Case No. D18/15

Profits tax - redevelopment of land & building - joint venture - whether change of intention - whether initial payment received for redevelopment rights capital in nature - sections 2, 14, 16, 65(4)(e), 67(1)(c) and 68(4) of the Inland Revenue Ordinance.

Panel: Kenneth Kwok Hing Wai (chairman), Miu Liong Nelson and Mark Richard Charlton Sutherland.

Dates of hearing: 7, 8, 10 and 11 May 2012.
Date of decision: 20 October 2015.

The Appellant owned the land ('the Lot') and the industrial building thereon since 1977.

From 1991 to 1994, a number of applications were made to various government departments for a redevelopment of the Lot.

On 21 April 1994, the board of directors resolved to proceed with discussions with Company A for a joint development of Lot.

The Appellant entered into the Redevelopment Agreement dated 30 July 1994 with Company A and its subsidiary, Company B.

As consideration for the Appellant granting to Company B the right to redevelop the Lot, Company B shall pay to the Appellant $165,104,100 ('Initial Payment') which was paid or accrued to the Appellant in the calendar year 1994.

By an assignment dated 14 November 1994, the Appellant assigned the Lot and the building to Company C, a wholly owned subsidiary of the Appellant.

By the Determination dated 19 May 2011, the Deputy Commissioner agrees with the assessor's view that the Initial Payment should be assessable to tax for the year of assessment 1994/95.

The Appellant appealed.

On 11 May 2012, the last day of the hearing of the appeal, the Appellant applied for leave to add new ground of appeal contending that all expenses and outgoings of any nature including the value of the land which the company disposed of in the relevant year must be taken into account to which the Appellant made no profit.

Held:

New Ground of Appeal

1. The Board disallows the application to add new ground of appeal:

    1.1 No question is raised by the original grounds of appeal on expenses, outgoings or deductions.

    1.2 The contention that all expenses and outgoings of any nature must be taken into account in the calculation of trading profit is bound to fail, fact sensitive and devoid of particulars.

    1.3 On the Appellant's own computation, the total gains amounted to $474,580,664. The contention that the Appellant 'made no profit' is untrue.

Substantive Appeal

2. Appeal dismissed by Kenneth Kwok Hing Wai (chairman):

    2.1 There was a change of intention from capital holding of the Lot and the building thereon to trading/business on 30 July 1994 when the Appellant entered into the Redevelopment Agreement.

    2.2 Chargeability arose before Company C came into existence or the picture.

    2.3 As there was a change of intention on 30 July 1994 by way of the Redevelopment Agreement, the Initial Payment was not capital receipt.

    2.4 Under the Redevelopment Agreement, all the instalments of the Initial Payment were paid or accrued in the calendar year 1994 which was recorded as such as per the Appellant's own tax computations.

3. Appeal allowed by Miu Liong Nelson:

    3.1. A finding of change of intention is a pre-requisite, but not necessarily sufficient condition, for the taxability of the Initial Payment.

    3.2. There has been a change of intention on 30 July 1994. Yet the Appellant had not injected the entire value of the Lot (HK$418 million) into the joint venture project at its start-up. The intention of

the Appellant was that the adventure in the nature of trade should be carried on by Company C, its wholly owned subsidiary.

3.3. The substance of the transaction was a sale of the Property by the Appellant and reinvestment of part of that value in a joint venture with Company A.

3.4. 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.

4. Appeal allowed by Mark Richard Charlton Sutherland:

4.1 The substance of the transaction in the Redevelopment Agreement was the sale of the Property by the Appellant followed by the subsequent reinvestment of a part of the realised value in a joint venture with Company A.

4.2 The Initial Payment was in effect the surplus of the value of the Property which itself was a capital asset in addition to what was required to invest in the joint venture.

4.3 The Initial Payment is in the nature of a capital receipt as opposed to income.

5. By reason of section 65(4)(e), this appeal is allowed.

Appeal allowed.

Cases referred to:

China Map Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 486
Commissioner of Inland Revenue v Secan Ltd and another (2000) 3 HKCFAR 411
Church Body of the Hong Kong Sheng Kung Hui and another v Commissioner of Inland Revenue [2014] 5 HKLRD 384
Shui On Credit Company Limited v Commissioner of Inland Revenue (2009) 12 HKCFAR 392
Lee Yee Shing Jacky and another v Board of Review (Inland Revenue Ordinance) and another [2012] 2 HKLRD 981
Kim Eng Securities (Hong Kong) Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 213
Wing Tai Development Co Ltd v Commissioner of Inland Revenue [1979] HKLR 642

Real Estate Investments (NT) Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 433
Nice Cheer Investment Limited v Commissioner of Inland Revenue [2014] 2 HKC 112
Simmons v IRC [1980] 1 WLR 1196
Marson v Morton [1986] 1 WLR 1343
All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750
Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6
Crawford Realty Ltd v Commissioner of Inland Revenue (1991) 3 HKTC 674
Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue [2001] 1 HKLRD 489
Tai Hing Cotton Mill Ltd v Commissioner of Inland Revenue (2007) 10 HKCFAR 704
McClure (Inspector of Taxes) v Petre [1988] 1 WLR 1386

Clifford Smith, Senior Counsel and William Wong, Counsel, instructed by Messrs Pang & Associates, for the Appellant.
Paul Shieh, Senior Counsel and Mike Lui, Counsel, instructed by Department of Justice for the Commissioner of Inland Revenue.

Decision:

Kenneth Kwok Hing Wai, SBS, BBS, SC, JP (Chairman):

Introduction

1. References to section numbers are, unless otherwise stated, to those in the Inland Revenue Ordinance, Chapter 112.

2. The Appellant was incorporated in April 1965.

3. (1) On 2 May 1969, the Appellant acquired a few floors of an industrial building.

(2) In 1977, the Appellant acquired the remaining floors of the industrial building.

4. The Commissioner of Inland Revenue ('CIR') accepts that the land ('the Lot') and the building thereon were 'acquired as capital' and that 'there had to be a change of intention before profits tax implications can arise'.

5. From 1991 to 1994, a number of applications were made to:

(1) the Town Planning Board for permission to develop an industrial/office building at the Lot;

(2) the District Lands Office/Kowloon East for modification of the leasehold conditions; and

(3) the Buildings Department for approval of building plans regarding the proposed industrial/office building at the Lot.

6. (1) The planning application was eventually approved subject to conditions.

(2) The building plans were approved.

(3) The District Lands Officer/Kowloon East stated that he was prepared to recommend to the Government for a modification of the lease by way of surrender and regrant, subject to conditions for the industrial/office development.

7. On 21 April 1994, the Appellant's Board of directors met and resolved that the Appellant should continue with the discussions with Company A on a joint redevelopment of the Lot.

8. The Appellant entered into the Redevelopment Agreement dated 30 July 1994 ('Redevelopment Agreement') with Company A and its subsidiary, Company B, by which it was agreed, among others, that Company B shall pay to the Appellant $165,104,100 ('Initial Payment').

9. (1) The Appellant made up its accounts to 31 December each year.

(2) The 1994 calendar year is the basis period (i.e. the period on the profits of which tax for the 1994/95 year of assessment ultimately falls to be computed) for the 1994/95 year of assessment.

(3) There is no dispute between the Appellant and CIR that the Initial Payment was paid or accrued to the Appellant in the calendar year 1994.

10. By an assignment dated 14 November 1994, the Appellant assigned the Lot and the building to Company C, the Appellant's subsidiary.

11. In March 2001, as a protective measure, the Assessor raised on the Appellant the following Additional Profits Tax Assessment for the year 1994/95:

Additional assessable profits	$13,000,000
Additional tax payable thereon	$2,145,000

12. The Appellant objected.

13. The Appellant failed in its objection. The Deputy Commissioner:

(1) agreed with the Assessor's view that the Initial Payment of $165,104,100 was paid to the Appellant for its participation in a joint venture with Company A;

(2) determined that the Initial Payment should be assessable to tax; and

(3) determined that the 1994/95 Additional Profits Tax Assessment should be increased as follows:

Initial Payment		$165,104,100
Less: Professional and legal fees	$2,455,294	
Agreed adjustments	24,008	2,479,302
Additional assessable profits		$162,624,798
Additional tax payable thereon		$26,833,092

14. By the Determination dated 19 May 2011, the Deputy Commissioner increased the Additional Profits Tax Assessment for the year of assessment 1994/95 dated 23 March 2001 showing additional assessable profits of $13,000,000 with additional tax payable thereon of $2,145,000 to additional assessable profits of $162,624,798 with additional tax payable thereon of $26,833,092.

15. The Appellant appealed to the Board of Review (Inland Revenue Ordinance).

The agreed facts

16. The Appellant and the respondent agreed the following facts and we find them as facts, see paragraph 17 to paragraph 48 below.

17. The Appellant was incorporated in April 1965. It has engaged in the business of toy manufacturing since its incorporation. Its first directors were Mr D, Mr E, Mr F, Mr G and Mr H.

18. By an assignment dated 2 May 1969, the Appellant acquired from Company J (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 Building K at Address L, representing 9 equal undivided 12th parts or shares of and in District M Inland Lot No. XXX ('the Lot') and the building thereon. The Appellant used the same as its manufacturing base in Hong Kong.

19. In 1977, the Appellant acquired the remaining equal undivided shares of and in the Lot and the building thereon. The Appellant used the same as its manufacturing base in Hong Kong.

20. In 1978, the Appellant entered into a processing arrangement with an entity in Mainland China and established Factory N in City P.

21. In 1985, the Appellant relocated Factory N to District Q in City R and that led to the establishment of Factory S through entering into a new processing arrangement with another entity in Mainland China.

22. In 1987, the Appellant ceased its manufacturing operations at Factory T[1] and thereafter disposed of the same.

23. On 23 July 1991, Company U made an application under section 16 of the Town Planning Ordinance (Chapter 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 Company U of the same on 18 October 1991.

24. On 10 June 1992, a second TPO section 16 application was submitted to TPB via Company V 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 Company V of their approval on 28 August 1992.

25. On 2 October 1992, Company X on behalf of the Appellant 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, Company Y submitted to the Appellant 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. Company Y 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 accepted the fee proposal and confirmed with Company Y of the same on 2 November 1992.

27. On 23 February 1993, Company V 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 Company V of the same on 7 May 1993.

29. On 31 July 1993 the Buildings Department ('BD') disapproved certain general building plans submitted by Company Y for the proposed composite industrial/office

[1] There is no definition of the 'Factory T' in the agreed facts. According to paragraph 7 of Mr W's witness statement, this was where the Appellant had been carrying on its manufacturing operations since incorporation.

building at the Lot. Company Y re-submitted certain general building plans for approval on 23 August 1993. BD approved the re-submitted plans and informed Company Y of the same on 22 September 1993.

30. On 2 February 1994, DLO/KE told Company X 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, Company X 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.

32. On 31 March 1994, Company Y wrote to the Appellant confirming the Appellant's instructions to appoint Company Z for valuation of the proposed composite industrial/office building at the Lot.

