Case No. D28/16

Profits tax – sale of land – intention at time of acquisition – whether subsequent change of intention – agency fee – whether expense incurred in the production of chargeable profits – sections 14(1), 16(1) and 68(4) of the Inland Revenue Ordinance

Panel: Cissy K S Lam (chairman), Cheng Wing Keung Raymond and Mak Po Lung Kelvin.

Dates of hearing: 23 and 24 May 2016.
Date of decision: 28 November 2016.

The Appellant objected to the Profits Tax Assessment for the year of assessment 2005/06.

The Appellant acquired 4 Land Lots back in 1991 to 1996. Parts of the First Land Lots were sold in 1992 as current assets and profits tax thereon was duly paid.

In the audited accounts of the Appellant:

- The 'Principal Activities' were stated to be 'property development' for the years ending 1991 to 1992 and 1998 to 2006 and 'property investment' for the years ending 1993 to 1997.

- The 4 Land Lots were classified under 'Current Assets' up to the year ending 1997; 'Property under Development' for 1998 and 1999; and 'Non-current assets' for 2000.

On 5 August 2004, the Government granted the Exchanged Land Lot to the Appellant upon the Appellant's payment of a premium of $23,430,000 and surrender of the First Land Lots (with the exception of 8 pieces of land therein), the Third Land Lot and the Fourth Land Lot.

On 15 August 2005, by an assignment, the Appellant sold the Exchanged Land Lot, the remaining 8 pieces of land in the First Land Lots and the Second Land Lots (collectively 'the Sold Land Lots') at a consideration of $130,000,000.

The Appellant contends that the profit from the sale of the Sold Land Lots was capital in nature.

The Appellant alternatively contends that if the gain from the sale of the Sold Land Lots was chargeable to profits tax, the Agency Fee of HK$5,000,000 paid to Mr AX was expenses incurred in the production of the chargeable profits.

Held:

1. All the facts and evidence considered, the 4 Land Lots (subsequently replaced by the Sold Land Lots) were purchased and sold as part of the current assets/trading stock of the Appellant. They were not capital in nature.

2. The Board cannot find any evidence to substantiate any change of intention of the Appellant to hold the 4 Land Lots as a long term investment.

3. The Board cannot determine the precise purpose of the $5 million Agency Fee paid to Mr AX in 2005. As such, the same is not deductible under section 16(1) of the IRO.

Appeal dismissed and costs order in the amount of $10,000 imposed.

Cases referred to:

Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6
Church Body of the Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue, HKCFA, FACV 16/2015
Real Estate Investment (NT) Ltd v Commissioner of Inland Revenue (2008) 1 HKCFAR 433
Simmons v IRC [1980] 1 WLR 1196, HL
China Map Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 486
Chinachem Investment Co Ltd v Commissioner of Inland Revenue [1987] 2 HKTC 261

Dixon Co, Counsel, instructed by Globe Intelligence Management Limited, for the appellant.
Suen Sze Yick, Senior Government Counsel, Gorden Chung, Government Counsel and Katherine Chan, Government Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

1. The Appellant objected to the Profits Tax Assessment for the year of assessment 2005/06, on the ground that the profit from the sale of several parcels of land was capital in nature and was not chargeable to profits tax.

2. By determination dated 16 February 2015, the Deputy Commissioner of Inland Revenue ('the Commissioner') confirmed the assessment. By notice of appeal dated 13 March 2015, the Appellant appealed against that determination.

Grounds of Appeal

3. The Grounds of Appeal are as follows:

(1) The original intention of the Appellant was to acquire the property as a long term investment and the gain on the realisation of the property is capital in nature and hence not subject to profits tax;

(2) Alternatively, if (which is denied) the original intention were one of trade, there was a subsequent change of intention to hold the property as a long term investment and the gain on the realisation of the property is capital in nature and hence not subject to profits tax;

(3) Further alternatively, if (which is denied) the gain on the realisation of the property were subject to profits tax, the Agency Fee of HK$5,000,000 paid to Mr A was expenses incurred during the basis period of the relevant year of assessment in the production of the said gain.

Facts

4. The facts are summarised in the Revised Statement of Agreed Facts ('RSAF'), a copy of which is attached to this Decision (Appendix A). The Appellant called two witnesses at the hearing, namely Ms B, a director of the Appellant, and Mr C, proprietor of Company D, and submitted a number of documents in support.

5. We adopt the RSAF. Further, based on all the evidence before us, we find the facts stated in paragraphs 6 to 44 hereinbelow proved. We further find, for the reasons set out below, that the appeal should be dismissed.

The Appellant's shareholders and directors

6. The Appellant was incorporated in October 1986. It was a wholly owned subsidiary of Company E.

7. Company E was at all material times owned and controlled by Mr F. His two sons, Mr G and Mr H, assisted in Company E's rattan business, but took little part in Company E's business in relation to the acquisition of land and properties.

8. Mr H lived abroad and played no part in the dealings presently in question. Mr G partook in the negotiations regarding the land premium; the letters of Company J of 18 November 2002, 1 August 2003 and 6 May 2004 (see below) were copied to him. But we accept that he played no part in the decision making. Mr F made all the major

decisions. He might consult other family members occasionally, but the final decision always rested with him.

9. Ms B married Mr G in 1997 and had since been assisting Mr F. She carried out Mr F's instructions, but likewise took no part in decision making.

10. The original directors of the Appellant were Mr F and the two sons. In 2007 Mr F resigned as director and Ms B was appointed director in his stead. Despite the change of directors on paper, Mr F remained in charge of the Appellant.

11. Mr F passed away on 18 April 2010, at the grand age of 99. Although he did not go back to the office every day, he remained to the end very alert and capable, and went horse racing regularly.

12. Company E was a 'family business' in the sense that it was controlled by Mr F and all the directors were members of the family. But Company E was not a small or medium sized business as Ms B would like us to believe. While not in the same league as the Company K or Company L groups of companies, Company E's accounts for 1991/1992 reveal a multi-million dollar business with a whole host of subsidiaries, associate companies and joint ventures.

13. Company E's property portfolio included both rental properties and properties for sale and purchase. All the rental properties were situated in business areas such as District M or District N. None were in the Region P.

The acquisition of the 4 Land Lots

14. The 4 Land Lots in issue were all agricultural land situated in District Q, Address R. They were acquired as follows:

Assignment	Land	Cost	Vendor
31-12-1991	First Land Lots: 25 pieces of land in various lots in District Q – for full description see RSAF paragraph (3)(a)	$18,941,370	Company S and Company T
19-05-1992	Second Land Lots: 4 pieces of land in Lot U in District Q – for full description see RSAF paragraph (3)(b)	$2,054,948	Individuals
08-06-1993	Third Land Lot: Lot V in District Q	$1	Company W
01-04-1996	Fourth Land Lot: Lot X in District Q	$222,813	Company T
	Total Cost:	$21,219,132	

15. Company S and Company W were unrelated to the Appellant. Company T was a wholly owned subsidiary of the Appellant.

16. The 25 pieces of land in the First Land Lots were contiguous with each other forming one big parcel of land.

Other sale and purchase transactions carried out by the Appellant

17. In 1987, the Appellant acquired two batches of land of which one was surrendered to the Government in 1988. We do not have the particulars of this batch. We shall refer to it as Pre-1991 Land Lot 1 in the table below.

18. The other was Lot Y in District Z and Lots AA and AB in District AC. These pieces of land were in the vicinity of the First Land Lots, but not adjacent to it. We shall refer to them as Pre-1991 Land Lot 2.

19. The Pre-1991 Land Lot 2 was valued at $250,908 in the audited accounts. It was not classified as current assets or non-current assets, but was described as 'Property Under Development' under a separate heading. When it was sold in 1990/1991, the Appellant declared a profit/income of $398,084.90 in its audited accounts for that year, thus classifying the sale as a sale of current asset. This sum was the Appellant's only income in that year of assessment.

20. According to the letter of Company AD, the auditors and former tax representative of the Appellant, dated 13 September 2010 ('2010 Letter'), Pre-1991 Land Lot 2 was sold because it was unfit for development.

21. In 1992, the Appellant sold two pieces of land in the First Land Lots, namely Section B of Lot AE and Section A of Lot AF, for the sum of $838,000 to Company T. They were on the periphery of the First Land Lots. The assignment was dated 16 May 1992. The Appellant declared a profit/income of $132,231.72 in its audited accounts for the year ending 1993 and submitted it for profits tax. Although Company T was a wholly owned subsidiary of the Appellant, there is nothing to suggest that it was other than an arm's length transaction. In June 1993, Company T sold Lot AG to Company W for a sum of $2,850,000.

22. In 1993/1994, the Appellant made another land sale and declared a profit/income of $106,224.99 in its audited accounts for the year ending 1994. As part of the relevant audited accounts was missing, the description of this land is not known, but it must be part of the existing land holding of the Appellant. Since the Third Land Lot was ultimately surrendered to the Government and the Second land Lots were sold to Company AT as part of the Sold Land Lots, this sale must also be a sale of part of the First Land Lots. This profit/income of $106,224.99 was the Appellant's only income in that year of assessment.

Summary of the various Sale and Purchase of land

23. Below is a summary of the sale and purchase of land by the Appellant up to 2005:

	Date	Property	Sale/Purchase	Accounting Treatment in the year of sale/purchase
1.	1987	Pre-1991 Land Lot 1 and Pre-1991 Land Lot 2	Purchase	accounts not available
2.	1988	Pre-1991 Land Lot 1	Surrender to Government	accounts not available
3.	1990/1991	Pre-1991 Land Lot 2	Sale	Profit of $398,084.90 declared for profits tax
4.	31-12-1991	First Land Lots	Purchase at $18,941,370	Current Assets
5.	16-05-1992	Part of the First Land Lot	Sale	Profit of $132,231.72 declared for profits tax
6.	19-05-1992	Second Land Lots	Purchase at $2,054,948	Current Assets
7.	08-06-1993	Third Land Lot	Purchase at $1	Current Assets
8.	1993/1994	Unknown – part of the First Land Lots	Sale	Profit of $106,224.99 declared for profits tax
9.	01-04-1996	Fourth Land Lot	Purchase at $222,813	Current Assets
10.	05-08-2004	Exchanged Land Lot	Surrender & Regrant at Premium $23,430,000	Non-Current Assets
11.	14-07-2005	Sold Land Lots	Sale at $130,000,000	Non-Current Assets

24. The 4 Land Lots were classified under ‘Current Assets’ in the audited accounts up to the year ending 1997. In the accounts for the years ending 1998 and 1999, they were not grouped under ‘Current Assets’ but were separately described as ‘Property under Development’, similar to the Pre-1991 Land Lot 2 (see paragraph 19 above). It was in the audited accounts for the year ending 2000 that they were, for the first time, grouped under ‘Non-current assets’ of the Appellant. This coincided with a change of auditors. The Appellant’s pre-2000 auditors were Company AH (‘the former Auditors’), the post-2000 auditors were Company AD.

