise of the Board's original function clearly includes the exercise of discretion on matters such as whether to allow amendments of the grounds of appeal. On appeal from the exercise of such power, the Court should proceed on the basis that the Court will only interfere if the Board had exercised its discretion wrongly, not in accordance with the recognised principles.

8.6 Despite the attractive argument of Mr Shieh that the Board had not given any previous direction for a split hearing on liability and the amount of the tax and that it behoves the taxpayer to bring forward at the hearing all the materials which may challenge the assessment made by the Commissioner and also that the taxpayer's original stance before the Board was that the valuation should be on the basis that the taxpayer only changed its intention to trade in 1999 and not 1994, I would say respectfully that the Board had erred in the exercise of its discretion on the amendment.

8.7 It is plain from the summary of the reasons given by Mr Kwok, he proceeded on the basis that the taxpayer's challenge on valuation is without merit according to its own case on the gain it had made as recorded in its financial statements. In support of this conclusion he relied on what Lord Millett said in *Secan* as to whether the Commissioner was bound by the taxpayer's own financial statements.

8.8 However, Lord Millett later in *Nice Cheer Investment Limited v Commissioner of Inland Revenue* [2014] 2 HKC 112 clarified what he actually said and meant in *Secan* :

> '34. It is a fundamental principle of the constitution of Hong Kong, as of England, Australia, the United States and other democratic societies, that the subject is to be taxed by the legislature and not by the courts, and that it is the responsibility of the courts to determine the meaning of

legislation. This is not a responsibility which can be delegated to accountants, however eminent. This does not mean that the generally accepted principles of commercial accounting are irrelevant, but their assistance is limited.

35. In the present case the subject matter of the tax is 'profit', and the question what constitutes a taxable profit is a question of law. While the amount of that profit must be computed and ascertained in accordance with the ordinary principles of commercial accounting, these are always subject to the overriding requirement of conformity, not merely with the express words of the statute, but with the way in which they have been judicially interpreted. Even where the question is a question of computation, the court must "always have the last word."

39. It is clear beyond argument that accounts drawn up in accordance with the ordinary principles of commercial accounting must nevertheless be adjusted for tax purposes if they do not conform to the underlying principles of taxation enunciated by the courts even if these are not expressly stated in the statute. ...

...

40. In particular, the principles of commercial accounting must give way to the core principles that profits are not taxable until they are realised and that profits must not be anticipated. ....

.....

44. It must be borne in mind that the new accountancy standards are directed to the preparation of financial statements and not tax computations, and that the two serve different purposes. Financial statements are prepared in order to give investors, potential investors, financial advisers, and the financial markets generally a true and fair view of the state of affairs of the company and in particular its financial position and profitability. Those who read them are concerned not with the past but with the future, and in particular the future profitability of the company. The Ordinance, however, is directed to the past. The Commissioner is not concerned with the likelihood that the taxpayer will make profits in future but whether it made them in the past.

> 45. The courts have had frequent occasion to comment that while a taxpayer's financial accounts, drawn in accordance with ordinary principles of commercial accountancy, may be appropriate for the purpose of showing its financial position they may not be appropriate for the assessment of tax. Where they are not appropriate for this purpose, the taxpayer is entitled or may be required to adjust them for tax purposes: the cases show both situations.....' (emphasis added)

8.9 These passages are, in fact, cited by Mr Kwok in other parts of his decision, but it seems that he had overlooked their significance and the requirement that it was for the Court (and in this instance the Board) to decide whether the financial statements put forward by the taxpayer are appropriate for the assessment of tax and if they are not appropriate for that purpose, the taxpayer is entitled to or may be required to adjust them. As the Board in the present instance said, it must consider the matter from the beginning, *anew*, and its 'ultimate function' is to 'confirm, reduce, increase or annul the assessment' appealed against. In my view, the Board had wrongly treated the taxpayer's financial statements which were put forward by the taxpayer on the premises that the initial payment as a capital gain and not profit was final and conclusive evidence against the taxpayer and cannot be adjusted even if it was to be held against the taxpayer that it had engaged in trade in 1994.