33. On 21 April 1994, the Board of the Appellant held a meeting to discuss a proposal from Company A regarding the redevelopment of the Lot. The minutes of that meeting recorded, *inter alia*, as follows:

> ' Re: 25 ;[Address L], Redevelopment plan
>
> The Chairman reported that discussions had taken place with representatives of [Company A] who had approached [the Appellant] with a suggestion of a joint development of the Company's industrial premises at [Address L]. As the premises were acquired 24 years ago (since May 1969) and were in need of upgrading it was recommended that the discussions [*sic*] with [Company A] 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 [Company A] envisaged the sale to third parties of the newly developed industrial & office building as the manufacturing business of [the Appellant] 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] to realise its long term asset. It was agreed that any joint development program would have to provide for the [Appellant] 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] 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 [Company A].'

34. On 23 April 1994, Company Z produced a valuation report in respect of the Lot valuing it at HK$418,000,000 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 Company Y.

35. On 25 April 1994, the Appellant and Company A held a meeting.

36. On 4 May 1994, Company A proposed to the Appellant a joint venture arrangement for the redevelopment of the Lot.

37. On 30 July 1994, the Appellant, Company B (a subsidiary of Company A) and Company A entered into the Redevelopment Agreement whereby it was agreed, *inter alia*, that:

> ' [Company B] shall pay to [the Appellant] as consideration for [the Appellant] granting to [Company B] the right to redevelop the Lot in accordance with the terms of this [Redevelopment Agreement] an Initial Payment totalling HK$165,104,100 [as follows …]' (Clause 3.02).

38. On 6 August 1994, the Appellant 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 assigned the Lot to its wholly owned subsidiary Company C at the consideration of HK$314,315,900.

40. On 24 November 1994, Company C, Company B and Company A entered into the new agreement ('New Agreement') (a draft copy of which was annexed to the Redevelopment Agreement).

41. On 9 December 1994, the representatives of the Appellant and Company B jointly inspected the Lot and confirmed the delivery of vacant possession of the same to Company B. Manufacturing operations of the Appellant at the Lot also ceased in December 1994.

42. On 6 August 1997, the Appellant notified Company B 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 'Building AA'.

43. On 3 November 1998, Company B asked Company C whether it would exercise its option under clause 11.04 of the New Agreement.

44. On 12 November 1998, the Appellant replied to Company B 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, Company A informed Company C 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) Company C, Company B and Company AB (another subsidiary of Company A) entered into an agreement for sale and purchase of the Lot whereby Company C sold the Lot to Company AB at a consideration of HK$332,661,000.

(ii) Company C, Company B and Company AB 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 Company B (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) Company AC (the sole beneficial owner of Company C at the time) sold Company C to Company AD (another subsidiary of Company A) at a consideration of HK$10.

47. On 11 February 1999, the Board of the Appellant ratified and approved, *inter alia*, an assignment between the Appellant and Company C whereby:

(i) Company C assigned its rights, interests, benefits and entitlements under the New Agreement to the Appellant; and

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

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

The grounds of appeal

49. By letter dated 16 June 2011, Messrs Pang & Associates wrote a 18-page letter giving notice of appeal. The grounds of appeal read as follows:

> ' We are duly authorized by the Appellant [Company AE] ("the Company") to give notice of appeal to the Board of Review under section 66 of the Inland Revenue Ordinance (Cap 112) ("the Ordinance"), which we hereby do, against the Determination of the Commissioner dated 19 May 2011 dismissing the Company's objection to the additional profits tax assessment for the year of assessment 1994/5. A copy of the Commissioner's written Determination accompanies this notice of appeal, and the grounds of the appeal are set out below.
>
> **Introduction**
>
> 1. Unless otherwise specified:
>
> (1) References to numbered paragraphs are references to paragraphs in the Determination by the Deputy Commissioner of Inland Revenue (the **"Commissioner"**) dated 19 May 2011 (the **"Determination"**);
>
> (2) The definitions and the abbreviations used in the Determination are adopted.
>
> 2. The Company advances four grounds of appeal:
>
> (1) **First**, the Commissioner erred in taking the view that the Company has changed its intention towards the Land so that it ceased to be a capital asset and became trading stock on 21 April 1994 when its directors resolved to proceed with discussions with [Company A] for a joint development of Land (or indeed at any other time) (see §3(3) at p. §15) (the **"First Ground of Appeal"**);
>
> (2) **Secondly**, the Commissioner erred in failing to take into account the fact that the Company and [Company C] were separate legal entities with separate and independent legal rights and obligations (the **"Second Ground of Appeal"**);
>
> (3) **Thirdly**, the Commissioner erred in holding that the Initial Payment constituted assessable profits (the **"Third Ground of Appeal"**);

(4) **Fourthly**, (in the alternative and without prejudice to the foregoing) the Commissioner erred in assessing the Initial Payment for tax for the year of assessment 1994/1995 (the **"Fourth Ground of Appeal"**).'

The proposed additional ground of appeal

50. On 11 May 2012, i.e. the last day of the hearing of the appeal, the Appellant 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.'

51. The Respondent opposed the application.

Decision on application to add new ground of appeal

52. Unless permitted by the Board under section 66(3), the appeal is *confined* to the original grounds of appeal. The grounds of appeal govern the scope of the admissible evidence and they define the issues on appeal, section 68(7).

Section 66(3)

' *Save with the consent of the Board and on such terms as the Board may determine, an Appellant may not at the hearing of his appeal rely on any grounds of appeal other than the grounds contained in his statement of grounds of appeal given in accordance with subsection (1).*'

Section 68(7)

' *At the hearing of the appeal the Board may, subject to the provisions of section 66(3), admit or reject any evidence adduced, whether oral or documentary, and the provisions of the Evidence Ordinance (Cap 8), relating to the admissibility of evidence shall not apply.*'

53. In China Map Limited v CIR[2], the Court of Final Appeal held that applications for the Board's consent to amend the grounds of appeal 'should be sought fairly, squarely and unambiguously'[3].

[2] (2008) 11 HKCFAR 486 at paragraphs 9 and 10.

[3] See China Map Limited v CIR (2008) 11 HKCFAR 486 at paragraphs 9 and 10.

> '*9. By its representative, each of the Taxpayers put forward the grounds of appeal that the profits in question 'were capital in nature and were not assessable to Profits Tax or alternatively that the assessment was excessive'. None of the Taxpayers pursued its alternative ground that the assessments were excessive. That left only one question raised by the grounds of appeal given in accordance with s.66(1). Did the profits in question arise from the sale of capital assets? But at the hearing before us, Mr Patrick Fung SC for the Taxpayers contended that there was an antecedent question. Were the profits in question from the carrying on of a trade, profession or business?*
>
> *10. No such question is raised by the Taxpayers' grounds of appeal given in accordance with s.66(1). But Mr Fung contended that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a fresh ground which raised such a question. For this contention, Mr Fung relied on an exchange between the Board's chairman and the Taxpayers' counsel (not Mr Fung or his junior Ms Catrina Lam). That exchange took place after the close of the evidence and during final speech. By its nature, such a question is fact-sensitive and its answer inherently dependent on evidence. For a tribunal of fact to entertain such a question after the close of the evidence would be unusual and plainly inappropriate if done without offering the party against whom the question is raised an opportunity to call further evidence. No such opportunity was offered to the Revenue. We do not think that the Board is to be treated as having consented under s.66(3) to the Taxpayers relying on a fresh ground which raised the antecedent question for which Mr Fung now contends. If and whenever s.66(3) consent is sought, it should be sought fairly, squarely and unambiguously. Nothing of that kind occurred in this case.*'

54. In my view, no question is raised by the original grounds of appeal in this case on expenses, outgoings or deductions. Unless the Board permits an amendment under section 66(3), the Appellant may not rely on any new ground of appeal or raise any question on expenses or outgoings or deductions.

55. I now consider whether the proposed amendment should be permitted.

56. To start with, the contention in the proposed new ground that:

> ' *all*[4] expenses and outgoings of *any*[5] nature' must be taken into account in the calculation of trading profit

is obviously unsustainable. It flies in the face of section 16 which provides that:

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[4] Emphasis added

[5] Emphasis added

> ' *In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period …*'.

57. Plainly, section 16 does not extend to *all* outgoings and expenses of *any* nature.

58. There are the following restrictions on deductibility.

(a) The outgoings and expenses must be incurred by the taxpayer *during the basis period for that year of assessment*[6]; and

(b) 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 Inland Revenue Ordinance for any period.

59. The Appellant's contention is bound to fail. This by itself is a fatal point against the application to amend.

60. There are other fatal objections.

61. The contention that:

> ' …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'

is fact sensitive. But it is conspicuous in its lack of any or any material particulars. There is no allegation of:

(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] See also paragraph 81 below.

(6) the subject matter of the disposal; and

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

The application was made on the last day of hearing. Yet, the fact sensitive contention is devoid of particulars. This is a further reason to refuse the application.

62. In any event, the contention that the Appellant 'made no profit' is on the Appellant's own tax computation for the year of assessment 1994/95 untrue.

63. In its Profits Tax Return for that year of assessment, the Appellant reported an exceptional item in its tax computation. Schedule 13 gave the following particulars of what the Appellant claimed to be capital gains:

	$
Cost[7] of Building AA, Address L	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

64. On the Appellant's own computation, the total gains amounted to $474,580,664.

65. As Lord Millet NPJ said in CIR v Secan Ltd and another[8], CIR 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*

[7] See paragraph 81 below.
[8] (2000) 3 HKCFAR 411 at page 419 C – F.

> *any estoppel, but because it is the Commissioner's function to make the assessment and for the taxpayer to show that it is wrong.*'

66. For these reasons and in the exercise of discretion, I, for my part, would not allow the amendment asked for.

Church Body of the Hong Kong Sheng Kung Hui and another v CIR[9]

67. When we were considering our Decision in draft, the Court of Appeal handed down its judgment in Church Body of the Hong Kong Sheng Kung Hui and another v CIR[10] ('the Judgment') on 11 September 2014.

68. At the request of the presiding chairman, the Clerk to the Board of Review wrote to the Appellant and CIR on 12 September 2014 asking whether they would like to make any submission on the Judgment.

69. By letter dated 26 September 2014, Messrs Pang & Associates indicated the Appellant would wish to make submission and submitted both parties should have 28 days to make submissions and a further 28 days to make reply submissions. By letter dated 29 September 2014, the Department of Justice stated that CIR had no objection to the Appellant's proposed directions. After considering the parties' respective submissions, the presiding chairman directed that both parties 'be at liberty to serve any submissions which [it/he] may wish to make on' the Judgment and further directed that both parties be at liberty to make reply submissions.

70. The Appellant made its submissions on 3 November 2014 and reply submissions on 1 December 2014. CIR made his submissions on 3 November 2014 and reply submissions on 1 December 2014.

71. In its submissions dated 3 November 2014, the Appellant:

> ' [reminded] the Board of its alternative argument that it in fact suffered a substantial loss from the sale of the Land.'