25. The ‘Principal Activities’ of the Appellant were stated to be ‘property development’ in some years (see Directors’ Reports for the years ending 1991 to 1992 and

1998 to 2006) and 'property investment' in others (see Directors' Reports for the years ending 1993 to 1997).

Land Zoning

26. As with most agricultural land in Region P, before any residential development (whether for resale or for rental) can begin, the land owner must (1) obtain the necessary planning permission from the Town Planning Board ('TPB') under section 16 of the Town Planning Ordinance (Chapter 131), and (2) obtain what is commonly known as 'a Surrender and Regrant' of the land to lift the lease restriction [HKSKH, paragraph 5]. This normally requires the payment of a premium.

27. We refer to paragraph (15) of the RSAF for the information obtained from the TPB.

28. The draft DPA Plan for Location AJ was gazetted in July 1991, a few months before the purchase of the First Land Lots. Under the draft DPA Plan (subsequently replaced by the OZ Plan in June 1994 and ultimately approved by the Chief Executive in May 2003), the 4 Land Lots fell within the Residential (Group C) Zone, which allowed for low-rise and low-density residential development with ancillary facilities. As such, planning permission was not required unless the Appellant wished to apply to relax the restrictions imposed under Residential (Group C) Zone regarding plot ratio, site coverage and building height.

29. The Appellant did make such application to the TPB in July 1993. This was rejected by the TPB on the ground, *inter alia*, that the proposed relaxation was not minor. There is no evidence that the Appellant had since made any other application to the TPB.

The Land Premium Negotiation

30. In respect of the Appellant's application for a Surrender and Regrant, all the relevant correspondence are set out in paragraph (14) of the RSAF. We note that some documents referred to in the correspondence are not available to us.

31. The Appellant first applied to the District Lands Office/Lands Department (collectively referred to 'DLO' below) for a Surrender and Regrant of the First Land Lots in January 1992. There were correspondences in 1992 and 1993, after which was a break for a few of years until 1996 when the application was 'reactivated'. The Appellant was represented by its surveyors, Company J.

32. The negotiation was principally on the amount of premium payable with offers and counter-offers as follows:

Date	Premium
15-08-1997	DLO: 1st offer at $76,330,000

Date	Premium
09-10-1997	Company J: Counter-offer at $50,250,000
24-12-1997	DLO: Counter-offer accepted
24-01-1998	Company J: 'having regard to the current declining state of the property market', declined the Counter-offer
28-04-1998	Company J: 2nd Counter-Offer at $16,850,000
28-09-1998	DLO: 2nd Counter-offer accepted
07-10-1998	Company J: 'because of the unstable state of the property market', decided not to proceed
03-11-1998	Company J: Re-applied for surrender and regrant
07-11-1998	DLO: Re-application treated as new application
01-08-2002	DLO: 1st offer at $19,740,000
18-11-2002	Company J: Counter-offer at $4,860,000
02-05-2003	DLO: Revised Offer at $10,110,000
01-08-2003	Company J: 2nd Counter-offer at $2,310,000
07-04-2004	DLO: 2nd Revised Offer at $23,430,000
06-05-2004	Company J: 2nd Revised Offer accepted

The Surrender and Regrant

33. By the Agreement and Conditions of Exchange dated 5 August 2004 ('New Grant'), the Government granted Lot AK in District Q ('the Exchanged Land Lot') to the Appellant on condition, *inter alia*, that :

(a) The Appellant surrendered the First Land Lots (except Lots AG, AL, AM, AN, AP, AQ, AR and AS), the Third Land Lot and the Fourth Land Lot contemporaneously with the execution of the agreement.

(b) The Appellant paid a premium of $23,430,000.

(c) Buildings on the Exchanged Land Lot must be completed and made fit for occupation on or before 31 March 2008.

34. By a Deed of Surrender dated the same date, the Appellant surrendered the relevant land lots in exchange for the Exchanged Land Lot.

35. One may note that the Second Land Lots and part of the First Land Lots were not covered by the Surrender and Regrant.

The Sale

36. By an agreement for sale and purchase dated 14 July 2005, the Appellant sold the Exchanged Land Lot, Lot AM, Lot AP, Lot AQ and Lot AS in the First Land Lots and the Second Land Lots (collectively referred to as 'the Sold Land Lots') to Company

AT at a consideration of $130,000,000. The assignment was dated 15 August 2005.

37. Company AT was part of the Company K group of companies. Mr AW represented Company K in their negotiation with Mr F. Company K owned land adjacent to the 4 Land Lots.

38. There are discrepancies in the facts regarding the circumstances in which the negotiation was carried out. We shall deal with them in more details below. We find the followings:

(1) It was Mr AW who first approached the Appellant.

(2) There were two meetings between Mr AW and Mr F, and in between were various telephone exchanges between them. The two meetings were in the space of 2 to 3 days. There is no evidence of what was said in the telephone exchanges.

(3) In the first meeting, Mr AW offered to develop the land with Mr F in a joint venture. Mr F rejected that offer saying that he intended to develop the land for rental and so had a different objective to Company K. Mr F said this to induce Mr AW to come back with a more attractive offer.

(4) This Mr AW did. The purchase price was $130,000,000. This gave the Appellant a net profit of $81,404,106 (excluding the alleged 'Agency Fee' of $5,000,000), almost twice the land costs and premium combined. For full computation, see RSAF paragraph (7).

The alleged Agency Fee

39. A sum of $5,000,000 was paid to Mr AX by cheque dated 17 August 2005.

40. Mr AX was at all relevant times a director of one Company AU.

41. Company AU was incorporated in June 1989 and dissolved in June 1997.

42. In the Notification of remuneration paid to persons other than employees (IR 56M) in Chinese dated 19 June 2006, the Appellant stated that the sum of $5,000,000 was commission paid to Mr AX for the sale of the land at Location AJ (售出本公司[AJ位置]土地之佣金). Mr AX served as a middleman (中介人).

43. Upon enquiries by the Assessor, however, Company AD in their letter dated 4 July 2008 ('2008 Letter') stated that Mr AX acted as a middleman when the Appellant purchased the First Land Lots in 1991, and the sum was paid to Mr AX as his commission in relation to that purchase. Mr AX was never involved in the sale of the land.

44. For reasons to be set out below, while we accept that the sum was paid and received by Mr AX, we cannot discern the true nature of the payment and we agree that the sum is not deductible under section 16(1) of the Inland Revenue Ordinance, Chapter 112 ('IRO').

Relevant Authorities

45. We were referred to the following authorities:

(1) Lee Yee Shing v CIR (2008) 11 HKCFAR 6;

(2) Church Body of the Hong Kong Sheng Kung Hui v CIR, HKCFA, FACV 16/2015, 4 February 2016 ('HKSKH');

(3) Real Estate Investment (NT) Ltd v CIR (2008) 1 HKCFAR 433

(4) Simmons v IRC [1980] 1 WLR 1196, HL

(5) China Map Ltd v CIR (2008) 11 HKCFAR 486

46. In addition, we rely on the Court of Appeal judgment in Chinachem Investment Co Ltd v CIR [1987] 2 HKTC 261.

47. By section 14(1) of the IRO, '*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) …*'

48. By section 16(1) of the IRO, in ascertaining the chargeable profits, '*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 …*'

49. Lord Wilberforce in Simmons v IRC [1980] 1 WLR 1196 at page 1199A-D:

> '*… 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.'

50. McHugh NPJ in Lee Yee Shing at paragraph 59:

'*59. The intention to trade to which Lord Wilberforce referred 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 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".*' (emphasis supplied)

51. Sir Alan Huggins, VP in Chinachem Investment at page 308:

'*It is accepted by the Commissioner that the accounts are not conclusive evidence of the matter in issue, and obviously that is rightly accepted. Nevertheless the accounts must remain important and call for credible explanation, because they are contemporaneous evidence of the Company's intention. Yet no other member of its staff – not even the accountant – was called to explain how the "mistake" came to be made. ... I agree with the judge that "the way in which the properties have been treated in the accounts is by no means an insignificant factor" …*'

Reasons for Decision

The Appellant's case

52. Company AD stated the Appellant's case in their 2008 Letter as follows:

> 'The [Appellant] was established by [Mr F] and his family in October 1986 through [Company E], the holding company for the purpose of acquiring pieces of land in [Region P]. The intention at the time of purchase of the pieces of land in [Address R] ("the land") in 1991 was to construct residential buildings for rental purposes. The land is near to [Estate AV], [Estate AY] and [Estate AZ] and according to our client, the buildings of the [Appellant] upon completion could attract people living at the above locations to become tenants of the [Appellant]. ….'

53. And in paragraph (21) of the same letter, Company AD summarised their reasons for arguing that the gain was capital in nature as follows:

(i) 'The land had been held for a very long time (more than 10 years), pointing to the fact that it is a capital asset.

(ii) [Company E], the ultimate holding company, was capable of providing financial support to [the Appellant] to develop the land. In fact, no external borrowings were or would be sought to finance the project.

(iii) The expected rental return is satisfactory as set out above.

(iv) [The Appellant] at all times did not initiate any actions to sell the land. The sale was initiated by the purchaser.

(v) [The Appellant] had taken actions to develop the property when they agreed the land premium with the Lands Department by submission of building plans.

(vi) The leasehold land was classified as a non-current asset and the loan from the holding company was classified as a long term liability in the accounts, indicating that the Company intends to hold and rent out the units after development. The rental generated would be used to repay the loan from the holding company.'

54. We shall explore each of these reasons in more details below, but in brief, we are not convinced by these reasons:

(i) The land had been held for more than 10 years – but most of the 10 years were spent on arguing for a lower land premium. Once the

New Grant was given, the Appellant sold the land within a year (see paragraph 78 below).

(ii) Company E was capable of providing financial support to the Appellant to develop the land – we accept this, but this does not necessarily support the Appellant's case.