8.10 The taxpayer's case before the Board was that it challenged the Commissioner's view that it had formed an intention to trade in July 1994 and it also put forward the alternative case that the change, if any, only occurred in 1999. Underneath the verbiage, one of its contentions was how the profit should be ascertained. It had put forward the valuation of its own surveyor. As Lord Millett observed in *Secan* at page 422 :

> 'A trader's profits or losses must be ascertained separately for each year of account.
>
> ....
>
> Today the rule applies generally to every kind of trade, profession or business which draws its accounts on an accruals basis, and receipts include work in progress as well as goods held for sale. In what follows I shall use the expression "stock" to include not only property held for sale (ie completed flats awaiting a purchaser) but also work in progress (i.e. uncompleted parts of the development).
>
> The first step is to ascertain the trading profits or losses for the year. This is done by debiting the opening stock (which is a purchase from the previous year of account) and purchases during the year and crediting the closing stock (which is a sale to the next

> year of account) and sales made during the year. The balance represents the trading profit or loss for the year.' (emphasis added)

8.11 This passage clearly answers Mr Shieh's argument that there is no provision in the *IRO* which requires one to regard the opening stock and closing stock. Lord Millett had specifically referred to *IRC v Cock Russell & Co Ltd* (1949) 29 TC 387 at page 392, where Croom-Johnson J in dealing with a similar argument held :

> '... It would be fantastic not to do it; it would be utterly impossible accurately to assess profits and gains merely on a statement of receipts and payments or on the basis of turnover. It has long been recognised that the right method of assessing profits and gains is to take into account the value of the stock-in-trade at the beginning and the value of the stock-in-trade at the end as two of the items in the computation.'

8.12 The valuation directly affects the amount of tax payable. Tang PJ in the *Church Body of Hong Kong Sheng Kung Hui* said :

> '6. .....The date of any change of intention is important because the amount of profits tax payable would vary according to the value at the time of change of intention. However, liability to pay profits tax could only arise upon a sale in the course of trade.....'

8.13 *The Annotated Ordinances of Hong Kong [on Inland Revenue Ordinance* (Cap. 112)] paragraph 14.15 stated :

> 'Where there is activity characteristic of trading, it is vital to show evidence of a change of intention because (1) the cost of property is deemed to be its value as at the date of change of intention rather than its historical cost, for the purpose of calculating the taxpayer's assessable profits from the sale of the property.'

8.14 Before the Board Mr Shieh argued that he had difficulties in accepting the taxpayer's valuation. If that was the case, then, in my view, the proper discharge of the Board's function would be to give further directions for the parties to call for evidence on the valuation. As Ribeiro PJ observed in *Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue* (2009) 12 HKCFAR 296 :

> '128. Where a Board of Review determines an appeal it may, under section 68(8)(a) of the Ordinance, confirm, reduce, increase or annul the assessment appealed from or "remit the case of the Commissioner with the opinion of the Board thereon". Section 68(8)(b) requires the Commissioner on such a remitter to "revise the assessment as the opinion of the Board may

> require and in accordance with such directions (if any) as the Board ... may give concerning the revision required in order to give effect to such opinion.
>
> 129. By s.69(5) of the Ordinance, the Court of First Instance determining a question of law arising on a stated case has power, in accordance with its decision, to confirm, reduce, increase or annul the assessment determined by the Board or to remit the case to the Board with the Court's opinion thereon, whereupon "the Board shall revise the assessment as the opinion of the court may require".
>
> 130. If the matter goes on appeal, s.13(4) of the High Court Ordinance confers on the Court of Appeal "all the authority and jurisdiction of the court ... from which the appeal is brought". That obviously includes the powers of the Court of First Instance under s.69(5) of the Inland Revenue Ordinance.'

8.15 In my view Chung J had also not properly addressed this point. As the discretion was wrongly exercised in the first place, I am of the view that this Court can intervene and exercise the discretion afresh. The circumstances of the case clearly require the issue of valuation put forward by the taxpayer to be properly examined. Accordingly I would allow the amendment and remit the issue of the valuation of the Lot for the purpose of assessing the taxable profit and the amount of the tax thereof to the Board for its determination.

IX. Conclusion

9. I would allow the appeal to the extent as I have indicated.

Hon McWalters JA :

10. I agree with the judgment of Cheung JA.

Hon G Lam J:

11. The facts and background of this case have been fully set out in the judgment of Cheung JA, which I gratefully adopt. In what follows I shall use the same abbreviations. I have, with great respect, reached a different conclusion in relation to the first ground. To explain my reasoning, it is necessary first to see what the Board actually decided.