The permission given by the presiding chairman was to make submissions on the Judgment. I have not invited submissions on matters which the Appellant had had ample opportunity to make submissions at the hearing. I do not find the Appellant's reminder helpful.

The Board's original and administrative function

72. Before I consider the grounds of appeal given in accordance with section 66(1), I must bear in mind the Board's function.

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9 [2014] 5 HKLRD 384.
10 [2014] 5 HKLRD 384.

73. On an appeal to the Board, the Board, not the Commissioner, is the fact finding body and the decision maker. The appeal is an appeal *from* a determination but against an assessment.

74. The Board must consider the matter from the beginning, *anew*, and its 'ultimate function' is to 'confirm, reduce, increase or annul the assessment' appealed against.

75. In Shui On Credit Company Limited v Commissioner of Inland Revenue[11], Lord Walker of Gestingthorpe NPJ said in the Court of Final Appeal judgment at paragraphs 29 and 30 that the Board's duty is to perform an *original and administrative*, not an appellate and judicial, function of considering what the proper assessment should be:

> ' *29. As the Board correctly observed, by reference to the decisions in Mok Tsze Fung v. CIR [1962] HKLR 258 and (after the amendment of s.64 of the IRO) CIR v. The Hong Kong Bottlers Ltd [1970] HKLR 581, the Commissioner's function, once objections had been made by the taxpayer, was to make a general review of the correctness of the assessment. In Mok Tsze Fung v Commissioner of Inland Revenue, Mills-Owens J said at pp 274-275: 'His duty is to review and revise the assessment and this, in my view, requires him to perform an original and administrative, not an appellate and judicial, function of considering what the proper assessment should be. He acts de novo, putting himself in the place of the Assessor, and forms, as it were, a second opinion in substitution for the opinion of the Assessor*' (emphasis added).
>
> ' *30. Similarly the Board's function, on hearing an appeal under s.68, is to consider the matter de novo: CIR v. Board of Review ex parte Herald International Limited [1964] HKLR 224, 237. The taxpayer's appeal is from a determination (s.64(4)) but it is against an assessment (s.68(3) and (4)) ...*'

76. Findings of fact are to be made by the Board which performs an *original and administrative* function of considering what the proper assessment should be. Subject to an appeal by way of case stated, the decision of the Board shall be final by reason of section 69. Whether the Commissioner has erred in his findings or reasons is beside the point. The real issue is whether the assessment appealed against is incorrect or excessive.

77. In Lee Yee Shing Jacky and another v Board of Review (Inland Revenue Ordinance) and another[12], Tang VP, as he then was, noted in paragraph 11 that:

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11 (2009) 12 HKCFAR 392.

12 [2012] 2 HKLRD 981.

> ' *The parties have proceeded on the basis that Article 10 [of the Hong Kong Bill of Rights] applies to the proceedings before the Board of Review, and that the Board of Review is an administrative tribunal.*'

His Lordship noted by footnote 3 that:

> ' *Lam J pointed out at para 100 of his judgment and I respectfully agree:*
>
> > *"[The Board of Review] exercises a function which is recognisably a judicial function, and does so in the public interest. It acts in accordance with detailed procedural rules which have close similarities to those followed in courts of law. Nevertheless it is not part of the judicial system of the state. Instead it is exercising (albeit with statutory sanction) [an administrative appeal function in aid of the duty of the Commissioner in tax assessment]."*'

78. Bearing in mind the nature of an appeal to the Board of Review and the function of the Board, whether:

(1) 'the Commissioner erred in taking the view …';

(2) 'the Commissioner erred in failing to take into account …';

(3) 'the Commissioner erred in holding …'; and

(4) 'the Commissioner erred in assessing';

as the Appellant contended in its grounds of appeal, are quite beside the point.

Burden of proof and accounts

79. Section 68(4) provides that:

> ' *The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant*'.

80. In Kim Eng Securities (Hong Kong) Ltd v CIR[13], Bokhary PJ referred in paragraph 5 to counsel for the taxpayer's citation of Wing Tai Development Co Ltd v CIR[14] on section 68(4) and stated at paragraph 50 that a taxpayer is not entitled to benefit from sparsity in evidence as it bears the burden of showing that the assessments are wrong:

[13] (2007) 10 HKCFAR 213.
[14] [1979] HKLR 642.

> ' *In relation to dealings on the other foreign stock exchanges, the evidence is sparse. The Taxpayer is not in the position to benefit from such sparsity. After all, it bears the burden of showing that the assessments are wrong.*'

81. In Secan[15], Lord Millett NPJ considered section 16 on deduction of expenses and pointed out that section 16 is to be read in a negative sense in that it permits outgoings to be deducted only to the extent to which they are incurred in the relevant year.

> ' *... s. 16 of the Ordinance lies at the heart of this case. It provides that in ascertaining the assessable profits for any year of assessment:*
>
> > *"there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment ... including –*
> >
> > *(a) ... interest ..."* (my emphasis).
>
> *Both parties agree that the section is mandatory, that is to say, that it positively compels the taxpayer to deduct outgoings, including interest, in ascertaining its assessable profits. But the profits of a business cannot be ascertained without deducting the expenses and outgoings incurred in making them, and the section is not needed to authorise them to be deducted. Sections 16 and 17 (which disallows certain deductions) are enacted for the protection of the revenue, not the taxpayer, and in my opinion section 16 is to be read in a negative sense. It permits outgoings to be deducted only to the extent to which they are incurred in the relevant year. In this respect there is no difference between the law of Hong Kong and the law of England. In both jurisdictions expenses and outgoings are deductible in the year in which they are incurred and not otherwise. Nothing, however, turns on this, for it is common ground that the taxpayer is entitled to re-open an assessment if an error, such as an accidental failure to make a deduction, is discovered in time.*
>
> *Two observations are necessary at this point. First, the section is concerned solely with deductions, that is to say the debit side of the account. It says nothing about the credit side. Secondly, the section is not limited to interest. It applies to expenses and outgoings of all kinds, provided only that they are of a revenue and not a capital nature. Thus it applies to the* ***original***[16] *cost of the site and construction costs as it applies to interest.*' [17]

82. In Real Estate Investments (NT) Limited v Commissioner of Inland Revenue[18], Bokhary and Chan PJJ said at paragraphs 32 – 35 that consistency between a taxpayer's

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15 (2000) 3 HKCFAR 411.
16 Emphasis added. See also computation referred to in paragraph 63 above.
17 Pages 419 H – 420 D.
18 (2008) 11 HKCFAR 433.

audited accounts and its stance does not go so far as to set up a *prima facie* case of that stance's correctness in law and that the notion of a shifting onus, is seldom if ever helpful and certainly it cannot shift the onus of proof from where section 68(4) places it:

> ' *32. ... 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.*
>
> *33. As noted above, the Property had been described in the Taxpayer's accounts from 1980 to 1995 as a fixed asset. It is argued on the Taxpayer's behalf as follows. Such accounting treatment gave rise to a prima facie case that the profits in question arose from the sale of a capital asset. Consequently, the onus of proof shifted so that the Revenue had to show by evidence that the assessments were correct.*
>
> *34. That argument is misconceived. Consistency between a taxpayer's audited accounts and its stance does not go so far as to set up a prima facie case of that stance's correctness in law. Where a taxpayer's audited accounts are consistent with its stance, such consistency is some evidence in support of that stance. Even where accounting treatment amounts to strong evidence, it still falls to be considered together with the rest of the evidence adduced in the case.*
>
> *35. 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.*'

83. In Nice Cheer Investment Limited v Commissioner of Inland Revenue[19], Lord Millett NPJ explained that both profits and losses must be ascertained in accordance with the ordinary principles of commercial accounting *as modified to conform with the Ordinance* and that 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.

> ' *The role of the principles of commercial accounting*
>
> *33. The Commissioner submitted that the amount of any profits or losses during the year of assessment must be ascertained by reference to the*

[19] [2014] 2 HKC 112. Also reported in (2013-14) IRBRD, vol 28, 527.

ordinary principles of commercial accounting unless these are contrary to an express statutory provision in the Ordinance, and relied on the decision of this Court in Commissioner of Inland Revenue v Secan Ltd[20] *for this purpose. That is a misreading of my judgment in that case. After citing the celebrated passage in the judgment of Sir John Pennycuick VC in Odeon Associated Theatres Limited v Jones*[21]*, in which he explained the relationship between accountancy evidence and the ascertainment of the taxpayer's assessable profits, I said*[22]*:*

> *"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."*

It should be noted that I said "in conformity with the Ordinance", not "in conformity with an express provision of the Ordinance".

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"[23]*.*'

' *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*

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20 (2000) 3 HKCFAR 411.
21 48 TC 257 at page 273.
22 At page 419.
23 Duple Motor Bodies Ltd v Inland Revenue Commissioners (note 15 supra) at page 753 per Lord Reid.

principles of taxation enunciated by the courts even if these are not expressly stated in the statute[24]*. In Willingale v International Commercial Bank*[25] *Lord Fraser said that*

> *"... where ordinary commercial principles run counter to the principles of income tax they must yield to the latter when computing profits or gains for tax purposes." (my emphasis)*

There are many other statements in the authorities to the same effect.

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. In the passage cited above from his speech in B S C Footwear Ltd v Ridgway[26] *Lord Reid stated in terms that*

> *"The application of the principles of commercial accountancy is, however, subject to one well-established though non-statutory principle. Neither profit nor loss may be anticipated."*

In Willingale v International Commercial Bank[27] *it was common ground that the taxpayer's accounts were drawn up in accordance with the principles of commercial accountancy*[28]*. Yet they were held to be "not a proper basis for assessing [its] liability for corporation tax" because they contravened the rule that profits may not be anticipated (per Lord Fraser*[29]*) or that a profit may not be taxed until realised (per Lord Keith*[30]*).*'

' *Financial Statements*

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

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24 See B S C Footwear Ltd v Ridgway (note 16 supra) at page 562 per Lord Guest.
25 Note 17 supra.
26 Note 23 supra.
27 Supra note 17.
28 See [1977] Ch At pages 97-8 per Sir John Pennycuick.
29 At page 847.
30 At page 852.

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*[31]*. 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. In Minister of National Revenue v Anaconda American Brass Ltd*[32] *Viscount Simonds, giving the opinion of the Privy Council, said*

> *"Their Lordships do not question that the Lifo method or some variant of it may be appropriate for the corporate purpose of a trading company. Business men and their accountant advisers must have in mind not only the fiscal year with which alone the Minister is concerned. It may well be prudent for them to carry in their books stock valued at a figure which represents neither market value nor its actual cost but the lower cost at which similar stock was bought long ago. A hidden reserve is thus created which may be of use in future years. But the Income Tax Act is not in the year 1947 concerned with the years 1948 or 1949: by that time the company may have gone out of existence and its assets been distributed … the evidence of expert witnesses, that the Lifo method is a generally acceptable, and in this case the most appropriate method of accountancy, is not conclusive of the question that the court has to decide. That may be found as a fact by the Exchequer Court and affirmed by the Supreme Court. The question remains whether it conforms to the prescription of the Income Tax Act. As already indicated, in their Lordships' opinion it does not."*

In Willingale v International Commercial Bank, where the taxpayer's financial statements were found to be drawn up in a way which anticipated future profits, Lord Fraser said that there were no doubt excellent commercial reasons for preparing the accounts in that way and borrowed the words of Walton J[33] *that they*

> *"are much better economic indicators than corporation tax accounts would be as to whether a bank is or is not doing what it*

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31 See the observations of Lord Warrington of Clyffe in The Naval Colliery case cited in paragraph 14 supra.