(iii) The expected rental return – the figures set out in the letter were not based on any proper valuation, but were clearly put together as an afterthought (see paragraphs 80 – 83 below).

(iv) The sale was initiated by the purchaser – we accept this, but with adjacent land held by a large developer, an offer to buy out the Appellant was not far off.

(v) The Appellant had taken actions to develop the property – but the Appellant could be developing the land for resale (see paragraph 76 below).

(vi) The leasehold land was classified as a non-current asset – this is far from the whole truth (see paragraph 24 above).

55. We do not think the Appellant has made out their case. Rather, the truth of the matter is that when Mr F decided to acquire the 4 Land Lots, his intention was to resell at a profit. Of course, the intention was not to resell the land as is. As it stood, the land, being restricted to agricultural use, had very little resale value. But once the user was converted to residential, then the development potential would be many times enlarged. All that was required was the payment of a land premium. That was not a problem. Company E had the capital. And precisely because there was no financial constraint, Mr F could afford to wait for the perfect time to seize the best deal with the DLO. This he did. When he finally agreed the land premium with the DLO in 2004, the property market was on the rise. After the New Grant was obtained, he had all the options open to him. He could simply sell the land at a much increased value. Or he could develop the land, by himself or by joint venture, and sell the houses upon completion. With no financial constraints, the options were manifold. Keeping all or some of the houses for rental was, of course, also an option he could take. But it is clear to us that the intention from the start was to realise the residential development potential of the land and harvest the enhanced value. So when the right offer came along, he took it.

The directing mind of the Appellant

56. There is no question that the directing mind and will of the Appellant at the time the 4 Land Lots were acquired was Mr F and Mr F alone.

57. Since Mr F has passed away in 2010, we look to contemporaneous documents and transactions to ascertain the original intention of Mr F.

The Accounts

58. In this regard, we have the audited accounts and Directors' Reports of the Appellant. They were all signed by Mr F as Chairman and director of the Appellant.

59. It is clear from these accounts that the 4 Land Lots were part of the trading stock or 'current assets' of the Appellant – the accounts say so in plain terms – see the accounts for the years ending 1992, 1993, 1994 and 1997, viz, the years in which the 4 Land Lots were acquired respectively.

60. The accounts for the year ending 1992 declared the profit arising from the sale of the two pieces of land in the First Land Lots as profit/income of the Appellant. This is another unequivocal statement that the First Land Lots was part of the trading stock/current assets of the Appellant.

61. An investment/capital asset can be sold. This is made clear in the authorities (HKSKH, paragraph 21). The owner of a capital asset can realise his investment at any time at a profit and yet not subject to profits tax. This is true whether the sale is to a wholly owned subsidiary or to a third party purchaser. Either the two pieces of land were sold as capital assets or they were sold as trading stock. The fact that the profit on the sale of the two pieces of land was declared for profits tax purposes is an unequivocal statement that they were sold as trading stock. They formed part of the First Land Lots. The First Land Lots were purchased in one transaction. There is no evidence that when Mr F purchased the First Land Lots, he had in mind a different intention for those two pieces of land. The First Land Lots must be looked at together. There is no evidence other than that a single intention is applicable across the board to the First Land Lots – if part was purchased and sold as trading stock, then the whole was purchased and sold as trading stock. It is the original intention at the time of acquisition which is important. The fact that the majority of the First Land Lots was sold at a much later date is not sufficient to impute a different intention.

62. There was another sale of part of the First Land Lots in 1993/1994 (see paragraph 22 above). Likewise, the profit arising from the sale was declared as profit/income of the Appellant. This is another unequivocal statement that the First Land Lots were held as trading stock.

63. Mr Co representing the Appellant referred us to Real Estate Investment (paragraphs 33-35) in which the Court of Final Appeal said this: '*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.*'

64. We accept that the question of intention to trade has to be determined objectively having regard to all the circumstances and audited accounts are but one of the many circumstances that we have to look at. But we think a distinction must be made

between accounts (and indeed documents and evidence in general) which are self-serving, and accounts which amount to a concession to one's detriment. Real Estate Investment was a case where the accounts were self-serving and the taxpayer tried to argue that the onus of proof under section 68(4) of IRO shifted to the Revenue. The Court of Final Appeal rejected that argument outright. On the other hand, where the accounts disclose an intention to resell for profit inconsistent with the taxpayer's stance, as is the case here, then as McHugh NPJ said in Lee Yee Shing (see paragraph 50 above), '*the concession is generally though not always decisive of intention*'.

65. This is particularly true where the directing mind of the taxpayer is not available to give evidence as in Chinachem Investment. Adopting the words of Sir Alan Huggins in that case (see paragraph 51 above) '*the accounts must remain important and call for credible explanation, because they are contemporaneous evidence of the Company's intention*'.

66. Is there any credible explanation for the accounting treatment of the land as current assets in the relevant years of acquisition if they were not so? We find none.

67. According to Company AD's 2008 Letter, 'the original intention was to develop residential building for rental purposes'. 'Consistent with [the Appellant's] intention to develop the property for rental purposes, the property was reclassified from current asset to non-current in 1998.' We fail to see any logics in this explanation.

68. In their 2010 Letter, Company AD said this: '(3) The land located at [District Q] was acquired with a view for development into residential buildings for rental purposes. The auditor at the time of purchase classified the said land in current assets because development of the land and negotiation with the Lands Department in respect of the land premium for the exchange of usage (i.e. 補地價) has not yet started. In 1997, the Lands Department proposed a premium of HK$76,330,000 for the exchange of usage, which [the Appellant] did not accept as explained in our [2008 letter]. However, it was under these circumstances that the auditor came to realise [the Appellant] had the intention to develop the land into residential buildings for rental purposes. Consequently, the auditor reclassified the land to property under development under non-current assets in 1997/98. The transfer of the land from current assets to non-current assets was a "reclassification" and should not be taken as a "change of intention".'

69. First of all, there is some deviation of the facts. It was in the accounts for the year ending 2000 that the land was, for the first time, explicitly classified as 'Non-current assets' of the Appellant (see paragraph 24 above). Secondly, and more importantly, we fail to see how the proposal of a premium of $76,330,000 in 1997 would trigger off the alleged eureka moment for the former Auditors:

(1) Although a figure for the land premium was not proposed until 1997, the negotiation for a Surrender and Regrant started as early as January 1992 and resumed in earnest in 1996.

(2) The negotiation for payment of a land premium was a first step towards residential development, but it could be a development for resale purposes. Indeed in arguing for a lower premium, Company J gauged their arguments on the resale value of the land, not its rental value. A proposed land premium could be a step closer to realising a current asset.

(3) Any responsible auditors would ascertain the nature of the land lots before the audited accounts were prepared and we have no reason to believe that the former Auditors did not do their duty before they audited the Appellant's accounts for the relevant years the 4 Land Lots were acquired.

(4) If the classification of the land lots as current assets was a mistake, Mr F, the shrewd businessman that he was, would have pointed out the mistake to the former Auditors. One must remember that Mr F was not simply the brains behind the Appellant, but the brains behind Company E, a multi-million dollar enterprise. We do not believe that he would blindly sign whatever documents put before him as Ms B would like us to believe.

70. Further, there is still no explanation of why the profits arising from the sale of part of the First land Lots were treated as income of the Appellant if it was the sale of a non-current asset.

71. There was some attempt to explain the sale of Pre-1991 Land Lot 2. In the Company AD's 2010 Letter, it said this: 'The [Appellant] was set up to purchase land and to develop buildings for rental purposes. Land bought by mistakes or subsequently thought to be unfit for development would be inevitably disposed. In line with this, the [Appellant] disposed of [Pre-1991 Land Lot 2] in 1990/91 for a gain of HK$398,084 (Appendix 2). The gain made was offered to profits tax in 1990/91, despite that the gain was of a capital nature in order to facilitate the finalisation of the assessment.' So the explanation seemed to be that the Appellant gratuitously accepted a tax liability for the sake of mere convenience. We find such undue generosity to the Revenue most unlikely. In the absence of a cogent explanation, we do not accept the allegation that the sale of Pre-1991 Land Lot 2 was capital in nature. We think the audited accounts reflect the true nature of the sale of the Pre-1991 Land Lot 2 as much as the sale of part of the First Land Lots.

The Appellant's Internal Ledger

72. Ms B produced an extract of the Appellant's internal ledger documenting the purchase of the First Land Lots. The ledger did not classify the land as either current asset or fixed asset.

73. We do not see how it assists the Appellant's case. If anything, there was all the more reason the former Auditors would have taken step to clarify the nature of the

asset before they classified the First Land Lots as current assets.

74. Apart from this single page, the Appellant has not produced any other ledger entries. It would have been helpful to see how the other transactions were dealt with by the ledgers, in particular, the sale of part of the First Land Lots in 1992 and 1993/1994.

Correspondence on the Land Premium

75. Next we turn to the correspondence regarding the application for a Surrender and Regrant (see paragraph 30 above). They were not all contemporaneous to the respective acquisitions, but they certainly concern the development of the First Land Lots and later the Third and Fourth Land Lots. Nothing in these correspondences indicated an intention to develop the land for long term investment purposes. Rather, as said, Company J gauged their contentions for a lower premium on the resale value of the land (see, for example, Company J's letters of 9 October 1997, 28 April 1998, 18 November 2002 and 1 August 2003). They even asked for a longer deferment period 'to allow for a longer marketing period in the present sluggish economic situation'. Their contentions demonstrated every intention to develop for resale.

The Application for Surrender and Regrant

76. Mr Co representing the Appellant spent a large part of his submission on the application for a Surrender and Regrant, which he said 'is the strongest evidence that the Appellant intended to develop the site'. Yes, we accept that the Appellant had intended to develop the site, but 'to develop the site' for what? To develop for resale or for long term investment – that is the question.

77. We think Mr Co fails to appreciate how sale and purchase of land in Region P operate. In fact the modus operandi has been well explained by the Court of Final Appeal in HKSKH. Agricultural land, as it stands, has very little resale value. Before any residential development can begin, the user restriction must be lifted by a Surrender and Regrant. Once a Regrant is given, the resale value of the land is many times enhanced, and the owner may then opt to develop the land himself and sell the houses after development, or he may sell the land *in situ* at the enhanced value. Of course, he may also opt to develop the land and then let out the houses long term. In any event, the application for a Surrender and Regrant is the first step towards residential development, whether for resale or for rental.