12. The decision was not unanimous, and the majority's decision (Mr Miu and Mr Sutherland) determined the result by virtue of s 65(4)(e) of the IRO. The majority expressly agreed with the Chairman (Mr Kwok SC), who was in the minority, on the dismissal of the taxpayer's application to add a new ground of appeal

(§§147, 185), but save as to that they did not adopt the minority's decision or reasoning as their own. For present purposes it is the decision of the majority that represented the decision of the Board, and their findings the findings of the Board.

13. The majority noted the Commissioner's acceptance that the Lot and the building erected thereon were acquired by the taxpayer as a capital asset in two tranches in 1969 and 1977 respectively, and positively found that there had been no requisite change of intention on the part of the taxpayer before 30 July 1994 (§§151, 186). They reminded themselves, emphasising it in their quotation from *Simmons v IRC* [1980] 1 WLR 1196, 1199, that in making findings about change of intention when it is said that what was previously investment was later put into trading stock, precision is required (§149).

14. Under the heading "Change of Intention", the majority noted that on 30 July 1994 the taxpayer entered into the Redevelopment Agreement, but they (correctly, in my view) reminded themselves, with reference to *Crawford Realty Ltd v CIR* (1991) 3 HKTC 674, that the execution of a joint venture agreement by a taxpayer does not necessarily mean he has formed an intention to trade. It depends on the "nature and implications" of the agreement (§152), a phrase taken from Barnett J's decision in *Crawford Realty* at p 693.

15. The majority then proceeded to consider the nature and implications of the Redevelopment Agreement. They took the view that where a joint venture agreement provides for profit to be shared equally (as in this case), the perceived value of the parties' contributions should also be equal (§154). Accepting that the fair market value of the Lot was $418,000,000, they essentially held that the initial payment in the sum of $165,104,100 was a "balancing payment" from Cheung Kong to the taxpayer intended to bring to parity the value of their respective contributions after giving credit for the value attributable to Cheung Kong's services (§§158-164).

16. As to their findings on the taxpayer's intention, it is best to set out the majority's reasoning in their own words (or, more accurately, in the words of Mr Miu concurred in by Mr Sutherland):

> "166. As Lord Wilberforce noted in *Simmons v IRC*, a permanent investment may be sold in order to acquire another investment. What the Appellant has done here was to sell the Lot for HK$418 million, and then use part of it (HK$252,895,900, representing the balance after payment of the Initial Payment) to invest in a joint venture. This joint venture was to be carried out by a subsidiary company, Newco (Prodes).
>
> 167. Although the Redevelopment Agreement contained provisions for the Appellant to step in and take up responsibilities which were to be assumed by its subsidiary (Prodes), this does not detract from the fact that the intention

> of the Appellant was that the adventure in the nature of trade should be carried on by Prodes. The Appellant only assumed the role of a guarantor.
>
> 168. The change of intention that took place on 30 July 1994 was therefore not simply that the Appellant would thereupon embark on an adventure in the nature of trade. The intention of the Appellant was to dispose of its capital asset, 'take home' part of its value (about 40%) in the form of cash (by way of Initial Payment), while reinvesting the balance (approximately 60%) in a joint venture with Cheung Kong with a view to earn more profit. The evidence of Mr Yeung Senior should be understood in this context.
>
> 169. It may not be a perfect analogy, but fairly often a non-gambler who ventures into a casino and hits a jackpot playing the coin machine would decide to keep a part of his winnings, and only uses the balance to continue playing, with a hope that his luck may continue and he may end up winning more. By setting aside part of his winnings at the outset, he knows that he will not lose all the winnings which good luck has brought him.
>
> 170. The Appellant is in a somewhat similar position. It has a capital asset which has increased substantially in value, thanks to the general state of the Hong Kong property market. It would like to earn more, but it is not a property developer. It could choose to invest the entire property (with all the capital gain that has accrued to it over the years) in a new joint venture, or it could retain part of what good fortune has brought it, and make an investment with the balance only. The latter course of action will assure that it would not lose all of the capital gains that had accrued to it, no matter how the joint venture should turn out." (footnotes omitted)

17. The reference in §166 to *Simmons v IRC* was to the passage in which Lord Wilberforce said "a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade …", which was emphasised by the majority in the quotation (§149).