32 [1956] AC 85, 102.

33 [1976] 1 WLR 657, 663.

> *ought to be doing, that is to say, steadily making an economic profit for its shareholders."*
>
> *Despite this he held that they were not a proper basis for assessing the bank's liability to tax.*'

Capital or trading/business issue

84. Section 2 defines:

- '*business*' as including '*agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government*' and

- '*trade*' as including '*every trade and manufacture, and every adventure and concern in the nature of trade*'.

85. Section 14 is the charging provision on profits tax. Sub-section (1) provides that:

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

86. The 1990 reprint of section 16(1) on ascertainment of chargeable profits provided that:

> ' *In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this part for any period ...*'

The current version (03/03/2014) remains the same.

Simmons

87. Lord Wilberforce stated in Simmons v IRC[34] that the relevant question is whether the stated intention existed at the time of the acquisition of the asset – was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? His Lordship recognised that intention may be changed (at page 1199) and that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention (at page 1202):

> ' *One must ask, first, what the commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: 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, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock - and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax: see Sharkey v. Wernher [1956] A.C. 58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status - neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review.*' (at page 1199)
>
> ' *Finally as to the decision of the Court of Appeal, the judgment, delivered by Orr L.J., contains a clear account of the facts, and, in my respectful opinion, a generally correct statement of the law. In particular, it is rightly recognised that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention.*' (at page 1202)

In the Court of Appeal, Orr L J accepted that it was clearly established that on appeal to the Commissioners[35] the burden is on the taxpayer to displace the assessment and in the circumstances the burden was clearly on the taxpayers to establish that the sales in question gave rise to a surplus on capital account and not to a trading profit. His Lordship stated the general principles in these terms:

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34 [1980] 1 WLR 1196 at page 1199.

35 In Hong Kong, the appeal is to the Board.

> ' *It is also clearly established that on appeal to the Commissioners the burden is on the taxpayer to displace the assessment, and in these circumstances the burden in the present case was clearly on the taxpayers to establish that the sales in question gave rise to a surplus on capital account and not to a trading profit (Norman v Golder 26 TC 293, at page 297, and Shadford v H Fairweather & Co Ltd 43 TC 291, at page 300). On the other hand it is also clear that if an asset is acquired in the first instance as an investment the fact that it is later sold does not take it out of the category of investment or render its disposal a sale in the course of trade unless there has been a change of intention on the part of the owner between the dates of acquisition and disposal (Eames v Stevnell Prouerties Ltd 43 TC 678). The question, moreover, whether an item is held as capital or as stock-in-trade is not concluded by the way in which it has been treated in the owner's books of account (CIR v Scottish Automobile and General Insurance Co Ltd 16 TC 381, at page 390) or by the Revenue in past years (Rellim Ltd v Vise 32 TC 254).*' [l980] 53 TC 461 at pages 488 and 489.

Marson v Morton

88. In Marson v Morton[36], Sir Nicolas Browne-Wilkinson VC thought that the only point which was as a matter of law clear was that a single, one-off transaction can be an adventure in the nature of trade and the question is whether the taxpayer was investing the money or was he doing a deal. His Lordship stated that:

- Only one point is as a matter of law clear, namely that a single, one-off transaction can be an adventure in the nature of trade.

- The purpose of authority is to find principle, not to seek analogies on the facts.

- The question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case.

- The most that his Lordship had been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another and that the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate. The matters which are apparently treated as a badge of trading are as follows:

[36] [1986] 1 WLR 1343 at pages 1347 – 1349.

‘ *(i) The transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.*

(ii) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.

(iii) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the chairman of the commissioners quoted from Inland Revenue Commissioners v. Reinhold, 1953 S.C. 49. For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.

(iv) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?

(v) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.

(vi) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.

(vii) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.

(viii) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a

trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(ix) Did the item purchased either provide enjoyment for the purchaser, for example a picture, or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment.'

- In order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?

All Best Wishes

89. Mortimer J (as he then was) pointed out in All Best Wishes Limited v CIR[37] that – 'was this an adventure and concern in the nature of trade' is a decision of fact and the fact to be decided is defined by the Statute.

' *Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.*' (at page 770)

' *The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.*

I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the

[37] (1992) 3 HKTC 750 at page 770 and page 771.

> *Statute – was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.*' (at page 771)

Lee Yee Shing

90. Lee Yee Shing v Commissioner of Inland Revenue[38] is a case on share dealing activities.

91. Bokhary PJ and Chan PJ emphasised at paragraph 38 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances. McHugh NPJ thought that ultimately, the issue is one of fact and degree.

92. On the question of 'trade', McHugh NPJ pointed out that the intention to trade referred to by Lord Wilberforce in Simmons was not subjective, but objective, to be inferred from all the circumstances of the case. His Lordship stated that:

> (a) No principle of law defines trade. Its application requires the tribunal of fact to make a value judgment after examining all the circumstances involved in the activities claimed to be a trade. (at paragraph 56)
>
> (b) The intention to trade to which Lord Wilberforce referred in Simmons is not subjective but objective: Iswera v Commissioner of Inland Revenue [1965] 1 WLR 663 at 668. It is inferred from all the circumstances of the case, as Mortimer J pointed out in All Best Wishes Ltd v. Commissioner of Inland Revenue (1992) 3 HKTC 750 at 771. A distinction has to be drawn between the case where the taxpayer concedes that he or she had the intention to resell for profit when the asset or commodity was acquired and the case where the taxpayer asserts that no such intention

[38] (2008) 11 HKCFAR 6.

existed. If the taxpayer concedes the intention in a case where the taxing authority claims that a profit is assessable to tax, the concession is generally but not always decisive of intention: Inland Revenue Commissioners v. Reinhold (1953) 34 TC 389. However, in cases where the taxpayer is claiming that a loss is an allowable deduction because he or she had an intention to resell for profit or where the taxpayer has made a profit but denies an intention to resell at the date of acquisition, the tribunal of fact determines the intention issue objectively by examining all the circumstances of the case. It examines the circumstances to see whether the 'badges of trade' are or are not present. In substance, it is 'the badges of trade' that are the criteria for determining what Lord Wilberforce called 'an operation of trade'. (at paragraph 59)

(c) What then are the 'badges of trade' that indicate an intention to trade or, perhaps more correctly, the carrying on of a trade? An examination of the many cases on the subject indicates that, for most cases, they are whether the taxpayer:

1. has frequently engaged in similar transactions?

2. has held the asset or commodity for a lengthy period?

3. has acquired an asset or commodity that is normally the subject of trading rather than investment?

4. has bought large quantities or numbers of the commodity or asset?

5. has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?

6. has sought to add re-sale value to the asset by additions or repair?

7. has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?

8. has conceded an actual intention to resell at a profit when the asset or commodity was acquired?

9. has purchased the asset or commodity for personal use or pleasure or for income? (at paragraph 60)

(d) In some cases, the source of finance for the purchase may also be a badge of trade, particularly where the asset or commodity is sold shortly after

> purchase. But borrowing to acquire an asset or commodity is usually a neutral factor. (at paragraph 61)

93. On the question of 'business', it has long been recognised that business is a wider concept than trade, per Bokhary PJ and Chan PJ at paragraph 17. McHugh NPJ is of the same view, stating in paragraph 68 that business is a wider term than trade. McHugh NPJ went on to state that:

> (a) What then is the definition or ordinary meaning of 'business'? The answer is that there is no definition or ordinary meaning that can be universally applied. Nevertheless, ever since Smith v. Anderson (1880) 15 Ch D 247, common law courts have never doubted that the expression 'carrying on' implies a repetition of acts and that, in the expression 'carrying on a business', the series of acts must be such that they constitute a business: Smith v. Anderson (1880) 15 Ch D 247 at 277 – 278 per Brett LJ. Much assistance in this context is also gained from the statement of Richardson J in Calkin v. Commissioner of Inland Revenue [1984] 1 NZLR 440 at 446 where he said 'that underlying … the term "business" itself when used in the context of a taxation statute, is the fundamental notion of the exercise of an activity in an organised and coherent way and one which is directed to an end result'. In Rangatira Ltd v. Commissioner of Inland Revenue [1997] STC 47, the Judicial Committee said that it found these words of Richardson J 'of assistance'. (at paragraph 69).
>
> (b) Ordinarily, a series of acts will not constitute a business unless they are continuous and repetitive and done for the purpose of making a gain or profit: Hope v. Bathurst City Council (1980) 144 CLR 1 at 8 – 9 per Mason J; Ferguson v. Federal Commissioner of Taxation (1979) 79 ATC 4261 at 4264. However, as Lord Diplock pointed out in American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia) [1979] AC 676 at 684 'depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between'. Exceptionally, a business may exist although the shareholders or members cannot obtain any gain or profit from the activities of the business: Inland Revenue Commissioners v. Incorporated Council of Law Reporting (1888) 22 QBD 279 (law reporting body prohibited by its constitution from dividing profits among members). It may exist even though the object of the activities is to make a loss: c.f. Griffiths v. JP Harrison (Watford) Ltd [1963] AC 1 (dividend stripping operation). And a corporation, firm or business may carry on business in a particular country even though its profits are earned in another country: South India Shipping Corp Ltd v. Export-Import Bank of Korea [1985] 2 All ER 219. (at paragraph 70)

(c) While engaging in activities with a view to profit making is an important indicator, and in some cases an essential characteristic, of a business, a profit making purpose does not conclude the question whether the activities constitute a business. Whether or not they do depends on a careful analysis of all the circumstances surrounding the activities. Some may indicate the existence of a business; some may indicate that no business exists. Ultimately, the issue is one of fact and degree. But, as Edwards v. Bairstow [1956] AC 14, Hope v. Bathurst City Council (1980) 144 CLR 1 and Lewis Emanuel & Son Ltd v. White (1965) 42 TC 369 show, the issue becomes one of law and not fact where the only reasonable conclusion to be drawn from the facts found or admitted is that the activities in question did or did not constitute the carrying on of a business. In such a case, an appellate court, although debarred from finding facts, may reverse the finding of the tribunal of fact and hold that a business was or was not being carried on. (at paragraph 71)

Real Estate Investments

94. In Real Estate Investments, Bokhary PJ and Chan PJ stated that, given section 68(4), it is possible although rare for such an appeal to end – and be disposed of – on the basis of burden of proof and that the onus cannot be shifted:

> ' *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.

95. Their Lordships went on to state that:

- the badges of trade are no less helpful here than in the United Kingdom;
- they do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention; and
- the question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.