78. Hence, the application *per se* does not answer the question, but we note 2 things:

(1) The Appellant argues that it has held the land for over 10 years and so pointed to a long term investment. But this argument is diminished by the fact that most of the 10 years was spent arguing for a lower land premium. Once the New Grant was given, the Appellant sold the land within a year. This is consistent with an

acute business acumen, the mastermind of a multi-million dollar enterprise, waiting for the opportune time to act. Indeed, when the Appellant ultimately accepted the premium in 2004, the property market was on the uptrend after it bottomed in 2003 at the SARS pandemic. This is the best time for any developer to obtain a Regrant – you pay the premium when the market is still low and then by the time the buildings are completed in a couple of years, the market has gone up.

(2) Long term investment of property for rental purposes are less affected by the immediate state of the property market. The various counter-offers and the refusal to accept the very low offers, citing the unstable state of the property market, point more to an intention to develop for immediate resale than long-term rental.

No assessment of the Rental Return

79. The Surrender and Regrant was made on 5 August 2004. According to the New Grant, the buildings must be completed and ready for occupation by 31 March 2008. If long term rental was indeed on the drawing board, by July 2005, almost one year after the New Grant, there are bound to be some documents in support, be them minutes of meeting, telephone records, correspondence, drawings or valuation report. But there is none. Even accepting that Company E was a family owned business so that things were not done formally as they would be in a large corporation, nevertheless, the absence of internal documents does not explain the absence of external communication with the architects and the surveyors. We do not find anything in writing to support the allegation that Mr F had instructed the architects that the development was for long term rental purpose, nor do we find any assessment of the long term rental value of the land.

80. Company J has made various valuations of the resale value, but there is no report on the long term rental value. Ms B in her evidence agreed that as far as she knew, such valuation was never done.

81. The only estimation ever attempted was by Company AD, who in their 2008 Letter gave these estimates: 'The development plan for the [Appellant] is simple. The total project cost is about $74,450,000 (Land cost: $21,519,183; Premium: $23,430,000; Estimated development cost: $29,500,000). The annual rental income to be generated from the completed buildings is estimated at $7,623,600 (33,020 sq. ft. x $15 per sq. ft. x 12 + 70 carparks x $2,000 x 12), making a rental yield of 10.24%. The project would be financed in full by [Company E], without any need to resort to external borrowings. …'

82. It indeed sounds simple, in fact too simple to ring true. How is the $15 per sq. ft rental estimated? We know not. How is the $2,000 a month rental for each car park estimated? We know not. Are these figures valid as at 2004, the time of the New Grant, or 2008, the date of the letter? The estimated development cost of $29,500,000 was adopted from Company J's estimate in 2002. Was it still applicable in 2004? Was it applicable to

development of all 4 Land Lots because the New Grant did not cover the Second Land Lot? Apart from construction costs, there were other costs in relation to slope maintenance, sewage treatment and noise reduction, etc., but these costs were not taken into account in these estimates.

83. These estimates are impractical. There are too many questions about them. They were clearly afterthoughts made up purportedly to argue for an intention to hold long term. It is clear to us that there was never any serious consideration of the rental potential of the development.

Circumstances in which the sale of the Sold Land Lot was agreed

84. Company AD's 2008 Letter set out the circumstances as follows:

> 'In around mid-2005, when the plans were being submitted for approval, [Mr AW] representing [Company K] approached [Mr F]. [Mr AW] explained that [Company K] owns nearby pieces of land and would like to jointly develop the site with [the Appellant]. However, our client considered that [the Appellant's] piece of land was too small compared to those of [Company K] and rejected his proposal. [Mr AW] then approached [the Appellant] again but this time, offered to purchase [the Appellant's] land for a very attractive price. After much consideration, the directors of [the Appellant] decided to sell the land to [Company K] to realize the gain held on capital account.'

85. In the 2010 Letter, Company AD said this:

> '(8) [Mr AW] called [Mr F] to arrange a meeting at the Appellant's office.
>
> …
>
> (10) [Mr F, Mr G, Ms B] and [Mr AW] had only two meetings; one was in early May 2005 where [Ms B] represented the board to talk with [Mr AW] who asked her if they were interested in developing the property together (which they rejected as it was not the intention of [the Appellant] to develop its properties for sale; more importantly [Ms B] had also indicated to [Mr AW] clearly that the properties of [the Appellant] were to be developed for long term investment purpose, contrary to [Company K's] intention of selling the properties for trading profits) and the other meeting (2 or 3 days later) was where [Mr AW] offered to purchase the land from [the Appellant]. All the other negotiations were conducted through phone calls. No formal minutes were prepared for the two meetings.
>
> Our clients would like to point out that had the properties of [the

> Appellant] been developed for sale, they would have agreed to [Company K's] joint development proposal, to take advantage of the brand name and business goodwill of [Company K] so as to maximise the trading gains on [the Appellant's] properties.
>
> …
>
> (14) [Mr AW] approached [Mr F] again a few days after the first meeting and offered to purchased the land from [the Appellant]. [Mr F], after considering the possibility that [Company K] may be building larger and better quality residential buildings nearby, which could compete with [the Appellant's] proposed development, rendering it difficult for [the Appellant] to let out its properties upon completion and at the price offered by [Company K] which was too tempting to be resisted, decided to dispose of land.
>
> …'

86. The first letter was written in 2008 before Mr F passed away in April 2010. The second letter was written in September 2010, but was in response to enquiries made by the Assessors in 2009. Presumably Company AD had taken instructions from Mr F before they drafted the two letters. Neither letter tells us what was discussed in the telephone exchanges.

87. Ms B also gave evidence on the circumstances in which the sale was agreed. We find several inconsistencies between the version of events stated in Company AD's two letters and that stated by Ms B in her witness statement:

(1) Instead of prior appointment, Ms B said that Mr AW simply dropped into their office one day in early May 2005 without an appointment, and the receptionist referred Mr AW to her.

(2) Ms B made no mention of the presence of Mr G in the meeting with Mr AW.

(3) According to Ms B, Mr F politely rejected Mr AW's offer for a joint venture, telling him that they intended to keep the land for rental income. And after Mr AW had left, Mr F told Ms B that co-operation would be difficult, not only because they would not be able to keep the properties for rental purpose, but also because the land held by the Appellant was much smaller than the land held by Company K and as compared with Company K; Company E group had limited financial ability, and so would be left with very little say in the proposed joint venture. This is in stark contrast to Company AD's 2010 letter which suggested that joint development would have been good because Company E would be able to take advantage of the brand name and business goodwill of Company K.

(4) Ms B never mentioned the other reason given in the 2010 Letter, namely the worry that Company K would be building better quality houses and the Appellant would not be able to compete with them. Indeed we do not understand how this could be a valid reason if the Appellant was aiming at the rental market as alleged, because then they and Company K would be targeting different groups of consumers.

88. In the midst of these discrepancies it is hard to make any definitive findings of fact. We are prepared to accept that (1) it was Mr AW who approached the Appellant; (2) Mr AW's first offer was for a joint venture; (3) in rejecting the offer, Mr F used long term rental as a pretext. But that was said in the course of negotiation with Mr AW. A reluctance to sell is the best inducement for a better offer. Immediately following the meeting there were telephone exchanges between Mr AW and Mr F, and within a matter of 2 to 3 days, a deal was made for the sale of the land at a handsome price. This whole scenario demonstrates to us an intention to sell – a preference for outright sale to a time-consuming joint venture development.

The Note signed by Mr AW

89. In the course of correspondence with the Assessor, Company AD produced a letter in Chinese dated 16 September 2010 ('the Note') from Ms B to Mr AW purportedly reciting what happened during the negotiation in 2005. The Note invited Mr AW to sign and confirm the same, which he did.

90. This Note has little evidential value:

(1) It was drafted by Ms B. Mr AW merely appended his signature to it.

(2) Mr AW is, of course, one of the accused involved in the criminal trial of Mr BA and others, and is currently serving a prison sentence. He was not available to give evidence, and so was not subject to any cross-examination.

(3) There is in any event no evidence that when Mr AW signed the Note, he agreed that should need arise, he was prepared to testify under oath and be cross-examined on the Note. There is no such statement in the Note.

(4) There is no declaration of truth by Mr AW as in an affirmation.

91. The Note was clearly drafted after the demise of Mr F. It largely repeats Ms B's evidence. It is little more than a self-serving statement. We place no weight on this Note.

The Evidence of Mr C

92. Mr C, proprietor of Company D, was called principally to tell us that after the First Land Lots were purchased in 1991, Mr F instructed him to prepare for the development of the land into residential houses and told him that the Appellant intended to keep the houses for rental purposes and, therefore, the houses should be built with better materials and higher standard of finishes. Mr F also mentioned expats and open space.

93. Mr C is a gentleman in his 80s. He was asked to recall conversations allegedly happened back in 1991, over 20 years ago. According to him, Mr F was a regular client of his since mid-1970s. Mr F had numerous property developments (as demonstrated by the accounts of Company E). How and why Mr C should remember this development in particular he did not say. He gave no detail of the circumstances in which the alleged instructions were given – were they written or verbal, if verbal, were they said in a meeting, when and where and was anyone else present?

94. There are no documents to refresh Mr C's memories. There is no engagement letter or correspondence of any kind, as one would expect for a project of this size. There is no document evidencing what instructions were given to him.

95. It appears from the correspondence that Mr C did prepare some layout plans for the Appellant in 1992/1993, but Mr C admitted that these were merely sketch plans, very rough drafts, and the need to consider finishing materials would come at a much later stage. Indeed in none of the documents, whether plans or otherwise prepared by Mr C, do we find any reference to finishing materials.

96. In a letter dated 14 May 1992 to the DLO, the Appellant did make reference to reducing the number of houses proposed to be built 'for the sake of rendering much more fresh air and spaces for the residents'. When asked in re-examination whether it was Mr C's initiative to revise the number of houses or how it was decided, Mr C said he could not remember. We note that even with the proposed reduction, the plot ratio was 1.0, which far exceeded the plot ratio of 0.4 permitted for the Residential (Group C) Zone. We have no clue whether the reduction was for the purpose of attracting expatriate tenants as alleged, or simply an attempt to match the plot ratio requirement.

97. In a letter of 16 July 2008 by Company D, signed by Mr C, it was stated:

> 'We confirm that we were commissioned by [the Appellant] to be the architect for the development at [District Q], [Address R] in 2004.
>
> We further confirm that we had prepared and submitted building plans in respect of the above site to the Buildings Department, pending its approval and that we were instructed by the client that the development scheme subsequent to the approval of the building plans was to be prepared on the basis that the completed properties having materials and finishes of durable and higher quality will be

used for rental purposes.'

