INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D109/03

Profits tax – sections 16, 61, 61A and 68(4) of the Inland Revenue Ordinance ('IRO') – the test under section 61A – whether the transaction conferred a tax benefit on the appellant – whether the transactions were artificial and commercially unrealistic – whether the sole or dominant purpose was the obtaining of a tax benefit.

Panel: Kenneth Kwok Hing Wai SC (chairman), Michael Robert Daniel Bunting SC and Wong Kwai Huen.

Dates of hearing: 23, 24 and 25 June 2003.
Date of decision: 29 March 2004.

The appellant was a private company. It has been a wholly owned subsidiary of the parent company. On 18 December 1987, the parent company sold Sites I and II to the appellant under a sale and purchase agreement. On the same date, 18 December 1987, the appellant, Company H and Company G entered into a joint venture agreement relating to the development of Sites I, II and III.

Under the joint venture agreement, Sites I and II would be developed into a commercial/residential complex under the name of 'Housing Estate P' and Site III would be developed into a replacement industrial building. Company H agreed to finance all the costs, expenses and charges in carrying out and completing the development of Sites I, II and III. The sales proceeds derived from the development would be applied firstly in reimbursing the appellant and Company H of the costs of the development and the balance would be shared between Company H and the appellant.

The assessors inquired as to why the appellant had not recognized the profits on sale of the properties in Housing Estate P in the accounts for the years 1989/90 to 1993/94. The appellant replied that it was only in the financial year 1994/95 that there had been any surplus funds which had been paid to the appellant. The assessor raised profits tax assessment for the year of assessment 1989/90. The appellant objected on the ground that it was estimated and excessive. The appellant further objected against the 1995/96 assessment claiming that the returned profits had been assessed under the estimated assessment raised for the year 1989/90.

On divers dates, the Assistant Commissioner exercised his power under section 61A(2) of the IRO to raise profits tax assessment and additional profits tax assessment. The appellant objected on the ground that the terms of section 61A of the IRO had no application to the

circumstances and that the transactions entered into by the appellant were not entered into for the avoidance of tax nor to enable the company to obtain a tax benefit.

Held:

1. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

2. The test under section 61A is not whether it 'can' be concluded, but whether it 'would' be concluded. The first question is whether the impugned transaction has, or would have had but for this section, the effect of conferring a tax benefit on the appellant. Unless there was a tax benefit, section 61A would not be relevant or the subject matter of consideration. In the Board's decision, the impugned transaction did not have, and would not have had but for section 61A, the effect of conferring a tax benefit on the appellant. Thus section 61A is not relevant (Seramco Ltd Superannuation Fund v ITC [1977] AC 287; CIR v Howe [1977] 1 HKTC 936 and Cheung Wah Keung v CIR [2002] 3 HKLRD 773 considered; Yick Fung Estates v CIR [2000] 1 HKLRD 381 followed).

3. The Board disagrees that the manner in which the transaction was entered into or carried out was artificial and commercially unrealistic. The Board found that the Site I and Site II agreement was realistic from a business or commercial point of view. It is not wrong in law for the consideration in a contract to be framed with reference to profit (British Sugar Manufacturers v Harris (1937) 21 TC 528 followed).

4. Having considered the strength or otherwise of the various resulting conclusions from considering the factors, the Board now looks at the matter globally. The Board's overall conclusion is that the sole or dominant purpose was not the obtaining of a tax benefit.

5. Section 61 is not applicable. Firstly, the impugned transaction did not reduce and would not reduce the amount of tax payable by any person. Secondly, the Site I and Site II agreement is neither artificial nor fictitious.

6. In view of the Board's finding that the consideration under Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view, section 16 does not assist the respondent. Even the Board had found that the consideration was excessive, section 16 confers no authority on the respondent or her assessors to reduce the amount of consideration to what she considers to be reasonable.

Appeal allowed in part.

Cases referred to:

D94/99, IRBRD, vol 14, 603
British Sugar Manufacturers v Harris (1937) 21 TC 528
Union Cold Storage v Adamson (1931) 16 TC 293
Europa Oil v IRC [1976] 1 WLR 464
Yick Fung Estates v CIR [2000] 1 HKLRD 381
IRC v Brebner [1967] 2 AC 18
Peabody v FCT (1993) 25 ATR 32
FCT v Peabody (1994) 28 ATR 344
Eastern Nitrogen v FCT (2001) 46 ATR 474
FCT v Spotless (1996) 34 ATR 183
D67/95, IRBRD, vol 11, 44
D44/92, IRBRD, vol 7, 324
Seramco Ltd Superannuation Fund v ITC [1977] AC 287
CIR v Howe [1977] 1 HKTC 936
Cheung Wah Keung v CIR [2002] 3 HKLRD 773
D154/01, IRBRD, vol 17, 213
Bath and West Counties Property Trust Ltd v Thomas (Inspector of Taxes) [1978] 1 All ER 305

Anselmo Reyes SC instructed by Department of Justice for the Commissioner of Inland Revenue.
Clifford Smith SC instructed by Messrs Johnson Stokes & Master Solicitors for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 5 March 2002 whereby:

(a) Profits tax assessment for the year of assessment 1989/90 under charge number 1-2123971-90-A, dated 18 March 1996, showing assessable profits of $130,000,000 with tax payable of $21,450,000 was annulled.