‘ *It is clear that question (ii)(b) uses the expression ‘badges of trade’ to mean the circumstances that shed light on the issue of intention. Those circumstances simply do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention*’, at paragraph 40.

‘ *Suppose a tax assessment is made on the footing that the position is X and the taxpayer appeals against the assessment by contending that the position is Y. The taxpayer will have to prove his contention. So his appeal to the Board of Review would fail if the Board positively determines that, contrary to his contention, the position is X. And it would likewise fail if the Board merely determines that he has not proved his contention that the position is Y. Either way, no appeal by the taxpayer against the Board’s decision could succeed on the ‘true and only reasonable conclusion’ basis unless the court is of the view that the true and only reasonable conclusion is that the position is Y*’, at paragraph 47.

‘ *... the list offered in Marson v. Morton is no less helpful in Hong Kong than it is in the United Kingdom. As the Privy Council observed in Beautiland Co. Ltd v. CIR [1991] 2 HKLR 511 at p.515G, there is no material difference between the Hong Kong and United Kingdom definitions of trade for tax purposes. Both include every adventure in the nature of trade*’ at paragraph 53.

‘ *In regard to one of the badges of trade which he listed in Marson v. Morton, the Vice-Chancellor said this (at p.1348 F-G):*

> *“What was the source of finance of the transaction? If money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.”*

That is as far as it goes, which is not very far when taken on its own. At p.1349 C-D the Vice-Chancellor emphasised that his list is not comprehensive, that no single item is in any way decisive and that it is always necessary to look at the whole picture.

The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case’ at paragraphs 54 – 55.

Crawford Realty Ltd v Commissioner of Inland Revenue[39]

96. In Crawford Realty Ltd v Commissioner of Inland Revenue[40], the Board concluded as follows:

> ' *What we have is a standard type of joint venture development agreement under which the developer, Company A, is entitled to be repaid his development costs out of the proceeds of sale of the new building. The value attributed to the land is not payable to the Taxpayer in advance of and in priority to all the other liabilities as would be the case if this were a sale but is deferred to certain other payments. The protection of the Taxpayer lay in the fact that the Taxpayer could cancel the Agreement and take back the second properties if it wished during the course of the development period.*
>
> *It is not necessary for us to go through the Development Agreement clause by clause and provision by provision to demonstrate that it is clearly a joint venture development and not a sale and purchase agreement. The document speaks for itself.*
>
> *On the evidence and facts before us we have no hesitation in finding in favour of the Commissioner and upholding the assessments appealed against.*'

97. It is not easy to follow the Board's reasoning in that case. On appeal, Barnett J accepted that:

> ' *it is possible to quibble with the way in which the Board expressed its conclusion*' [41].

98. The taxpayer's primary complaint on appeal to the High Court was that:

> ' *the Board failed to ask itself the right question or apply the correct test. Effectively, it contended that the Board asked itself whether the Agreement was a joint venture or a sale and purchase, and having found the agreement to be a standard form of joint venture, assumed that it followed that the Appellant was trading. Such an assumption, the Appellant argued, is not permissible.*' [42]

99. Barnett J agreed that such an assumption was not permissible. I interpose to add that it is trite law that 'the question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.'[43] Making a joint venture agreement was not dispositive of the question.

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39 (1991) 3 HKTC 674 at page 687.
40 (1991) 3 HKTC 674 at page 687.
41 (1991) 3 HKTC 674 at page 693. See also paragraph 100 below.
42 (1991) 3 HKTC 674 at page 688.
43 See paragraph 95 above.

The assumption was clearly wrong. But that does not mean making a joint venture agreement was irrelevant and the judge did not so rule. He was dealing with the way the Board wrote its conclusion and with the taxpayer's primary complaint. He said[44]:

> ' *I agree that such an assumption is not permissible. I do not agree, however, that the Board was in error. The Board, in its summary of counsels' submissions, referred to "well established law that the mere realization of non-trading assets will not convert them into trading transaction" and that the Agreement "went far beyond the mere realization and concluded, although not expressly, that it found the activity to have been an adventure in the nature of trade. That this was its finding or conclusion is implicitly accepted by the wording of questions (1) and (2)." Accordingly, I find nothing in this complaint.'*

100. Indeed, in Church Body of the Hong Kong Sheng Kung Hui and another v CIR[45], Cheung JA said what Barnett J really wanted to say was as follows:

> ' *…what Barnett J really wanted to say was that by the time the taxpayer had entered into the development agreement, the activities had gone beyond mere enhancement for the purpose of realizing the old property for its maximum profit. The taxpayer was then engaged in trade. Hence earlier he emphasized the importance of the development agreement that the taxpayer had entered into with the developer :*
>
> > *"the nature and implications of the agreement seem to me to be crucial. I do not find it surprising that the Board should focus upon the agreement albeit not to the total exclusion of the other relevant factors. As I have already said I do not find the Board to have excluded those other factors."'*

101. Cheung JA cited Hong Kong Oxygen & Acetylene Co Ltd v CIR[46] as another example that the taxpayer formed the trading intention when its board gave its approval and decided to proceed with the joint venture agreement[47].

102. Coming back to Crawford, Barnett J[48] went on to draw a distinction between enhancement and substitution of an asset:

> ' *In my judgment what the Board is clearly saying is that, while having in mind all the considerations urged on it by counsel, the activity constituted by the Agreement was such that it outweighed, and outweighed heavily, those*

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44 (1991) 3 HKTC 674 at page 688.
45 [2014] 5 HKLRD 384 at paragraph 12.17.
46 [2001] 1 HKLRD 489.
47 See paragraph 12.18 of the Judgment.
48 (1991) 3 HKTC 674 at page 693 at paragraph 12.17.

considerations. I am unable to say the Board was wrong. Enhancement of an asset, making it as attractive and saleable as reasonable expenditure of time and money can achieve, is one thing. The end product remains substantially the same. Substitution, however, is another matter. It is the taking of one's old car, removing the bodywork, engine and suspension from the chassis and replacing them with the latest styling and mechanical components. And that is effectively what happened here. The Appellant obtained a price for the old car in excess of its apparent value (about which no complaint is made by the Commissioner) but then went on to participate in the expenditure of time and money on rebuilding the car with new components in the hope of another profit therefrom. The Appellant was actively involved in this process. Without going so far as to say the Board could have come to no other conclusion, I do not find it difficult to see why the Board reached the conclusion it did. As the Board says, "the document speaks for itself".

I accept that it is possible to quibble with the way in which the Board expressed its conclusion. I am satisfied, however, that there is foundation for all the points made by the Board which, perhaps somewhat clumsily, is essentially seeking to say that the signposts point not to mere realization but rather a profit making scheme amounting to an adventure.'

Church Body of the Hong Kong Sheng Kung Hui and another v CIR[49]

103. The facts in Church Body, taken from paragraph 2.2 – 2.15 of the Judgment, were as follows:

'*2.2 The Church Body and the Foundation owned certain land ("the Old Lots") in Tai Po, New Territories. Part of the Old Lots was occupied by an orphanage known as the St Christopher's Home ("the Home"). The Old Lots had belonged to the Church Body and the Foundation since the 1930s. The Church Body and the Foundation had planned since the 1970s to develop the Old Lots.*

2.3 Although there had been discussions in the 1970s to use the land adjacent to the Home as a retirement village for the clergy, that plan was put on hold in the 1980s and never revived.

2.4 In the 1980s there had also been talk about refurbishing the Home. But the Home was so old that renovation was unlikely to prolong its life for more than 5 years. Eventually, from September 1989 at the latest, the re-provisioning of the Home was treated as a separate project from the development of the Old Lots. In September 1989, the proposal being seriously considered in relation to the Home was to re-locate the children's section of the Home to an adjacent site, the babies' section to

[49] [2014] 5 HKLRD 384.

Yuen Long, and the rest of the Home to another location in Tai Po owned by the Foundation.

2.5 In the early 1990s, architects commissioned by the Church Body and the Foundation submitted various plans to the Government for the purpose of obtaining town planning permission for a substantial residential development in the Old Lots. A set of plans were approved by the Town Planning Board in July 1990.

2.6 In December 1990 architects applied on behalf of the Church Body and the Foundation to the Districts Land Office Tai Po for a land exchange of the Old Lots to permit the building of the residential development as approved.

2.7 In May 1993 a premium of some $704 million was agreed between Government, the Church Body and the Foundation.

2.8 In July 1993 the Church Body and the Foundation invited various developers to submit tender offers for two options. Option A was for the outright purchase of the Old Lots at a consideration inclusive of the $704 million premium. Option B entailed the establishment of a joint venture with the Church Body and Foundation for the redevelopment of the Old Lots.

2.9 In August 1993 the Church Body and the Foundation accepted a tender from Cheung Kong (Holdings) Limited ('Cheung Kong') for Option B.

2.10 In November 1993 the Church Body and the Foundation surrendered the Old Lots to the Government in exchange for a new grant of the land ("the New Lot"). The Church Body and the Foundation owned the New Lot as tenants-in-common in the ratio of 44:56.

2.11 In December 1993 the Church Body and the Foundation entered into a joint venture agreement with Cheung Kong and one of its subsidiaries (collectively, the Developers) for the development of the New Lot as a private residential area.

2.12 In March 1998 the Church Body, the Foundation and the Developers agreed that 129 residential units and 94 car parking spaces in the development would be allocated to the Church Body and the Foundation.

2.13 In August 1998 the Government issued an occupation permit for the development (which had been named "Deerhill Bay"). Deerhill Bay

comprised 22 houses, five blocks of low-rise buildings and five blocks of high-rise buildings. It had 381 residential units in all.

2.14 Between 1998 and 2006, the Church Body and the Foundation sold their residential units and car-parking spaces at Deerhill Bay. From the sales, the Church Body derived a profit of some $452 million, while the Foundation made a profit of some $667 million.

2.15 The Church Body's tax liability is $75,881,426. The Foundation's tax liability is $108,912,965.'

104. The Board in that case decided in favour of the Revenue[50].

' *The Board held that, although the Church Body and Foundation had initially acquired the Old Lots as a capital asset, their initial intention changed to one of using the Old Lots (or parts thereof) for the purpose of trading or business. According to the Board, that change of intention had occurred by September 1989 or, alternatively, December 1990 at the latest. The reasonings of the Board are as follows:*

' *70. Mr Li Fook Hing was appointed a co-chairman of the Tai Po Kau Joint Development Committee in May 1989, after the re-provisioning of the Home had been separated from the development of the Old Lots and the retirement village project had been frozen for a long time. It is clear from the evidence of Mr. Li [Fook Hing] that he approached the matter on commercial principles, with the laudable object of raising as much income as possible for [the Church] and its charitable activities. [The Church and the Foundation] actively marketed the disposal of the Old Lots by approaching leading developers in Hong Kong for offers and tenders. They sought and subsequently obtained town planning permission. [They] have performed activities in relation to the Old Lots in an organised and coherent way with a view to maximising the income from their development. They sought and subsequently obtained a new grant by surrendering the Old Lots, thereby substituting the Olds Lots by the new Lot. They have chosen to carry on a separate adventure or enterprise of a lucrative commercial and trade character, different and distinct from their charitable work.*"'

105. At paragraph 12.19, Cheung JA held that the Board erred:

' *In the present case, while a charity may be engaged in trade, in my view, an error of law had been made by the Board when it held that there was a change*

[50] See paragraph 3.1 of the Judgment.

of intention in 1989 or 1990 when, on the facts found by the Board, all that the taxpayers had done was to have engaged in the process of realizing the Old Lots. It cannot be said that in 1989 or 1990 the taxpayers had become a property developer engaged in the trade of selling flats. In my view, even if the Board purported to apply the enhancement principle, it had not properly done so.'