98. This letter was supplied to the Assessor by Company AD. Again we note the lack of precision of this letter. It referred to 'the client' and 'we'. But by whom and to whom the alleged instructions were given it did not say. This letter was written in 2008 when Mr F was still alive. This letter was written for the very purpose of arguing that the 4 Land Lots were for long term rental. One would expect Mr C and Mr F to make more effort in jogging each other's memories and giving us more details of the alleged instructions, if they were indeed ever given. Moreover, Company AD was well aware that the argument was on the requisite intention at the time the 4 Land Lots were purchased back in 1991 to 1996, yet this letter talked of 2004, the time of the New Grant. It made no mention whatsoever of any instructions given in 1991, as Mr C now claimed to have received.

99. Having listened to his evidence carefully and having regard to all the evidence before us, we are of the view that Mr C's evidence of the alleged instructions is unreliable and we place no weight on it.

The Evidence of Ms B

100. We have dealt with relevant parts of Ms B's evidence in our discussions above. Ms B is, of course, handicapped in her evidence, not only by the fact that she did not join Company E until 1997, but also by the fact that Mr F dealt with the surveyors and the architects (and Mr AX, see below) directly. Her knowledge was limited to whatever Mr F told her or whatever instructions Mr F gave her. Her evidence is thus deficient in many respects.

101. She told us that Mr F had on a number of occasions mentioned that the land at Location AJ was for rental, but the circumstances in which such was mentioned she could not elaborate. The impression we are given is that it was mentioned in a casual informal manner during family gatherings.

102. We do not rule out the possibility that Mr F might have considered the chances of rental every now and then in the 10 years or so that he was holding the land, but 'contemplation' and 'decision' are quite different matters (HKSKH, note 19). Such desultory remarks, even if made, are nowhere near sufficient to prove the requisite intention.

Badges of Trade

103. We do not think we need to examine the badges of trade as a checklist in this case, save to point out that:

(1) The Appellant had engaged in similar transactions – there were sale and purchase of other pieces of land as well as part of the First Land Lots, none of the land was developed for rental purposes.

(2) The Appellant had held the 4 Land Lots for over 10 years, but most of the 10 years were spent on arguing for a lower premium.

(3) The Appellant has sought to add re-sale value to the land by the Surrender and Regrant.

(4) We cannot say, however, that the Appellant had expended time, money and effort that went beyond what might be expected of a non-trader. A developer of the land for rental would likewise have to apply for the Surrender and Regrant. But this question is not as important here as in HKSKH because in the present case, the intention from the start was to develop for resale.

(5) The audited accounts were as good as a concession of an actual intention to resell at a profit when the land lots were acquired.

Construction works before the land was sold

104. In Company AD's 2008 Letter and 2010 Letter, they stated that 'the land was disposed of when site preparation works such as geotechnical investigation were being carried out but before commencement of actual construction work.' They produced various plans and correspondence in support. Further supporting documents were produced in their 2011 Letter.

105. The Commissioner in his determination referred to some of those documents and considered that the Appellant had not 'taken concrete steps to carry out the required construction works'. He viewed it as one of the factors to show that the Appellant had no genuine intention to develop the land for rental purposes.

106. We agree that slow progress in the construction of the site would indicate an intention to make an outright sale. However, without the assistance of expert evidence, we do not feel able to decide by simply looking at these documents whether the Appellant had 'taken concrete steps' to carry out the construction works. The Appellant had clearly taken some steps, but the exact extent of these works we cannot tell. Nor can we tell whether progress was expeditious or slack.

107. Unlike the Commissioner, we do not feel we can place any weight on this factor.

Summary

Realisation of capital assets (Ground 1 of the Grounds of Appeal)

108. In summary:

(1) The contemporaneous documents, namely the audited accounts for the years in which the 4 Land Lots were purchased, made it plain

that the land lots were trading stocks/current assets of the Appellant.

(2) Consistent with this, parts of the First Land Lots were sold as current assets and profits tax thereon were duly paid.

(3) There are no credible explanations for these account treatments if they were not correct.

(4) None of the documents (except the correspondence between Company AD and the Assessor, which were self-serving) evidenced an intention for long term rental.

(5) Apart from gauging their contentions for a lower premium on the resale value of the land, Company J even asked for a longer deferment period 'to allow for a longer marketing period in the present sluggish economic situation'. Their contentions demonstrated an intention to develop for resale.

(6) The long drawn out negotiation on the land premium was more consistent with a development for resale than long term rental.

(7) Once the Regrant was made, the Appellant sold the land within a year.

(8) The circumstances in which the sale was agreed demonstrates an intention to sell – a preference for outright sale to a time-consuming joint venture development.

(9) There was never any assessment of the rental potential of the land.

(10) Mr C's evidence of instructions given to him in 1991 on better finishing materials and more open space is unreliable for the reasons given.

(11) Mr B's evidence was deficient in many respects. Insofar as Mr F had intimated an intention to develop the 4 Land Lots for rental, such remarks were made in casual informal circumstances and were insufficient to prove the requisite intention.

(12) An examination of the badges of trade does not bear out an intention to purchase for investment, but is more consistent with an intention to sell.

109. Having regard to all the facts and evidence, we find that the requisite intention was always one of trade. The 4 Land Lots in questions (subsequently replaced by the Sold Land Lots) were purchased and sold as part of the current assets/trading stock of the Appellant. They were not capital in nature.

Change of intention (Ground 2 of the Grounds of Appeal)

110. Ground (2) of the Grounds of Appeal seeks to argue as an alternative that if the original intention were one of trade, there was a subsequent change of intention to hold the property as a long term investment. It does not specify when the alleged change occurred, when the authorities are clear that if findings of this kind are to be made, precision is required [HKSKH, paragraph 18].

111. Mr Co, who essentially spent one paragraph on it in his submission, did not seriously argue this ground. He suggested that the change was in 1998.

112. Company AD made it clear in their letters that there was no change of intention. They made it clear that the 'reclassification' of the land holding to 'non-current assets' in the accounts was simply a reclassification, not a change of intention.

113. On the facts before us, we cannot find any evidence to substantiate a change of intention.

The Agency Fee (Ground 3 of the Grounds of Appeal)

114. In Company AD's 2008 letter, the Appellant's case was simply that Mr AX acted as a middleman when the Appellant purchased the First Land Lots in 1991 and the 'Agency Fee' was paid to him as his commission in relation to that purchase. This letter gave no explanation of why the commission was not paid in 1991, but in 2005.

115. In Company AD's 2010 Letter, they sought to explain this by stating that in 1991 when the land was purchased, Mr F agreed with Mr AX that the commission would be paid when the development was completed and the Appellant started to receive income from the development. As the land was sold prior to actual development, the Appellant paid Mr AX at the time of sale in 2005. They confirmed that Mr AX was not involved in the sale of the land. This letter gave no explanation of how the figure of HK$5 million was agreed.

116. Then in their letter dated 28 September 2011 ('2011 Letter'), Company AD sought to give further explanation by stating that Mr AX was a well-known figure in his village and in order to purchase and develop the land 'smoothly', the Appellant engaged the service of Mr AX to make the best use of his 'connections'. The commission paid was based on 'the level of difficulty' in negotiating the purchase and development of the land. We note that this letter was made in 2011, in response to enquiries made by the Assessor in October 2010, well after Mr F had passed away. The instructions were given to Company AD by Ms B.

117. In Ms B's evidence, she elaborated on this explanation. According to her understanding, land in Region P are held by indigenous people of different interests and some of them are persons with background who can stir up troubles and sabotage the construction works. Villagers who are well-connected and well respected are engaged as

middlemen to help to avert such troubles. Mr AX was engaged as such a middleman.

118. Ms B frankly admitted that when Mr F asked her to get the cheque of $5 million ready, he did not tell her the reason for the payment. She had no personal knowledge of the actual agreement between Mr F and Mr AX. She had met Mr AX a few times when he came to the office to see Mr F, but she never engaged in negotiation with Mr AX herself. Her explanation of the payment was based on her understanding of the role of Mr AX.

119. In cross-examination, Mr Suen referred her to the Appellant's ledger referred to above regarding the purchase of the First Land Lots in 1991. There is an entry for brokerage commission (經紀佣金) paid to Company AU on 4 January 1992 in the sum of $312,532.60. This 'Commission' was also set out in the audited accounts for the year ending 1992. Neither the ledger nor the audited accounts made any reference to a commission or 'Agency Fee' of $5 million. Ms B had no knowledge of this payment of $312,532.60 to Company AU. As stated above, Mr AX was at all material times a director of Company AU.

120. Under section 16(1) of the IRO, in order to be deductible, the sum must be incurred in the production of the chargeable profit.

121. Given the copied cheque and receipt submitted by the Appellant, we accept that a sum of $5 million was paid to Mr AX, but we cannot discern the precise purpose of this payment:

(1) If, as per the 2008 Letter, the sum was paid as commission in relation to that purchase of the First Land Lots, then there was no reason why it was paid in 2005 – almost 14 years afterwards, and, in any event, a commission of $312,532.60 was already paid to Company AU in 1992.

(2) If, as per the subsequent letters and Ms B's evidence, it was paid to Mr AX because of his connections and position in the area, then, first of all, this was simply conjecture on the part of Ms B, and secondly, we do not see how expenses of this kind can be regarded as outgoings and expenses incurred in the production of the chargeable profits. Mr AX's connections and position in the area did not contribute to the sale of the Sold Land Lots.

(3) Further, the purchase price of the First Land Lots was $18,941,370. An 'Agency Fee' of $5,000,000 would be over 25% of the purchase price. There is still no explanation of how a substantial fee such as this was arrived at.

122. In the circumstances, we agreed that the Agency Fee is not deductible under section 16(1) of the IRO.

Conclusion

123. The requisite intention was always one of trade. The 4 Land Lots in questions (subsequently replaced by the Sold Land Lots) were purchased and sold as part of the current assets/trading stock of the Appellant. The profit arising from the sale thereof was not profit arising from the sale of a capital asset under section 14(1) of the IRO.

124. There was never any change of intention from trade to investment as alleged.

125. The Agency Fee was not deductible under section 16(1) of the IRO.

126. Further and alternatively, the Appellant has fallen far short of its burden of proof under section 68(4) of the IRO in respect of each of the grounds of appeal.