18. Following their reasoning, the majority concluded (at §182, see also §192):

> "… in my view, the substance of the transaction as embodied in the Redevelopment Agreement was a sale of the Property by the appellant and reinvestment of part of that value in a joint venture with Cheung Kong. The Initial Payment represented the surplus of the value of the Property (a capital asset) over what would be needed

> for investing in the joint venture. It was therefore in the nature of a capital receipt, not income."

They eventually allowed the appeal on the basis of the third ground advanced by the taxpayer, which simply contended "the Commissioner erred in holding that the Initial Payment constituted assessable profits".

19. Neither in the court below nor on this appeal was it seriously suggested that the majority's reasoning could be defended. The notion of "balancing payment" was not the way the taxpayer had run its case or how the witnesses had explained the transaction, as a result of which the Commissioner had not addressed the point which was essentially a theory formulated by the majority without evidential basis. The notion of equality of value of contribution was also flawed as the risk profiles of the two sides were quite different. An appeal by the Commissioner to the Court of First Instance not surprisingly followed.

20. The questions submitted in the case stated have been set out in §4.1 of Cheung JA's judgment above. They included both questions proposed by the Commissioner (Questions 1 to 3) and those proposed by the taxpayer (Questions 4 to 7). Question 1 and 2, in particular, were targeted at the "balancing payment" theory of the majority. As Chung J recorded, the taxpayer's position was that the majority's ultimate conclusion could be supported even if their reasons were to be ignored as incorrect (see Chung J's judgment, §33).

21. Chung J's decision and answers to the questions submitted have been summarised in §4.2 of Cheung JA's judgment above. Chung J considered that there was no evidential basis for the majority to conclude that the taxpayer "re-invested" part of the value of the Lot into the redevelopment, and no basis for making the assumption that the value of the joint venture parties' contributions would be equal (Chung J's judgment §§53, 56). This led him to answer Question 1 in the negative.

22. His Lordship also upheld the Commissioner's complaint of not having been given a proper opportunity to deal with the point on which the majority's decision was eventually based (Chung J's judgment §§57-60). This led him to answer Question 2 in the affirmative.

23. Furthermore, the majority's decision in my view plainly ignored the separate legal personalities of the taxpayer and its subsidiary, Prodes. As is apparent from the passages in the majority's decision quoted above, while they noted that the joint venture was to be "carried out" by the taxpayer's subsidiary, Prodes (§166), and that the taxpayer's intention was that "the adventure in the nature of trade should be carried on by Prodes" (§167), they concluded that *the taxpayer* re-invested the remaining value of the Lot in a joint venture with Cheung Kong (§§168, 174, 182, 192); the analogy drawn was that the taxpayer pocketed part of the winnings, but continued to gamble with the rest (§169). The majority apparently reached this conclusion by trying to look at the "substance" of what was done (§§181-182, 188, 192). It is not clear whether they shared

the minority's view in this regard that Prodes was the taxpayer's "alter ego" (§127), but in their reasoning they seem to me to have treated the taxpayer and Prodes as one.

24. This, with respect, is impermissible. "Substance" can no more than "commercial reality"[1] allow the separate legal personalities of different companies to be disregarded and the activities of a subsidiary to be treated as those of the parent company, except where a specific legal basis for doing so exists, such as under statutory rules (eg ss 60 or 61A of the IRO) or the common law doctrine of piercing the corporate veil. In the present case, where neither basis had been even mentioned by anyone, it was not open to the Board to say that Prodes was the taxpayer's "alter ego" or, which amounts to the same thing, that they were to be treated as the same person.

25. As recognised by Lord Hoffmann NPJ in *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd* (2007) 10 HKCFAR 704 in the passage quoted by Cheung JA in §6.10 above, it is perfectly normal commercial practice to employ subsidiaries to undertake development of properties acquired from the parent. The proper approach to taxation of the parent and subsidiary was explained by Lord Hoffmann at §8 as follows:

> "… it is necessary to explain the principles upon which Tai Hing [ie the parent company] and the taxpayer [ie the subsidiary] paid profits tax. Tai Hing traded in cotton but not in land. Its land was part of its capital. Anything which it received from selling its land was not a profit arising from its trade. The taxpayer, on the other hand, was embarking on the trade of developing and selling land. Any land which it acquired for the purpose of this trade was part of its trading stock and its cost was deductible from receipts in calculating its taxable profits. Thus the price of the land was deductible by the taxpayer but free of tax in the hands of Tai Hing. The more the taxpayer had to pay Tai Hing for the land, the less tax the group as a whole would have to pay."