(b) Profits tax assessment for the year of assessment 1990/91 under charge number 1-5006926-91-9, dated 26 March 1997, showing assessable profits of $15,000,000 with tax payable of $2,475,000 was annulled.

(c) Profits tax assessment for the year of assessment 1991/92 under charge number 1-5013829-92-3, dated 12 March 1998, showing assessable profits of $2,000,000 with tax payable of $330,000 was annulled.

(d) Profits tax assessment for the year of assessment 1992/93 under charge number 1-5022208-93-6, dated 23 March 1999, showing assessable profits of $131,225,000 with tax payable of $22,964,375 was annulled.

(e) Profits tax assessment for the year of assessment 1993/94 under charge number 1-5031008-94-4, dated 27 March 2000, showing assessable profits of $500,000 with tax payable of $87,500 was annulled.

(f) Profits tax assessment for the year of assessment 1994/95 under charge number 1-5056597-95-1, dated 19 March 2001, showing assessable profits of $500,000 with tax payable of $82,500 was annulled.

(g) Profits tax assessment for the year of assessment 1995/96 under charge number 1-3074424-96-4, dated 28 November 1996, showing assessable profits of $108,676,540 (after setting off loss brought forward of $65,000) with tax payable of $17,931,629 was increased to assessable profits of $393,098,962 (after setting off loss brought forward of $65,000) with tax payable of $64,861,328.

(h) Additional profits tax assessment for the year of assessment 1996/97 under charge number 1-1140701-97-3, dated 23 March 1999, showing additional assessable profits of $190,000,000 with additional tax payable of $31,350,000 was confirmed.

(i) Additional profits tax assessment for the year of assessment 1997/98 under charge number 1-2875490-98-0, dated 29 March 1999, showing additional assessable profits of $36,000,000 with additional tax payable of $5,346,001 was confirmed.

The agreed facts

2. The following facts (as set out in the statement of agreed facts) were agreed by the parties and we find them as facts.

3. The following abbreviations have been used:

'the appellant'	Company A

'the parent company'	Company B
'the co-subsidiary'	Company C
'Site I'	TMTL D
'Site II'	TMTL E
'Site III'	TMTL F
'Company G'	[Company G]
'Company H'	[Company H]
'the First Tax Representative'	Company J
'the Second Tax Representative'	Company K
'JSM'	Messrs Johnson Stokes & Master

4. The appellant was incorporated as a private company in Hong Kong on 20 January 1981 and commenced business on 16 October 1987. It has been a wholly owned subsidiary of the parent company. In its accounts, the appellant described the nature of its business as land development.

5. The parent company was incorporated as a private company in Hong Kong on [date] 1957. It has been carrying on a business of cotton spinning and yarn manufacturing in Hong Kong. It was the registered owner of part of Lot No L, and Lot No M and Lot No N in DDXXX. The land was acquired in 1958 and had been classified as a capital asset in the books and accounts of the parent company. Since acquisition, the land had been used by the parent company for their yarn manufacturing operation.

6. Lot No L covered an area of approximately 451,000 square feet which was designated as an industrial site. The original Lot L was divided into two separate lots, being Lot D comprising 397,800 square feet and Lot F comprising 53,820 square feet.

7. Lot No M covered an area of 67,962 square feet and was designated for residential use. Lot No N consisted of 23,130 square feet. Both land lots accommodated a residential building for use by the parent company's employees.

8. In 1986, Lot Nos M and N in DD XXX were surrendered and exchanged for Site II. The registered site area of Site II is about 8,110 square metres (87,296 square feet). The parent company paid a premium of $26,700,000 on 26 November 1986 for the exchange.

9. In 1987, Lot No L was surrendered to the Government in exchange for Site I and Site III. The registered site areas of Site I and Site III are about 36,880 square metres (396,976 square feet) and 5,000 square metres respectively. Premiums paid for the exchange of Site I and Site III were $139,750,000 and $250,000 respectively.

10. Use and development of Site I and Site II are governed by New Grant No XXXX dated 28 November 1987 and New Grant No XXXX dated 24 February 1987 respectively.