127. In the circumstances, we dismiss the appeal and confirm the assessment to profits tax under section 68(8) of the IRO.

128. This appeal has little merits. Under section 68(9) of the IRO, we order the Appellant to pay as costs of this Board the sum of $10,000.

129. We are grateful to both Counsel for their assistance.

Appendix A

For hearing before the Board of Review on 23-24 May 2016

Company BB
Appeal to the Board of Review
Profits Tax assessment 2005/06

REVISED STATEMENT OF AGREED FACTS

1. Company BB ('the Company') has objected to the Profits Tax Assessment for the year of Assessment 2005/06 raised on it. The Company claims that the profit derived by it from the sale of land was capital in nature and should not be chargeable to Profits Tax.

2. (a) The Company was incorporated as a private company in Hong Kong in October 1986. At all relevant times, the Company's paid-up share capital was $10,000 divided into 10,000 shares of $1 each. Company E held 9,999 shares and Mr F ('the Deceased Director'), who passed away on 18 April 2010, held the remaining 1 share in the Company.

(b) The Company's directors during the years of assessment 1990/91 to 2005/06 were the Deceased Director, Mr G and Mr H. The Deceased Director resigned from directorship on 8 September 2007 and Ms B was appointed as a director on 18 January 2007.

(c) Mr G is the son of the Deceased Director. Ms B is the spouse of Mr G.

3. (a) By an assignment dated 31 December 1991, the Company purchased the following 25 pieces of agricultural land in District Q, Address R at a consideration of $18,941,370 - Lots AF[1], AN, BC[2], AQ, AS[3], BD[4], BE, BF, BG, BH, BJ, BK, BL, BM, BN, BP, BQ, BR, BS, BT, BU, BV, BW, BX[5] and BY ('the First Land Lots').

Notes

[1] Lot AF was subsequently carved into sections A, B, C and RP.

[2] Lot BC was subsequently carved into sections A and RP.

[3] Lot AS was subsequently carved into sections A, B and RP.

[4] By a Deed of Rectification and Confirmatory Assignment dated 15 October 1998, the Company and the vendor confirmed that the land lot assigned to the Company should be Lot BZ instead of BD.

[5] The Company subsequently confirmed with the Lands Department that Lot BX had never existed.

(b) By an assignment dated 19 May 1992, the Company purchased the following 4 pieces of agricultural land in Lot U in District Q at a consideration of $2,054,948 - Section A of Sub-Section 1 of Section A, Section B of Sub-Section 1 of Section A, Sub-section 2 of Section B and Remaining Portion of Sub-Section 3 of Section B ('the Second Land Lots').

(c) By an assignment dated 8 June 1993, the Company purchased Lot V in District Q at a consideration of $1 ('the Third Land Lot').

(d) By an assignment dated 1 April 1996, the Company purchased Lot X in District Q at a consideration of $222,813 ('the Fourth Land Lot').

4. (a) By an agreement and conditions of exchange dated 5 August 2004, the Government of the Hong Kong Special Administrative Region granted Lot AK in District Q ('the Exchanged Land Lot') to the Company under, among others, the following conditions:

(i) The Company had to surrender the First Land Lots (except Lots AG, AL, AM, AN, AP, AQ, AR and AS), the Third Land Lots and the Fourth Land Lots contemporaneously with the execution of the agreement.

(ii) The Company had to pay a premium of $23,430,000 to the Government.

(iii) The Company had to develop on the Exchanged Land Lot by the erection thereon a building or buildings and such building or buildings had to be completed and made fit for occupation on or before 31 March 2008.

(iv) The total gross floor area of any building or buildings to be erected on the Exchanged Land Lot should not be less than 1,981 square metres and exceed 3,302 square metres or three storeys.

(v) The Company should not partition the Exchanged Land Lot whether by way of assignment or other means of disposal. The Company, however, might assign the whole lot but not a part thereof absolutely.

(b) Mr G signed the agreement on behalf of the Company. By a Deed

of Surrender dated 5 August 2004, the Company surrendered the relevant land lots [Fact (4)(a)(i)] in exchange for the Exchanged Land Lot.

5. By an agreement for sale and purchase dated 14 July 2005, the Company sold the Exchanged Land Lot, Lots AM, AP, AQ and AS in the First Land Lots and the Second Land Lots (collectively referred to as 'the Sold Land Lots') to Company AT at a consideration of $130,000,000. By a letter dated 13 May 2005, before signing the agreement for sale and purchase, Company AT's solicitors requested the Company's solicitors to provide a draft agreement for sale and purchase for their approval. The Sold Land Lots were assigned to Company AT on 15 August 2005.

6. (a) The Company filed its 2005/06 Profits Tax Return with supporting accounts for the year ended 31 March 2006 and a tax computation.[1]

(b) The Company described its principal activities in the directors' report as property development.

(c) In the tax return, the Company declared an adjusted loss of $157,198. In computing the adjusted loss, the Company excluded and did not offer for assessment the profit of $76,404,106 derived from the sale of the Sold Land Lots.

7. The profit of $76,404,106 derived from the sale of the Sold Land Lots was computed as follows:

	$	$
Sale proceeds		130,000,000
Purchase costs		21,519,183
		108,480,817
Less:		
Architect fee	565,970	
Consultant fee	924,450	
Site Fencing and security	554,280	
Salaries and allowances	810,934	
Administration fee paid to the Government	344,470	
Planning fee	113,190	
Legal fee	129,157	
Site expenses	204,260	
Land premium for exchange	23,430,000	
		27,076,711
		81,404,106
Less: Agency fee ('the Fee')		5,000,000
Profit		76,404,106

[1] The Company filed 2005/06 Profits Tax return on 14 June 2007.

8. The Company did not reply the Assessor's enquiry on the purchase and sale of the Sold Land Lots.[2] The Assessor raised on the Company the following 2005/06 Profits Tax Assessment:[3]

	$	$
Loss per return		(157,198)
Add:		
Profits on sale of the Sold Land Lots	76,404,106	
The Fee	5,000,000	
		81,404,106
Assessable Profits		81,246,908
Less:		
Loss brought forward set off		(445,719)
Net Assessable Profits		80,801,189
Tax Payable thereon		14,140,208

9. The Company, through Company AD ('the Former Representatives'), objected to the 2005/06 Profits Tax Assessment on the following grounds:[4]

(a) the profit of $76,404,106 arose from the sale of the Sold Land Lots was capital in nature and should not be chargeable to Profits Tax; and

(b) the Fee of $5,000,000 should be deductible as it was related to the purchase of the Sold Land Lots.

10. In correspondence with the Assessor, the Former Representatives provided, *inter alia*, the following information:

(a) The Company was established by the Deceased Director and his family through Company E for the purpose of acquiring land in Region P.[5]

(b) Company E was a well-established property investment company founded by the Deceased Director in 1970.[6]

(c) The Sold Land Lots were disposed of when site preparation works such as geotechnical investigation had been carried out but before the commencement of the actual construction work.[7]

[2] The Assessor's enquiry was issued on 23 July 2007.
[3] The Assessor issued the 2005/06 Profits Tax Assessment on 27 June 2008.
[4] The Company objected to the 2005/06 Profits Tax Assessment on 9 July 2008.
[5] Provided in the letter dated 7 July 2008.
[6] Provided in letters dated 13 September 2010 and 28 September 2011.
[7] Provided in the letter dated 4 July 2008.

(d) The Sold Land Lots fell within Location AJ Outline Zoning Plan No. X/XX-XXX/X dated 27 June 1994 for 'Residential (Group C)' purpose. Neighbouring area was predominately zoned for Residential (D), Village Type Development (V), Comprehensive Development Area (CDA) and Green Belt (GB). As of 19 May 2015, the Sold Land Lots fell within Outline Zoning Plan No. X/XX-XXX/XX. The explanatory notes attached to the Outline Zoning Plan No. X/XX-XXX/XX contained the following remarks:[8]

> 'On land zoned "Residential (Group C)", any new building or any addition, alteration and/or modification to an existing building, i.e. a building which is in existence on the date of first publication in the Gazette of the Notice of the interim development permission area plan, … shall not result in a total development or redevelopment in excess of a plot ratio of 0.4, a site coverage of 20% and a building height of 3 storeys (9m) including carport or the plot ratio, site coverage and height of the existing building, whichever is the greater. Minor relaxation of these restrictions, based on the merits of individual development proposals, may be considered by the Town Planning Board on application under section 16 of the Town Planning Ordinance.'

11. The Former Representatives made, *inter alia*, the following claims:

(a) At the time of the acquisition, the Company intended to construct residential buildings for earning rental income at the time it purchased the First Land Lots. The lots were close to Estate AV, Estate AY and Estate AZ. The properties developed by the Company would attract people living nearby to become tenants of the Company. The Company indicated its intention to develop the lots into residential area in a letter to the District Lands Officer with layout plans attached in 1992. The Company also instructed Company D, architects in 2004 for the proposed development project. Company D provided a letter dated 16 July 2008 claiming that the Company instructed them to use materials of a higher quality for the proposed development in view that those buildings will be rented out. The building plans were prepared in or around September 2004 and were submitted to the Building Authority in 2005.[9]

(b) The Company negotiated with the Lands Department regarding the premium payable for the change of use of land during 1992 to 1997. The amount of premium determined by the Lands Department in

[8] Provided in the letter dated 30 October 2014.
[9] Provided in the letter dated 4 July 2008.