If the sale of the land by the parent was artificially overpriced so as to reduce the subsidiary's trading profit, the law's response is to deprive the taxpayer of that benefit under s 61A of the IRO, which was what the decision in *Tai Hing Cotton Mill* was about. But there is no suggestion at all in this case that there was any such avoidance scheme or an inflated price. The price at which the Lot was sold to Prodes ($314,315,900), together with the initial payment of $165,104,100 paid by Cheung Kong, approximated to the valuation of the Lot at $418 million (as at April 1994) plus an increase in market value of $60 million by July 1994.

26. On this basis the result seems to me to be that there was no or no valid majority finding by the Board that there was the requisite change of intention to one of trading. The majority, knowing precision was required in this matter, found there was

[1] *per* Lord Millett in *ING Barings Securities (Hong Kong) Ltd v The Commissioner of Inland Revenue* (2007) 10 HKCFAR 417, §134.

a change of intention, but it was *not* to an intention to put the Lot into trading stock (see also §3.3 of Cheung JA's judgment above). A change from an intention to hold, to an "intention to dispose of [the taxpayer's] capital asset" (majority's decision, §168) is not relevant. In any event, the majority's finding on intention was part and parcel of, and inextricably bound up with, their balancing payment theory, which has been roundly rejected. There was no finding by them of a change to an intention to trade in relation to the Lot which could be said to have been left intact.

27. Given that the Board (unanimously) found that the taxpayer's intention had hitherto been to hold the Lot as a capital investment, without a proper finding of change of intention to one of trading, no profits tax could be charged. The minority's decision, in my view, did not become the decision of the Board upon the majority's reasoning, findings and decision being found to have been vitiated by legal error. While for convenience the whole of the document called "Decision" has been annexed to the case stated, strictly speaking the minority's opinions (save those adopted or concurred in by the majority expressly or by necessary implication) do not form part of the findings that ought to be stated in the case.

28. Where does this leave us? Where a decision of the Board is so vitiated by misdirection in law as to leave no valid finding on the question of change of intention, the proper course would generally be to remit the case to the Board with the opinion of the court for proper findings to be made free from the legal errors identified and, on those findings, to revise the assessment as appropriate. I appreciate this was not what the Commissioner or the taxpayer sought before Chung J or before us in relation to these grounds, but this does not prevent this court from exercising the power which was clearly available to Chung J (see s 69(5) of the IRO), and therefore available to this court, if the circumstances so require.

29. The question whether there was a change of intention to one of trading is a question of fact and degree: *Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue* (2016) 19 HKCFAR 54 at §§23, 45. Under the statute it is a question for the Board. It was not held by Chung J (nor was it contended by Mr Shieh SC for the Commissioner before us) that the minority's decision (summarised by Cheung JA at §6.3 above) was the true and only reasonable conclusion on that question of fact. On that basis, it seems to me that, with respect, it was not open to Chung J to substitute the finding of the minority for that of the Board.

30. I do not, however, think a remission is necessary because, for my part, I am persuaded by Mr Smith SC's argument that the true and only reasonable conclusion on the undisputed evidence and primary facts – and therefore a conclusion that the court on an appeal on law may itself reach (see *Kwong Mile Services Ltd v Commissioner of Inland Revenue* (2004) 7 HKCFAR 275 at §37) – is that the taxpayer did not change its intention and put the Lot into its trading stock. None of the preparatory steps by way of enhancement of the value of the Lot (eg obtaining planning permission, governmental consent for variation of the lease terms, and approval of building plans), as the Board unanimously found, was sufficient to indicate a change of intention: to hold

otherwise would be wrong in law according to the subsequent decision of the Court of Final Appeal in the *Church Body* case.