106. Cheung JA went on to explain the remission of the case to the Board:

'*Although it is not necessary for me to decide, and I will refrain from so deciding, there may well be a valid argument that there was a change of intention to trade when the taxpayers entered into the Joint Venture Agreement on 12 August 1993 with Cheung Kong.*'[51]

'*He argued that it is wrong in law to assume that a joint venture agreement must involve trading/business. Reliance was placed by Mr Chang on the comments by Barnett J in Crawford Realty Ltd that it was 'not permissible' to assume that a joint venture agreement (instead of a sale and purchase) must involve trading (p.688); and that: "[t]he nature and implications of the Agreement" were "crucial" (p.693).*'[52]

'*In my view the further point taken by Mr Chang does not call for discussion in view of the lack of analysis by the Board on this topic. It is sufficient for the purpose of this appeal, in relation to Question 1, to decide whether the conclusion of the Board that there was a change of intention in 1989 or 1990 was in error. The issue whether the change occurred in some other subsequent dates could only be decided by the Board when the matter is remitted to it for consideration.*'[53]

'*However, I would remit the matter to the Board to consider whether the change of intention occurred in August 1993 or December 1993 or alternatively some other date or dates (other than September 1989 or December 1990).*'[54]

First ground of appeal

107. The first ground of appeal reads as follows:

'the Commissioner erred in taking the view that the Company has changed its intention towards the Land so that it ceased to be a capital asset and became trading stock on 21 April 1994 when its directors resolved to proceed with

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51 At paragraph 12.22.
52 At paragraph 12.23.
53 At paragraph 12.24.
54 At paragraph 12.25.

discussions with Company A for a joint development of Land (or indeed at any other time)'.

Whether change of intention

108. Paragraphs 23 to 32 above set out the agreed facts on the steps taken by the Appellant from 1991 to 1994 in retaining professional advisers and experts to seek and obtain:

(1) the Town Planning Board's permission to develop an industrial/office building at the Lot;

(2) the District Lands Office/Kowloon East's agreement for modification of the leasehold conditions;

(3) the Buildings Department's approval of building plans regarding the proposed industrial/office building at the Lot; and

(4) valuation[55] of the proposed composite industrial/office building at the Lot.

109. In doing so, the Appellant incurred fees, costs and expenses, including:

- The fees proposed by Company Y in its letter dated 9 October 1992 referred to in paragraph 26 above in the sums of:

  (a) Stage 1 only: $800,000.

  (b) Stages 1 and 2: $6,200,000.

  The proposal was accepted by the Appellant on 2 November 1992.

- The administrative fee stated in the letter dated 2 February 1994 referred to in paragraph 30 above for the surrender and regrant in the sum of $100,000. A copy of the receipted demand note for the administrative fee was attached to the letter dated 25 February 1994 referred to in paragraph 31 above. Company X went on to state:

  > ' We … shall be grateful if you[56] will now please prepare the necessary documentation for execution by our clients.'

110. The minutes dated 21 April 1994 referred to in paragraph 33 above recorded:

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55 The valuation was obtained on 23 April 1994, see paragraph 34 above.

56 i.e. DLO/KE.

- the decision 'for internal purposes' to carry out 'in an entity separate from [the Appellant]' 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*[57] with Company A'.

111. As stated in paragraphs 35 and 36 above, Company A held a meeting with the Appellant on 25 April 1994 and proposed to the Appellant on 4 May 1994 a joint venture arrangement for the redevelopment of the Lot.

112. The Redevelopment Agreement dated 30 July 1994 referred to in paragraph 37 above entered into by the Appellant, Company B and Company A contained, *inter alia*, the following terms:

> Recital (3): '[The Appellant] has resolved to grant permission to the [Company B] 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 Appellant] intends to transfer the registered and beneficial ownership of the Lot to its wholly owned subsidiary (Company AF).'
>
> Clause 3.02: '[Company B] shall pay to [the Appellant] as consideration for [the Appellant] granting to [Company B] the right to redevelop the Lot in accordance with the terms of this [Agreement] an Initial Payment totalling HK$165,104,100 as follows:
>
> (i) the sum of HK$30,000,000 forthwith upon the signing of this agreement[58];
>
> (ii) a further sum of HK$70,000,000 within seven (7) Business Days after written confirmation from Government being received by [Company B] that the Conditions has been duly executed by all parties[59];

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57 Emphasis added.

58 The Redevelopment Agreement was signed on 30 July 1994, see paragraph 37 above.

59 On 6 August 1994, the Appellant and the Government entered into the agreement and conditions of exchange in respect of the Lot, see paragraph 38 above.

(iii) A further sum of HK$65,104,100 upon vacant possession of the Lot together with any buildings thereupon being delivered to [Company B] free from encumbrances or rights which are capable of preventing the Development. Vacant possession shall mean the handing over of the Lot to [Company B] free from any occupant(s) as curtained by joint inspection of [Company AF] and [Company B]. [Company AF] shall give to [Company B] seven (7) Business Days prior notice of the date vacant possession will be given to [Company B]'[60].

Clause 5.01 'Within four (4) months after the date of issue of the Conditions [the Appellant] shall at its sole cost and expense transfer the registered and beneficial ownership of the Lot to [Company AF][61] subject to [Company AF][62] executing the new agreement referred to in Clause 5.02 below.'

Clause 5.02 '[The Appellant] hereby agrees and undertakes with [Company B] to procure that [Company AF] 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 [Company B] and [Company A] in the form as set out in Appendix II. [Company B] and [Company A] agree and undertake with [the Appellant] that they shall enter into the New Agreement with [Company AF]. Should [Company AF] 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[63] and [the Appellant] shall be deemed to have replaced [Company AF] in its position and continue as the registered and beneficial owner of the Lot under the New Agreement …'

Clause 8 '8. *JOINT VENTURE*[64]

8.01 This Agreement is *in the nature of a joint venture and sale and purchase of interest in property* [65] …'

Clause 15 '15. *BINDING EFFECT*[66]

60 Vacant possession was delivered to Company B on 9 December 1994, see paragraph 41 above.
61 Company AF was not a party to the Redevelopment Agreement.
62 Company AF was not a party to the Redevelopment Agreement.
63 Company AF was not a party to the Redevelopment Agreement.
64 Emphasis added.
65 Emphasis added.
66 Emphasis added.

15.01 This Agreement shall be *binding*[67] upon and enure to the benefit of the *parties hereto*[68] and their respective successors and permitted assigns (as the case may be).'

113. The consideration stated in the assignment of the Lot dated 14 November 1994 referred to in paragraph 39 above by the Appellant to its wholly owned subsidiary, Company C, was $314,315,900. As a matter of arithmetic, $314,315,900 + $165,104,100[69] - $61,420,000[70] = $418,000,000[71].

114. This gives the impression that the disposal of the Lot by the Appellant to its subsidiary, Company C, was at Company Z's valuation.

115. However, the amount which the Appellant and its subsidiary, Company C, put as the sale and purchase price was of no concern to:

- Company B and Company A[72]; and
- the Appellant and its subsidiary, Company C. As Lord Hoffmann NPJ said in paragraph 26 in Tai Hing Cotton Mill Ltd v CIR[73]:

> ' *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.*'

In my view, it did not matter to the Appellant and Company C what the consideration of the sale of the Lot by the Appellant to Company C was. In economic terms, the result would have been exactly the same whatever the consideration was. I do not see any real purpose of seeking or obtaining Company Z's valuation.

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67 Emphasis added.

68 Emphasis added.

69 The Initial Payment payable by Company B to the Appellant to be added to the sales price of the sale by the Appellant to Company C to arrive at the total amount received by the Appellant.

70 As Company Z's valuation did not take into account the premium payable, the premium must be deducted in order to obtain a modification of the Government lease to permit redevelopment and to obtain a sales price on the footing that redevelopment was permitted under the lease as modified, see paragraph 30 above.

71 The valuation placed by Company Z on the Lot.

72 It does not affect the pockets of Company A and Company B at all.

73 (2007) 10 HKCFAR 704.

116. The Appellant's ownership of the Lot comprised ownership of the land and ownership of the old building thereon. However:

(1) The old Lot was to be surrendered. The proposed re-grant may be *in situ*, but it is nevertheless a new grant.

(2) The old building was to be demolished.

In my decision, 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.

117. When Mr G 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 Paul Shieh SC described as a forthright answer – Mr G wanted to make more money as the price might go up after redevelopment.

' Q Did you want to sell the whole land, the lot, to [Company A] in return for a purchase price?

A I cannot recall.

Q Because the minutes talked about redevelopment of the site and subsequent sale would be an appropriate method for [Company AE] to realise its long-term asset.

A Yes.

Q So, at the time of this meeting, at the time of this meeting, the thinking of the board was not that the land would be sold outright to [Company A]?

A At first we intended to sell.

Q But by the time of this meeting the thinking of the board was that the transaction was not a sale of the factory and the land?

A I don't know how to express.

Q Instead the transaction was going to be a cooperation with [Company A] whereby the building was to be knocked down, a new building was to be built, units were going to be sold and proceeds to be divided and shared?

A Yes.

Q Thank you. Why did the transaction take place in this way rather than simply an outright sale of the factory and the land to [Company A]?

A We were hoping to make more money because whether we cooperation and then we could-, the price could have value added on it.

MR SHIEH: I have no further questions.

CHAIRMAN: He is looking for a better price which, land price, may go up at the time of completion of the building.

INTERPRETER: I beg your pardon?

CHAIRMAN: Is that a correct interpretation?

MR SHIEH: I think he said [in Cantonese]. Unless the witness can perhaps …

CHAIRMAN: Let us just agree a translation of the last one otherwise you go around again.

MR SHIEH: It was actually all recorded anyway therefore I think we can simply later on replay the tape.

CHAIRMAN: The transcript is only in English.

MR SHIEH: Perhaps I can re-put the question again. When you said you want to make more money, how did you intend to make more money?

A When we worked together to build buildings, of course, we were hoping to make more money but whether it is going to happen or not, is not my wish.

Q Because, if you build the building, the eventual units that are sold, they might be sold at more than the price that the land was worth in 1994, correct? That is what you expected?

A This was what I wanted but then the circumstances will change and it may not-, I may not get what I want.'

118. 'Venture' is a common English word. 'Joint venture' is a common English term.