1997 was $76,330,000. The Company considered that the amount of premium was too high and negotiated with the Lands Department but without success. At the same time, Asian financial crisis broke out and the property market started to deteriorate drastically with no signs of recovery. The directors decided to slow down the negotiation and development. The directors negotiated with the Lands Department regarding the premium again in 2004. The amount was finally determined and agreed at $23,430,000. The payment of the premium was financed by Company E.[10]

(c) The auditor at the time of purchase classified the First Land Lots as current asset as the development and the negotiation with Lands Department had not yet commenced. In 1997 when the Lands Department proposed a premium of $76,330,000 for the change of usage, the auditor realized in the circumstances that the Company had the intention to develop the land for rental purpose. The auditor thus reclassified the land from current assets to non-current assets in the year ended 31 March 1998. No independent valuer was appointed to ascertain the market value of the land in 1997/98 as the transfer was merely a reclassification and not a change of intention.[11]

(d) The Company estimated that the total project cost approximately was $74,450,000 (i.e. land cost of $21,519,183, premium of $23,430,000 and estimated development cost of $29,500,000) and the annual rental income to be generated from the completed buildings approximately was $7,623,600 (i.e. 33,020 square feet x $15 per square foot x 12 + 70 carparks x $2,000 x 12). Thus, the rental yield was 10.24% (i.e. $7,623,600 / $74,450,000 x 100%).[12]

(e) Company E would finance the project entirely without the need to resort to external borrowings. Company E had net current assets of $320,948,372 as at 31 March 2006, which included bank deposits of $99,715,377. Company E was in good position to finance the project.[13]

(f) The Company did not put the land on sale. The sale was initiated by the purchaser, Company AT, a group company of Company K, under the following circumstances:

(i) In around mid-2005, when the development plans were being submitted for approval, a person named Mr AW representing

[10] Provided in the letter dated 4 July 2008.
[11] Provided in the letter dated 4 July 2008.
[12] Provided in the letter dated 4 July 2008.
[13] Provided in the letter dated 4 July 2008.

Company K approached the Deceased Director. Mr AW explained that Company K owned nearby lots of land and would like to develop the site jointly with the Company. The Company considered that the Sold Land Lots were too small compared to those of Company K and rejected Mr AW's proposal.[14]

(ii) Two meetings were held in May 2005 between the Deceased Director, Mr G, Ms B and Mr AW. In the first meeting held on 5 March 2005, Ms B represented the Company's board of directors to discuss with Mr AW. Mr AW asked Ms B if the Company was interested in developing the property together. Ms B rejected the offer and indicated to Mr AW that the Sold Land Lots were to be developed for long term investment purpose, contrary to Company K's intention of selling the properties for trading profits. Mr AW approached the Company again two or 3 days later and held another meeting to offer to purchase the Sold Land Lots. No formal minutes were prepared for the two meetings.[15]

(iii) The directors of the Company decided to sell the Sold Land Lots to Company K to realize the gain as the price was very attractive. The initial price offered by Mr AW was very close to the final selling price of $130 million. All negotiations were conducted through phone calls between Mr AW and the Deceased Director a few days after the first meeting.[16]

(g) The Company provided a letter dated 16 September 2010 with Mr AW's signature explaining the circumstances.[17]

(h) The fund obtained from the sale of the Sold Land Lots was held by the Company pending good investment opportunities.[18]

12. The Company contended that the gain on disposal of the Sold Land Lots was capital in nature for, *inter alia*, the following reasons:[19]

(a) The Sold Land Lots had been held for more than 10 years.

(b) Company E was capable of providing financial support to the Company to develop the land. In fact, no external borrowing was sought to finance the project.

[14] Provided in letter dated 4 July 2008.
[15] Provided in letter dated 13 September 2008.
[16] Provided in letter dated 13 September 2008.
[17] Provided with the letter dated 28 September 2011.
[18] Provided in letter dated 4 July 2008.
[19] Provided in letter dated 4 July 2008.

(c) The expected rental return was satisfactory.

(d) The Company at all times did not initiate to sell the Sold Land Lots. The sale was initiated by the purchaser.

(e) The Company had taken actions to develop the Sold Land Lots by submitting building plans after it had agreed to the land premium.

(f) The Sold Land Lots were classified as non-current asset and the loan from Company E was classified as long term liability in the accounts indicated that the Company intended to hold and let the units after development. The rental generated was used to repay the loan from Company E.

(g) Although the Company did not carry out any property development prior to the disposal of the Sold Land Lots, Company E had established records of developing building for rental purposes.[20]

13. On the Fee of $5,000,000, the Company made the following claims:

(a) The Fee was paid to Mr AX. Mr AX was a well-known person in the village. The Company engaged the services of Mr AX to ensure that the purchase and development of the Sold Land Lots could be carried out smoothly. The Fee was not paid for sale of the Sold Land Lots.[21]

(b) The Deceased Director agreed orally to pay Mr AX commission for acting as the middleman in the purchase of land in 1991. The Deceased Director agreed to pay Mr AX commission when the development had completed and commenced to generate rental income. However, the Sold Land Lots were sold prior to the development had actually carried out and the Company paid Mr AX the commission in 2005 at the time the Sold Land Lots were sold.[22]

(c) No service agreement or minutes of directors' meetings authorizing the payment of the Fee was available.[23]

(d) Payment of the Fee was supported by cheque and receipt. The Company had also reported the payment to the Inland Revenue Department in the 'Notification of remuneration paid to persons

[20] Provided in letter dated 30 October 2008.
[21] Provided in letters dated 4 July 2008 and 28 September 2011.
[22] Provided in letters dated 13 September 2010 and 28 September 2011.
[23] Provided in letter dated 4 July 2008.

other than employees' dated 19 June 2006.[24]

14. The Assessor ascertained the following information from the Company's correspondences with government departments:

Date	Particulars
21-01-1992	The Company as registered owners of the First Land Lots applied to the District Lands Office ('DLO') for a land exchange.
12-02-1992	DLO replied the Company that residential development would be considered provided that standards including the following were conformed with: (a) Plot ratio: 0.4 (b) Site coverage: 20% (c) Building height: 2 storeys over one level of carport (d) No exempted building (i.e. full submission of building plans to BOO for approval) DLO further stated that minor relaxation of the restrictions would be considered by the Town Planning Board on application under section 16 of the Town Planning Ordinance.
14-05-1992	The Company notified DLO that it had decided to reduce the number of houses proposed to be built on the First Land Lots from 52 to 46.
13-10-1992	DLO provided the following preliminary comments on the layout plan: '(A) The proposed development as shown on the Master Layout Plan indicates a plot ratio of 1.0, a site coverage of 33.3% and a building height of 3 storeys which are not in accordance with the planning parameters of the 'R(C)' zoning on the draft [Location AJ] DPA Plan. If your development proposal is to deviate from the planning parameters as laid down by the DPA Plan, planning application to the Town Planning Board is required. (B) The traffic noise level at the proposed façade of the first row of buildings will be up to 78.5 dBA, if there is not any noise mitigation measures. The Layout Plan No. G1a is not acceptable from noise point of view … (C) Car parking spaces are suggested to be provided at a rate of not less than 1 space per residential unit or per 100 sq. m. gross floor area whichever is the less.'

[24] Provided in letter dated 30 October 2014.

Date	Particulars
10-07-1993	The Company made an application to the Town Planning Board to change the use of the First Land Lots from agricultural use to residential use for building 36 three-storey houses.
21-10-1993	Town Planning Board notified the Company that the board decided not to approve the application on the following grounds: '(a) the proposed relaxation of plot ratio, site coverage and building height is not minor … (b) the proposed master layout plan is unsatisfactory in respect of the housing layout and open space provision; and (c) the proposed number of carparking spaces is inadequate and no detailed information on vehicular access arrangement has been included in the submission.'
07-06-1996	DLO notified the Company that its land exchange application could be reactivated and asked the Company to confirm whether it wished to proceed with the development on the basis of the same parameters it proposed in December 1993.
14-06-1996	The Company, through Company J ('the Chartered Surveyors'), notified DLO that the development proposal remained unchanged and asked DLO to process the application based on the same parameters as proposed in December 1993.
10-01-1997	DLO notified the Company that it was prepared to recommend to the Government to proceed with the land exchange and the amount of premium was to be determined.
17-01-1997	The Chartered Surveyors replied that: (a) the Company had 'no in-principle objection to the basic term offer subject to the maximum GFA shall be amended to reflect a plot ratio of 0.4 based on the regrant site boundary to be finalised'; and (b) 'caretakers and recreational clause be included and carparking spaces provided in accordance with the lease conditions shall not be accountable for gross floor area and roof-top structure not exceeding 3 metres shall be permitted'.
15-08-1997	DLO confirmed that it was prepared to recommend to the Government for land exchange at a premium of $76,330,000.

Date	Particulars
09-10-1997	The Chartered Surveyors replied DLO that the basic terms for the proposed land exchange were acceptable to the Company except the premium which should be reduced to $50,250,000. The Chartered Surveyors stated the following: 'In considering the "After Value", we have adopted a development proposal similar to those in the vicinity, i.e. house-type development of 3-storey inclusive of carport. In assessing the gross development value, we have had regard to the sale price of houses in [Estate AV], [Estate CA] and [Estate CB]. However, consideration must be given to the fact that the subject development is of much smaller scale (about 20 houses) and is therefore not so attractive as those large scale developments such as [Estate AV]. The subject site is very close to [Highway CC] and stringent noise mitigation measures are required. It was previously suggested by Government that a noise barrier of at least 7.5m high from ground level has to be erected along the lot boundary facing [Highway CC]. Furthermore, a considerable number of exchange cases have been approved and will be approved by Government for low-rise residential development in the area and there is now an anticipated over-supply. Consequently, the sale price which can be achieved will need to take into account the over-supply situation.'
24-12-1997	DLO agreed to reduce the premium for the proposed land exchange to $50,250,000.
24-01-1998	The Chartered Surveyors notified DLO that the Company considered that the premium was excessively high and would submit a revised assessment shortly.

Date	Particulars
28-04-1998	The Chartered Surveyor lodged an appeal against the premium and asked DLO to reduce premium to $16,850,000 and stated the following: 'Given the current state of the economy generally and the property market specifically, it is evident that the property market is on a downward trend which is unlikely to be reversed in the near future. This is clearly reflected in the recent sales of the [Estate CD] ([Address CE]) which is of a similar development and is very close to the subject site. The asking price is only $4.98 million for a house of 1,615ft^2, representing $3,084/ft^2. Even with this "bargain" price, the take-up is still very sluggish. We were given to understand that there were only one or two transactions. The prospective purchasers have been hit by reduced incomes, the banks' tight mortgage policies, high interest rates and job insecurity. In assessing the gross development value, we have had regard to the sale price of houses in [Estate AV]. These transactions also show the general drop in prices over the last few months from $5,500/ft^2 ($59,200/m^2) in late last year to currently $4,200/ft^2 ($45,200/m^2), a drop of about 24%.'
28-09-1998	DLO agreed to reduce the premium to $16,850,000.
07-10-1998	The Chartered Surveyors replied that the Company had decided not to proceed with the land exchange.
03-11-1998	The Chartered Surveyors, on behalf of the Company, re-applied for the land exchange. The letter was copied to the Deceased Director for his attention.
07-11-1998	DLO replied that the re-application for land exchange would be regarded as 'a new application'.
30-11-2000	DLO notified the Company that it was prepared to recommend to the Government to proceed with the exchange and the amount of premium was to be determined.
13-12-2000	The Chartered Surveyors replied that the provisional basic terms as contained in the letter of 30 November 2000 were acceptable to the Company. The letter was copied to Mr G for his attention.
01-08-2002	DLO advised the Company that the land exchange would be proceeded with and the amount of premium set at $19,740,000.