31. Nor did the taxpayer's board minutes dated 21 April 1994 (quoted in §33 of the agreed facts set out in §2 above), as the Board again unanimously found, show any such change of intention. The phrase "for internal purposes" in the minutes did not show that the use of a subsidiary was in any way sinister or a sham. It indicated an intention that within the taxpayer's group, it was not the taxpayer but a subsidiary that would enter into the development venture. Insofar as Chung J relied on the phrase to suggest that the real intention was for the taxpayer to redevelop the Lot (see Chung J's judgment §§46-47 & 52), I would respectfully disagree.

32. The crucial matter is the Redevelopment Agreement, but under that agreement it was to "Newco" – a subsidiary of the taxpayer which turned out to be Prodes – that the Lot was to be assigned and it was for Newco immediately thereafter to enter into a development agreement (called the "New Agreement") with Cheung Kong. This structure was wholly consistent with the intention evinced by the board minutes, namely, that the development should be carried out by an entity separate from the taxpayer and that the Lot would be sold to a subsidiary which would subsequently enter into a development venture with Cheung Kong, as well as with the evidence of the witnesses concerning the discussions with Cheung Kong.

33. By the Redevelopment Agreement the taxpayer essentially assumed the primary obligation to Cheung Kong to sell the Lot to a subsidiary and to procure that subsidiary to enter into the New Agreement with Cheung Kong. In return the taxpayer was entitled to the initial payment for so committing the Lot (described as "granting … the right to redevelop the Lot" in clause 3.02). It is true that the taxpayer accepted, under clause 5.02, that should Newco fail to enter into the New Agreement with Cheung Kong, the taxpayer would be deemed to have replaced Newco. But this provision, together with clause 6.01(i) which gave Cheung Kong an option in that event to terminate the agreement instead, were clearly intended for the protection of Cheung Kong (in addition to the general remedy of specific performance which clause 6.04 specifically preserved). It was something the taxpayer was prepared to suffer should Newco fail to proceed, but also something wholly within the power of the taxpayer to avoid. Recital (6) stated that subsequent to the Government's regrant of the Lot but prior to redevelopment, the taxpayer intended to transfer the ownership of the Lot to Newco. There was nothing to indicate that the taxpayer had any intention whatsoever that Newco should not proceed. As a matter of fact, Newco – in the person of Prodes – indeed was formed, was assigned the Lot, and entered into the New Agreement. Under the Redevelopment Agreement, once that happened, the taxpayer would – as it in fact did – drop out of the picture altogether. There was no requirement for the taxpayer to be a party to the New Agreement, whether as guarantor for Newco or otherwise; it was not even required to continue to hold Newco.

34. While the exercise of finding the relevant intention is an objective one, it is *the taxpayer's* intention alone that one must objectively find, not the intention of Cheung Kong or the intention of all the parties to the Redevelopment Agreement. I

accept Mr Smith's submission that unless and until Newco did fail to enter into the New Agreement when required to do so, it could not be said that the taxpayer intended to put the Lot into *its own* trading stock. Nor does it matter that Prodes had not yet been formed on 30 July 1994. We are not concerned with the legal effect of a pre-incorporation contract purportedly entered on behalf of a company, but with the factual question of the taxpayer's intention.

35. It might be said that the Redevelopment Agreement was a "profit-making" agreement for the taxpayer, in the sense that it would receive money, in the form of the initial payment, that exceeded the cost of its original acquisition of the Lot even in real (as opposed to nominal) terms (albeit much less than the open market value of the Lot). But that is not enough: profit made from the mere realisation of a capital asset is not taxable. Apart from the fixed sum of $165,104,100, the taxpayer would not stand to gain any further profit or bear any risk. Instead, as developers in their joint venture, Prodes and Cheung Kong would.

36. In a very loose sense (with which the evidence of the senior Mr Yeung referred to in §55 of Chung J's judgment is entirely consistent), some may of course say there was a risk of profit or loss for the taxpayer indirectly through its wholly-owned subsidiary, Prodes. Indeed, the market could turn so adverse that there would be little surplus after paying off the development costs, so that Prodes would end up having little asset available for paying the price of the Lot owed to the taxpayer – as in fact happened. But this risk was no different from the risk for the parent company in *Tai Hing Cotton Mill*, and could no more render the exercise an adventure in the nature of trade on the part of the taxpayer in this case.