119. The dictionary meaning of a 'venture' is:

- 'a business enterprise involving considerable risk'[74];
- 'a new business or activity'[75].

120. A 'joint venture' means:

- '聯營'[76];
- 'In a business context, this is an arrangement between two or more existing businesses to undertake economic activity together for one particular project or as a continuing business relationship'[77];
- 'an association of persons for particular trading, commercial, mining, or other financial undertakings or endeavours with a view to mutual profit … Any arrangement whereby two or more parties co-operate in order to run a business or to achieve a commercial objective'[78];
- 'a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities[79].

121. The nature of a joint venture involves a commercial, business or trade purpose. Company A, Company B and the Appellant entered into the Redevelopment Agreement to engage in trade with a view to making a profit. I do not accept that Company A and Company B joined hands with the Appellant to merely enhance the old property for the benefit of the Appellant.

122. In my Decision, by the time the Appellant 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[80] on the Appellant. The Appellant was then engaged in trade.

123. Having considered all the circumstances urged on us, I find and hold that:

(1) 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:

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74 The New Oxford Dictionary of English.
75 Macmillan English Dictionary.
76 The English-Chinese Glossary of Legal Terms.
77 Jowitt's Dictionary of English Law.
78 Hong Kong Legal Dictionary.
79 The New Oxford Dictionary of English.
80 Clause 15 of the Redevelopment Agreement.

(a) the [old] Lot and the [old] building thereon ceased to be the Appellant's capital assets; and

(b) the [old] Lot and the [old] building thereon became the Appellant's trading stock;

(3) The change of intention took place on 30 July 1994 when the Appellant entered into the Redevelopment Agreement.

124. The first ground of appeal fails.

The second ground of appeal

125. The second ground of appeal reads as follows:

> ' the Commissioner erred in failing to take into account the fact that the Company and [Company C] were separate legal entities with separate and independent legal rights and obligations'.

126. I have decided in paragraph 123 above that the change of intention took place on 30 July 1994 when the Appellant entered into the Redevelopment Agreement. The change took place before Company C came into existence or the picture. Hence the reference to 'Company AF'. Chargeability arose before Company C came into existence or the picture.

127. In any event, the facts, including:

- the fact that the Redevelopment Agreement purported to bind 'Company AF' before it came into existence or the picture; and

- the facts stated in paragraphs 47 and 48 above;

showed that Company C was the Appellant's alter ego.

128. I fail to see any significance of the second ground of appeal on the question of the chargeability of the Initial Payment.

129. The second ground of appeal fails.

The third ground of appeal

130. The third ground of appeal reads as follows:

> ' the Commissioner erred in holding that the Initial Payment constituted assessable profits'.

131. I 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.

132. Clause 3.02 of the Redevelopment Agreement provided, *inter alia*, that:

> ' [Company B] shall pay to [the Appellant] as consideration for [the Appellant] granting to [Company B] the right to redevelop the Lot in accordance with the terms of this [Agreement] an Initial Payment totalling HK$165,104,100 [as follows …]' (Clause 3.02).

133. The Appellant cited cases such as McClure (Inspector of Taxes) v Petre[81] to contend that the Initial Payment was capital receipt.

134. What the Board is concerned with is the charge under section 14 which provides that:

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

135. McClure[82] was on the Schedule A charge as provided for by section 67(1) of the Income and Corporation Taxes Act 1970 which provided that:

> ' *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) rents under leases of land in the United Kingdom, (b) rentcharges, ground annuals and feu duties, and any other annual payments reserved in respect of, or charged on or issuing out of, such land, 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.*'

136. The charges are different.

137. Sir Nicolas Browne-Wilkinson held that in order to be taxable under section 67(1)(c) two requirements have to be satisfied[83].

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81 [1988] 1 WLR 1386.
82 [1988] 1 WLR 1386.
83 [1988] 1 WLR 1386 at page 1389.

> ' *It must be shown, first, that the receipt is an "other receipt" arising from, or by virtue of, ownership of an estate or interest in land; and, secondly, that the receipt is an annual profit or gain. In the present case there is no dispute that the first requirement is satisfied. The taxpayer accepted that the moneys he received constituted a receipt arising from his freehold interest in the land. The sole dispute is as to the second question; namely, were the moneys paid by McAlpines and the other licensee paid by way of being an annual profit or gain - that is to say, were the payments in the nature of income - or were they payments in the nature of capital and therefore not liable to income tax? For this purpose it should be noted that the word "annual" in the statute casts no light on the problem. It is established by authority and is common ground between the parties that the word "annual" in this context does not connote any element of recurrence. It is tantamount to saying "moneys arising in any year." It is also common ground that a single non-recurrent payment can be an "annual" payment so as to be taxable: see Ryall v. Hoare [1923] 2 K.B. 447.*
>
> *In my judgment it is equally established by authority that to decide whether a particular receipt is in the nature of income or in the nature of capital one has to look at all the circumstances of the particular case and apply judicial common sense in reaching a conclusion as to how the receipt is to be classified.*'

138. Sir Nicolas Browne-Wilkinson concluded that it was capital receipt[84]:

> In my judgment the case is authority for the proposition that 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 … 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, whether it was effected by a licence, involving a contractual arrangement without the disposal of a legal right, or whether it was effected, as it could have been, by the grant

[84] [1988] 1 WLR 1386 at page 1390.

> for a lump sum of a long term of years to the company with a lease back. The liability to tax in such a case should in my judgment depend not on the technical machinery by which the transaction is carried through but on the substance of what was done. In my judgment in essence this was a capital receipt for a once-and-for-all realisation of part of the capital value.

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's capital assets and became the Appellant's trading stock.

140. The third ground of appeal fails.

The fourth ground of appeal

141. The fourth ground of appeal reads as follows:

> ' (in the alternative and without prejudice to the foregoing) the Commissioner erred in assessing the Initial Payment for tax for the year of assessment 1994/1995'.

142. It is plain from paragraph 112 above and the footnotes under clause 3.02 of the Redevelopment Agreement that all the instalments of the Initial Payment were paid or accrued in the calendar year 1994.

143. Further and in any event, the Appellant's own tax computations referred to in paragraphs 63 to 65 are fatal against ground 4.

144. The fourth ground of appeal fails.

Conclusion

145. The appeal fails.

146. Speaking for myself, I would dismiss the appeal and confirm the assessment appeal against.

Miu Liong, Nelson

147. I agree with the Chairman, for the reasons he stated, that the Appellant's application to add a new ground of appeal should be dismissed.

148. I note, and bear in mind, the Chairman's reminder in paragraph 73 above, that the Board and not the Commissioner is the fact finding body.

149. I further bear in mind the following passage of Lord Wilberforce in Simmons v IRC[85] :

> Trading requires an intention to trade: *normally the question to be asked is whether this intention existed at the time of the acquisition of the asset*. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: *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*, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock - and, I suppose, vice versa. *If findings of this kind are to be made precision is required*, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax: see Sharkey v. Wernher [1956] A.C. 58.[86]

Change of Intention

150. The Respondent accepted that the Lot was a capital asset at the time of acquisition, and submitted that a finding of change of intention would be required before the Initial Payment can become taxable. In my opinion, a finding of change of intention is a pre-requisite, but not necessarily sufficient condition, for the taxability of the Initial Payment.

151. Following Church Body of the Hong Kong Sheng Kung Hui v CIR[87], I take the view that there has been no change of intention before 30 July 1994, when the Redevelopment Agreement was signed. The Appellant only resolved at the board meeting of 21 April 1994 that discussions with Company A should *proceed*. The form of joint development has not yet been agreed. The board was keeping its options open.

152. On 30 July 1994, upon the signing of the Redevelopment Agreement, the Appellant became contractually bound to go through with the redevelopment. However, as Barnett J noted in Crawford Realty Ltd v CIR[88], it was not permissible to assume that a joint venture agreement must involve trading/business. The nature and implications of the agreement are crucial.

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85 [1980] 1 WLR 1196, at page 1199. Quoted by Nourse LJ in Kirkham v Williams [1991] 1 WLR 863, 869A-C and by Cheung JA in Church Body of the Hong Kong Sheng Kung Hui v CIR [2014] 5 HKLRD 384, at page 396.

86 Emphasis (italics) added.

87 [2014] 5 HKLRD 384.

88 (1991) 3 HKTC 674, see also paragraphs 99 – 100 above.

The nature and implications of the Redevelopment Agreement

153. The intention of the Appellant (and of its joint venture partner) was that the profits of the joint venture, after deduction of all expenses, shall be shared equally.

154. 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. Contribution, of course, may take different forms.

155. It is further clear that the parties understood right from the beginning that the contribution from the Appellant would be in the form of physical asset (land/building), whereas Company A's contribution would primarily take the form of provision of services and knowhow – project management, implementation and supervision.

156. It will be rare that the value of a physical asset owned by one party to such a joint venture will happen to equal exactly the perceived value of the services to be provided by the other.

157. Whereas the value of the services to be provided by the developer may be difficult to quantify (hence allowing room for negotiation), the value of a physical asset such as a piece of land (and building thereon), by contrast, may not be difficult to ascertain, objectively/professionally.

158. Where the value of the physical asset owned by one party far exceeds the perceived value of the services to be provided by the other party, then before there can be equal profit sharing, a balancing payment must be paid by one party to the other, so that the value of both sides' contributions to the project would be equal.

159. On 23 April 1994, Company Z produced a valuation report valuing the land (the Lot) at HK$418,000,000 reflecting its development potential for redevelopment.[89] Previously, on 2 February 1994, DLO/KE had indicated to the Appellant's representative that premium of HK$61,420,000 would be required for the proposed redevelopment into an industrial/office building.

160. Assuming (and accepting, which I do) that the figure of HK$418,000,000 represented the fair market value of the Lot in April 1994, then the basic start-up cost for the intended joint venture would be HK$479,420,000 (= 418,000,000 + 61,420,000).

161. A half share of this basic start-up cost would be HK$239,710,000. Since the Lot was worth HK$418,000,000, the Appellant should be entitled to receive a balancing payment of HK$178,290,000 (being the difference between the two figures), *if there were no other costs*. But that was not what it received. Instead it only received the sum of HK$165,104,100 by way of Initial Payment. The difference could be attributed to the value

[89] Paragraphs 32 and 34 above.

of services provided by Company A. Although this figure has not been spelt out in the agreement, it can be arrived at by deduction to be HK$26,371,800.

162. This can be verified as follows :

	Value/amount (HK$)	Contribution / Paid by Company A/ Company B	Contribution/ (Receipt) by Appellant
Land/Building	418,000,000		418,000,000
Land Premium	61,420,000	61,420,000	
Company A's Service	26,371,800	26,371,800	
Balancing Payment		165,104,100	(165,104,100)
Total Start-up Cost	505,791,800	252,895,900	252,895,900

163. The amount of HK$26,371,800 did not represent the total value of the services to be rendered by Company A, but only the value of its services (working on feasibility of the project, coming up with the proposal, etc.) up to the time of project start-up. In other words, up to 30 July 1994.