Date	Particulars
18-11-2002	The Chartered Surveyors replied that the terms of exchange were acceptable save for the amount of premium which should be $4.86 million and stated the following: 'In assessing the "After Value", we have adopted a development proposal similar to those in the vicinity of the site i.e. 3-storey house-type development including a storey of carport. However, consideration must be given to the fact that the subject development is of a much smaller scale (about 26 houses with an average flat size of about 127m^2 saleable) and is therefore not so attractive as those nearby large scale developments such as [Estate AY] and [Estate AV]. Besides, the subject site is very close to [Highway CC] and the provision of stringent noise mitigation measures upon redevelopment are required. … In view of the small scale development and the ample supply of similar house-type developments in the nearby areas, in particular [Estate AY] which consists of more than 1,000 units and contains adequate recreational facilities, the developer will need to lower the average asking price of the subject development in order to enhance its attractiveness to the prospective purchasers.' The letter was copied to Mr G for his attention.
01-08-2003	The Chartered Surveyors notified DLO that the Company intended to further appeal on the amount of premium which was considered to be about $2.31 million and stated the following: 'In view of the inferior location of the subject development and the ample supply of similar house-type residential developments in nearby areas, in particular [Estate AY] which consists of more than 1,000 low rise residential units and with the provision of sufficient recreational facilities, (the Company) will need to lower the average asking price of the subject development so as to enhance its attractiveness to the prospective buyers.' The letter was copied to Mr G for his attention.
07-04-2004	DLO offered a land exchange at a premium of $23,430,000.
06-05-2004	The Chartered Surveyors accepted the terms and conditions, including the premium, set out in DLO's letter of 7 April 2004 for the land exchange. The letter was copied to Mr G for his attention.

Date	Particulars
09-06-2004	DLO notified the Company that their Legal Advisory and Conveyancing Office had recently proposed to revise the 'Restriction on alienation before compliance' clause and asked the Company to consider the amendments.
16-06-2004	The Chartered Surveyors replied that the 'Restriction on alienation before compliance' clause was not acceptable to the Company. The letter was copied to Mr G for his attention.
08-07-2004	DLO sent the Conditions of Exchange, the Deed of Surrender and the Indemnity to the Chartered Surveyors for the Company's execution.
22-03-2005	The Company applied for approval of the building plans and the works to be carried out on the Exchanged Land Lot.
18-04-2005	DLO disapproved the building plans submitted by the Company on 7 April 2005 as it failed to satisfy the requirements stipulated in the Practice Note issued by the Lands Department.
19-05-2005	The Building Department found that the building proposals on the Exchanged Land Lot submitted by the Company was 'fundamentally unacceptable' and disapproved them.
26-07-2005	Company D, sent a statement of account to the Company, which stated 'final account on termination of services'.
17-08-2005	The Company under the Conditions of Exchange was required to fulfil the Building Covenant by 31 March 2008. DLO by an inspection noted that no construction work had yet taken place on the Exchanged Land Lot and asked the Company for the proposed programme of development.
23-09-2005	The Company notified DLO that the Exchanged Land Lot had been sold to Company AT on 15 August 2005.

15. The Assessor ascertained the following information from the Town Planning Board:

(a) There are two types of statutory plans, namely the Outline Zoning Plan ('OZ Plan') and the Development Permission Area Plan ('DPA Plan') prepared by and published by the Town Planning Board under the Town Planning Ordinance.

(b) A draft OZ Plan shows the proposed land-uses and major road systems of individual planning scheme areas. Areas covered by a draft OZ Plan are zoned for such uses as residential, commercial, industrial, open space, Government, institution or community uses, green belt, conservation areas, comprehensive development areas, village type development, open storage or other specified purposes.

(c) A DPA Plan is prepared since the enactment of the Town Planning (Amendment) Ordinance 1991 mainly for the non-urban area. The purpose of a DPA Plan is to provide interim planning control and development guidance for selected areas pending the preparation of a OZ Plan. Any development which is not permitted in terms of a DPA Plan and without the necessary planning permission constitutes an unauthorized development and is subject to enforcement and prosecution by the Planning Authority.

(d) A DPA Plan also indicates land-use zones and is accompanied by a set of notes, which specify the uses that are always permitted and those require the permission of the Town Planning Board, and an explanatory statement setting out the background, the planning principles and intentions of the Board for the various land-use designations. Being interim in nature, a DPA Plan is effective for a period of three years from the date of first publication unless the effective period is extended by the Chief Executive. The Board needs to prepare a OZ Plan to replace a gazetted DPA Plan before its expiry.

(e) The Hong Kong Government gazetted the draft Location AJ Development Permission Area Plan No. XXX/XX-XXX/X and the draft Location AJ Outline Zoning Plan No. X/XX-XXX/X on 12 July 1991 and 24 June 1994 respectively. On 30 May 2003, the Chief Executive in Council approved the draft Location AJ Outline Zone Plan (and renumbered as X/XX-XXX/X upon approval).

16. (a) The Company's profit and loss accounts showed the following income:

For the year ended 31 March	Rent $	Bank interest $	Sundry $	Total $
1996	263,793	-	-	263,793
1997	450,000	-	-	450,000
1998	-	-	-	-
1999	-	-	-	-
2000	-	-	2,469	2,469
2001	-	-	-	-
2002	-	-	-	-
2003	-	-	500	500
2004	-		-	-
2005	-		1,300	1,300
2006	-	2,896,028	6,715	2,902,743

(b) The Company's balance sheets showed the following particulars:

As at 31 March	1991 $	1992 $	1993 $
Assets			
Landed properties	-	19,844,853	21,335,038
Liabilities			
Amount due (from)/to Company E	(419,258)	20,400,778	21,490,778

As at 31 March	1996 $	1997 $	1998 $	1999 $
Assets				
Interest in subsidiary company	19,831,565	27,652,635	44,990,943	46,670,943
Landed properties	21,293,890	21,519,182	22,709,720	22,823,019
	41,125,455	49,171,817	67,700,663	69,493,962
Liabilities				
Amount due to Company E	40,017,086	47,720,969	65,954,077	67,731,077

As at 31 March	2000 $	2001 $	2002 $	2003 $
Assets				
Interest in subsidiary company	31,640,943	31,640,943	31,640,943	31,640,943
Landed properties	23,009,410	23,123,477	23,351,643	23,743,394
	54,650,353	54,764,420	54,992,586	55,384,337
Liabilities				
Amount due to Company E	68,381,077	68,502,077	68,743,331	69,138,381

As at 31 March	2004 $	2005 $	2006 $
Assets			
Interest in subsidiary company	31,640,943	31,640,943	19,140,943
Landed properties	23,838,310	47,650,133	-
	55,479,253	79,291,076	19,140,943
Liabilities			
Amount due to Company E	69,235,832	93,104,827	93,501,640

(c) Notes on the Company's financial statements stated that the amounts due to Company E were unsecured and interest free.

(d) The Company's auditors, the Former Representatives, expressed the following opinion on the landed properties shown in the Company's balance sheets as at 31 March 2001, 2002 and 2004:

> 'Due to lack of development plans and professional valuation of the property, we were unable to form an opinion on the carrying value of the property and to determine whether any provision needs to be made against the cost of the property to recognise any impairment losses.'

17. In response to the Assessor's draft statement of facts, the Company, through Globe Intelligence Management Limited ('the Representative'), made the

following claims:[25]

(a) It was the Company's intention to develop the Sold Land Lots and construct buildings for long term investment. The intention was evidenced by the following actions:

(i) Negotiations with the Lands Department for land exchange for residential development.

(ii) Engagement of the architect to prepare building plans for 'residential development' immediately after the land exchange premium was agreed with the Lands Department.

(iii) Application to the Buildings Department for approval of the residential development plan.

(iv) Engagement of professional to conduct topographical survey, geotechnical investigation works and ground investigation work following the Buildings Department's approval on 19 May 2005.

The survey and investigation works carried out in May 2005 clearly indicated that the Company did not have any intention to dispose of the Sold Land Lots at the material time and the statement made by Ms B to Mr AW during the meetings in May 2005 was genuine.

(b) In the course of negotiation with the Lands Department, the Chartered Surveyors stated that '(the Company) will need to lower the average asking price of the subject development so as to enhance its attractiveness to the prospective buyers'. This was by no means declaration of the Company's intention. It was so stated in the application because the amount of premium would take into account the market price of the houses on completion.

(c) The Sold Land Lots were classified as 'current assets' after acquisition because the intention could not be realized without the Lands Department's approval. Upon receiving the Lands Department's approval, the Company realized that the investment intention was realizable and the Sold Land Lots were then properly reclassified as 'non-current assets'. The classification of the Sold Land Lots as 'current assets' after acquisition was therefore not a declaration of the Company's intention.

(d) If the Department took the view that the investment intention did not

[25] The following were provided in the letter dated 30 October 2014.

exist at the time of acquisition of the Sold Land Lots because of the account treatments, the Department should admit a change of intention in 1998 when the Sold Land Lots were reclassified as 'non-current assets'.

(e) The Company acquired two pieces of land in 1987. One of which was surrendered to the Government in 1988 and the other was sold in 1990/91. The Sold Land Lots were acquired in 1991/92 and sold in 2005/06. During the years 1991/92 to 2005/06, the Company did not engage in similar transaction. The lack of repetition was a pointer which indicated there might not be trade but something else.

(f) Although the Company did not have any record of developing land for long term investment prior to the disposal of the Sold Land Lots, Company E had an established record of development and holding properties for long term investment.

(g) The circumstances leading to the sale of the Sold Land Lots did not exist at the time of acquisition. The Company was not aware that the buyer, Company K, would carry out a large project in the vicinity until it received the invitation from Mr AW. Company K is a prestigious developer. The Deceased Director's concern over the impending competition was not unfounded.

Dated 30th May 2016

(signed)	(signed)
Dixon Co Counsel for Company BB	Gordon Chung Government Counsel for the Commissioner of Inland Revenue