37. Finally on this matter, I would add some observations on the case of *Hong Kong Oxygen & Acetylene Co Ltd v CIR* [2001] 1 HKLRD 489 and (1998) 13 IRBRD 582, relied upon by the Commissioner, which has a superficial resemblance to the present case in that it was also concerned with an initial payment in a joint venture. The facts of that case are materially quite different in that: (i) the taxpayer's board resolved to enter into the joint venture in question before any decision was made for a subsidiary to be used, so that the subsidiary was no more than a vehicle to implement that intention (see pp 500H, 502I-J); (ii) the taxpayer was a party to the actual joint venture development agreement and remained a real participant in the project; and (iii) the land was assigned by the taxpayer to its subsidiary for the entire market value of $497 million so that the additional payment the taxpayer received of $180 million could be said to be not on account of the capital value of the land.

38. With the above in mind I come to Questions 4 and 5, which read as follows:

> "4. Whether:-
>
> (a) on the facts found by the Board, the Board (at paragraph 168 of the Decision) erred in law in concluding that there was a change of intention on the part of the appellant; and

(b) there is any evidence in support of such finding;

having regard to, inter alia, the Board's findings that:-

(i) the joint venture was to be carried out by a subsidiary company, Newco (Prodes) (paragraph 166 of the Decision);

(ii) the intention of the appellant was that the adventure in the nature of trade should be carried on by Prodes (paragraph 167 of the Decision); and

(iii) the Redevelopment Agreement contained provisions for the appellant to step in and take up responsibilities which were to be assumed by its subsidiary (Prodes) (paragraph 167 of the Decision), but only if the subsidiary failed to enter into the New Agreement.

5. Whether the Board erred in law (at paragraph 168 of the Decision) by taking into account the activities and intention of the appellant's subsidiary (Prodes) in ascertaining the intention of the appellant."

39. Both questions were clearly directed to the *majority's* decision, which contains §§166-168 as specified. I do not think that Question 4 is precluded by Question 3. In fact, Question 3 presupposes there was a valid and intact finding by the Board of a change of intention on the part of the taxpayer. On the analysis I have adopted, the premise of Question 3 is undermined.

40. For the reasons given above, I would answer Question 4 in this way: the Board (meaning the majority) did not find a change of intention to one of trading simpliciter, but nevertheless it did err in law in concluding there was a change of intention since its finding was based on the flawed "balancing payment" theory and disregarding the separate legal personalities of the taxpayer and Prodes. Insofar as the Board (the majority) found that the taxpayer had changed its intention to one of trading, there was no evidence in support of such finding or, in other words, the true and only reasonable conclusion on the facts found is that the taxpayer had not so changed its intention.

41. It follows that I would answer Question 5 in the affirmative.

42. Chung J answered both Questions 4 and 5 in the negative (see Chung J's judgment §63(c)) but, with great respect, it is not clear how he arrived at that conclusion. If, as it appears to Cheung JA (see §4.3 above), Chung J actually answered these questions with reference to the *minority's* opinion, then I would respectfully suggest that that was not what the questions asked (though this is not fatal), and, more importantly, that no question for the court arose from the minority's view which was neither the

decision of the Board nor became such when the majority's decision was found to have been vitiated.

43. It follows from my views in §§30-37 above that I would allow the appeal and annul the assessment. If I am wrong, however, in holding that the true and only reasonable conclusion was that there was no requisite change of intention on the part of the taxpayer, then it follows from §§19-29 above that I would remit the case to the Board with the court's opinion for it to make findings on the question of change of intention and, on those findings, to revise the assessment as appropriate.

44. With regard to the second and third grounds of appeal, I respectfully agree with the judgment of Cheung JA and have nothing to add.

Hon Cheung JA :

Disposition

45. The appeal is allowed to the extent that the taxpayer is allowed to amend its ground of appeal and the issue of the valuation of the Lot for the purpose of assessing the taxable profit and the amount of tax thereof is remitted to the Board for its determination.

Costs

46. The Court directs the parties to lodge written submissions within 14 days on the costs of the appeal and below.

(Peter Cheung)	(Ian McWalters)	(Godfrey Lam)
Justice of Appeal	Justice of Appeal	Judge of the Court of First Instance

Mr Paul Shieh SC and Mr Mike Lui, instructed by Department of Justice, for the appellant
Mr Clifford Smith SC and Mr Justin Lam, instructed by Pang & Associates, for the respondent