164. Although Company A/Company B were required to pay the Land Premium of HK$61,420,000 upon signing of the Redevelopment Agreement, Company B was entitled to be paid/reimbursed the amount of Land Premium out of the proceeds of sale of the units in the completed redevelopment. In effect, this amount of HK$61,420,000 represented the value attributable to the services (project management, implementation and supervision) to be provided by Company A between project start-up and project completion.

165. Coming back then to the nature of the Redevelopment Agreement. Clause 8.01 of the Redevelopment Agreement stated that 'This Agreement is in the nature of a joint venture and sale and purchase of interest in property'.[90] I find this to be an accurate description of its nature.

166. As Lord Wilberforce noted in Simmons v IRC[91], 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, Company AF (Company C).

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 (Company C), 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 Company C. The Appellant only assumed the role of a guarantor.

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[90] Also quoted in paragraph 112 above.

[91] Quoted in paragraph 149 above.

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 Company A with a view to earn more profit. The evidence of Mr G[92] 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.

171. Notwithstanding that there has been a change of intention on 30 July 1994, I find that the Appellant had not injected the entire value of the Lot (HK$418 million) into the joint venture project at its start-up. If that was what it had invested and put at risk, then the Appellant should have been entitled to a share of profit far greater than 50 percent.[93] But the parties had decided to embark on a joint venture where the profits were to be shared equally. They had negotiated and worked out what was needed to be paid by way of balancing payment, so that the parties' *contributions* to the joint venture project would be equal in value.

172. The Initial Payment therefore was not, in my opinion, in the nature of a trading or revenue receipt. It was a balancing payment made to equalize the parties' contribution *before* trading commenced. It represented the carving out of part of a capital asset which was larger than that required to contribute to a joint venture project where profit was to be shared equally.

173. The Initial Payment has been described as a payment for 'Redevelopment Right'. I do not attach any importance to the name. Although the fact that a piece of land has a potential for redevelopment may enhance its value, I do not think that such enhancement is capable of objective quantification by any valuer or surveyor, any more than

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92 Quoted by the Chairman in paragraph 117 above.

93 Assuming the above analysis and figures to be correct, the Appellant would be contributing $418M of basic start-up costs of $505 million, and should be entitled to over 80% of the profit of the joint venture if there were no balancing payment.

the 'hope value' embedded in a piece of agricultural land with residential zoning could be objectively quantified.[94] McClure v Petre[95] is distinguishable because there the right to deposit subsoil on the land is something separate and distinct. The economic value of a grant of such disposal rights could be ascertained and quantified objectively.

174. In November 1994, the Appellant assigned the Lot to Company C for the consideration of HK$314,315,900. This figure is the sum of HK$252,895,900 + HK$61,420,000. The latter figure was the Land Premium. This was actually paid by Company A/Company B to the Appellant for onward payment to the Government.[96] The former figure represented the Appellant's investment in the joint venture.[97]

Hong Kong Oxygen & Acetylene Co Ltd v CIR[98]

175. The Respondent contended that the following features of the Hong Kong Oxygen case made it factually indistinguishable from the present case:

(1) an initial payment was made to the taxpayer;

(2) the initial payment did not represent the market value of the property at the time;

(3) the property was transferred to a subsidiary of the taxpayer;

(4) the initial payment was in return for the entering into of the JV agreement; and

(5) the entity entitled to share profit with the JV partner under the JV agreement was the subsidiary, not the taxpayer itself.

176. The distribution of the financial benefits in the JV Agreement in that case provided that[99]

(1) The developer shall pay the taxpayer $180,000,000 ('the Initial Payment') by two instalments of $90,000,000 each upon signing of the JV Agreement (on 28 July 1993) and on 31 March respectively (the nature of which payment was the subject matter of appeal to the Board);

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94 See Director of Lands v Yin Shuen Enterprises Ltd & Anor (2003) 6 HKCFAR 1, LDLR 3/2000 (judgment dated 21/10/2003) paragraphs 7-9 and Dragon House Dev Ltd & Anor v Sec for Transport and Housing (2005) 8 HKCFAR 668, paragrpahs 6-7 & 44,

95 [1988] 1 WLR 1386.

96 As the Government will normally only accept payment of Land Premium from the registered owner of the Property.

97 Paragraph 163 above.

98 [2001] 1 HKLRD 489; D126/98 (1998) 13 IRBRD 582.

99 (1998) 13 IRBRD 585-586, paragraph 3.11 and paragraph 3.12.

(2) The developer shall be entitled to reimbursement of both the Initial Payment and all redevelopment costs out of the proceeds of sale.

(3) The remaining sales proceeds shall be distributed between the taxpayer's subsidiary and the developer as follows :

(a) To the taxpayer's subsidiary, the first $320,000,000 representing the guaranteed profit;

(b) To the developer, the next $320,000,000.

(c) Any further balance of the sales proceeds beyond $640,000,000 and up to $900,000,000, to be shared by the taxpayer's subsidiary and the developer equally;

(d) Any further amount of the balance of the sales proceeds beyond $900,000,000 is to be shared in the ratio of 45%/55% to the taxpayer's subsidiary and the developer respectively.

177. There are at least two distinguishing features between the Redevelopment Agreement in the present case and the JV Agreement in the Hong Kong Oxygen case. Firstly, unlike Hong Kong Oxygen, there was no provision for Company A/Company B to recover the Initial Payment from the sales proceeds. This is consistent with its nature as a balancing payment. Secondly, the sharing of the profits in Hong Kong Oxygen was, save for proceeds over $640 million and under $900 million, not on an equal basis. Instead, the taxpayer was assured a 'Guaranteed Profit' of $500 million, which assured that it will recover *the whole* of the market value of its property ($497 million), i.e., the total of its investment in the project, *before* the developer can start to reap any profit from the JV. In the present case, there was no guaranteed profit, nor any assurance that the Appellant would get back the full value of the Lot before the other party can start to reap any profit. The Appellant had invested the balance of the value of the Lot[100] in the joint venture project through its subsidiary Company C, which, as events turned out, was almost totally lost.

178. Every case must turn on its own facts. The nature and implications of the JV Agreement in the Hong Kong Oxygen case, for the reasons explained above, were quite different from the nature and implications of the Redevelopment Agreement in the present case.

Crawford Realty Ltd v Commissioner of Inland Revenue

179. In Crawford Realty Ltd v CIR, the Board has found[101]

[100] $252,895,900, being the difference between the market value of the Lot and the Initial Payment : see paragraph 163 above.

[101] (1991) 3 HKTC 674 at page 684.

> ' *What we have is a standard type of joint venture development agreement under which the developer, Cheung Kong, is entitled to be repaid his development costs out of the proceeds of sale of the new building. The value attributed to the land is not payable to the Taxpayer in advance of and in priority to all the other liabilities as would be the case if this were a sale but is deferred to certain other payments. The protection of the Taxpayer lay in the fact that the Taxpayer could cancel the Agreement and take back the second properties if it wished during the course of the development period.*
>
> *It is not necessary for us to go through the Development Agreement clause by clause and provision by provision to demonstrate that it is clearly a joint venture development and not a sale and purchase agreement. The document speaks for itself.*'[102]

180. Here, the Initial Payment representing part of the value of the Lot which was to be excluded from the intended joint venture was paid in advance of and in priority to all other liabilities. As pointed above[103], clause 8.01 of the Redevelopment Agreement did expressly state that it was a joint venture *and* a sale and purchase agreement.

The Substance of the Transaction

181. As Sir Nicolas Browne-Wilkinson VC noted in McClure[104]: '*The liability to tax … should in my judgment depend not on the technical machinery by which the transaction is carried through but on the substance of what was done.*'

182. For the reasons stated above, in my view, the substance of the transaction as embodied in the Redevelopment Agreement was a sale of the Lot by the Appellant and reinvestment of part of that value in a joint venture with Company A. The Initial Payment represented the surplus of the value of the Lot (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.

Conclusion

183. On my part, I would allow the appeal on the basis that the Appellant is entitled to succeed on the third ground of appeal, although as pointed out by the Chairman[105], this has not been felicitously worded.

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102 Underlining added, italics original.
103 Paragraphs 165 and 112 above.
104 [1988] 1 WLR 1386, 1393G.
105 Paragraph 78 above.

Mark Richard Charlton Sutherland, Barrister-at-Law, FCIArb

184. I have had the opportunity to consider the decision of both the Chairman of the Board, Mr Kenneth Kwok Hing Wai, SBS, BBS, SC, JP, as well as that of Mr Nelson Miu.

185. I concur with the decision of the Chairman to dismiss the Appellant's application to add a new ground of appeal for the reasons that he has stated.[106] I have also carefully considered the Chairman's reminder that it is the Board and not the Commissioner which is the fact finding body in cases such as these.[107]

186. With the greatest of respect to the Chairman's decision and his reasoning, I concur with the decision of Mr Nelson Miu and I would adopt his reasoning. Accordingly, I would allow the Appeal on the third ground of appeal.

187. That said, I would add the following observations.

188. It is necessary to look at the substance as opposed to the form of the underlying transaction when considering the Redevelopment Agreement and the sale of the Lot when assessing the liability to taxation.

189. Sir Nicolas Browne-Wilkinson VC in McClure (Inspector of Taxes) v Petre [1988] 1 WLR 1386 at 1392-1393 referred to the case of Earl Haig's Trustees v Inland Revenue Commissioners 1939 SC 676 and stated as follows:

> ' *In my judgment the case is authority for the proposition that 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.*'

190. In the case of McClure, Sir Nicolas Browne-Wilkinson VC concluded that there was no such absolute distinction 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 that case land it can be, and indeed normally will be, in itself a capital receipt.

191. Sir Nicholas Browne-Wilkinson VC concluded that the realisation of part of the value of the freehold land was a disposal of a capital nature regardless of how it was effected. Sir Nicolas Browne-Wilkinson VC held that '*The liability to tax in such a case should in my judgment depend not on the technical machinery by which the transaction is*

[106] Paragraphs 50 to 66.
[107] Paragraph 73.

carried through but on the substance of what was done. In my judgment in essence this was a capital receipt for a once-and-for-all realisation of part of the capital value.'

192. Adopting similar reasoning in the case of McClure, I agree with Mr Nelson Miu that the substance of the transaction in the present appeal as set out in the Redevelopment Agreement was the sale of the Lot by the Appellant followed by the subsequent reinvestment of a part of the realised value in a joint venture with Company A. The Initial Payment was in effect the surplus of the value of the Lot which itself was a capital asset in addition to what was required to invest in the joint venture.

193. For the reasons stated *supra*, I find that the Initial Payment is in the nature of a capital receipt as opposed to income.

194. I would therefore allow the appeal on the basis of the third ground of appeal advanced by the Appellant.

Kenneth Kwok Hing Wai, SBS, BBS, SC, JP (Chairman)

195. By reason of section 65(4)(e), this appeal is allowed and the Board remits the assessment appealed against to the Commissioner to revise or annul to give effect to the decision of the majority.