11. On 18 December 1987, the appellant entered into a Sale and Purchase Agreement ('the Site I and Site II agreement') with the parent company for the purchase of Site I and Site II. The consideration comprised of:

(a) a payment of $346,309,452.06 and interest thereon ('the Initial Sum');

(b) an obligation to build or procure the building of a new industrial building on Site III not exceeding a construction cost of $193,000,000;

(c) a further sum of $400,000,000 subject to the appellant realising net profits of such amount; and

(d) an additional sum of 50% of the final net profits realised by the appellant from the development of the properties at Site I and Site II.

A copy of the Site I and Site II agreement is at Board of Review Bundle (B1), pages 28 to 38.

12. By an agreement for sale and purchase dated 18 December 1987 ('the Site III agreement'), the parent company agreed to sell Site III to the co-subsidiary, another wholly owned subsidiary of the parent company but reserving the right of redevelopment by the demolition of the existing buildings and erections thereon a new industrial building. Under the Site III agreement, the parent company was obliged to build or to procure a new replacement industrial building to be built on Site III for the benefit of the co-subsidiary.

13. On the same date, 18 December 1987, the appellant, Company H and Company G entered into a joint venture agreement ('the JV agreement') relating to the development of Sites I, II and III. Under the JV agreement, Company G agreed in principle with the appellant to procure such redevelopment and construction on Site I and Site II into a commercial/residential complex under the name of 'Housing Estate P' and Site III into a replacement industrial building. As regards Site III, the industrial building was built so as to enable the appellant to satisfy its obligation to the

parent company under the Site I and Site II agreement, and thereby to enable the parent company to satisfy its obligation to the co-subsidiary under the Site III agreement. The industrial building was to be delivered to the appellant at no cost to the appellant. Company G nominated Company H to be the developer. Company H agreed to finance all the costs, expenses and charges in carrying out and completing the development of Sites I, II and III. The sales proceeds derived from the development would be applied firstly in reimbursing the appellant and Company H of the costs of the development and the balance would be shared between Company H and the appellant.

A copy of the JV agreement is at B1, pages 39 to 94.

14. Company H is a wholly owned subsidiary of Company G formed for the purpose of the development.

15. Company H completed the construction of Housing Estate P Phase I on Site II and the industrial building on Site III. The occupation permits were issued on 26 September 1989 and 3 April 1990 respectively.

16. Company H completed the construction of Housing Estate P Phase II on Site I. The occupation permit was issued on 17 January 1994.

17. The residential units in Housing Estate P Phase I and Phase II were offered to the public for sale before the construction was completed.

18. Payments made by the appellant to the parent company under the Site I and Site II agreement are summarised at B1, page 95.

19. Payments made by Company H to the appellant under the JV agreement are summarised at B1, pages 96 to 97.

20. Extracts of the audited accounts of the appellant for years 1988/89 to 1997/98 are shown at B1, pages 98 to 101.

21. In reply to enquiries raised by the assessor, the First Tax Representative, on behalf of the appellant, provided the following information:

(a) In arriving at a valuation of Site I and Site II the directors of the parent company had received advice from Property Consultant Q.

(b) The industrial land was valued at $1,500 per square foot and the residential land was valued at $1,800 per square foot.

(c) There was no formal valuation report, the values being agreed in meetings.

22. The assessor inquired as to why the appellant had not recognised the profits on sale of the properties in Housing Estate P in the accounts for the years 1989/90 to 1993/94. In a reply dated 28 July 1995, the First Tax Representative provided the following information:

(a) 'The proceeds of sale of flats are credited into accounts maintained by the solicitors for the development. Payments have been made out of these accounts to reimburse costs of construction, architects' fees and so forth. It is only in the financial year 1994/95 that there have been any surplus funds which have been paid to [the appellant].'

(b) 'No profit will be realized in [the appellant] until the land cost has been fully paid off, and all construction costs etc. have been settled... the land cost comprises various elements which will not be calculable until all the units in the development have been sold. Until this occurs, and the development has been concluded, the profits cannot be determined. Currently, the development has not generated sufficient income to cover the land cost so there is, as yet, not profit.'

23. The assessor raised on the appellant the following profits tax assessment for the year of assessment 1989/90:

Estimated assessable profits	$130,000,000
Tax payable	$21,450,000

24. The appellant objected against the 1989/90 assessment on the ground that it was estimated and excessive.

25. In a letter dated 24 April 1996, the First Tax Representative contended that:

'From the commencement of the joint venture the accounting treatment of [the appellant] has been to treat the joint venture as a long term development project. You state that the Statement of Standard Accounting Practice issued by the Hong Kong Society of Accountants suggests that attributable profit which fairly reflects the profit attributed that part of the work performed at the accounting date should be recognized.... In this case [the appellant] is unable to calculate the cost of the acquisition of the land until the joint venture is completed and until the overall cost of the land is ascertained [the appellant] cannot calculate the profit that is attributable to that part of the work performed. Therefore the accounting standard cannot apply in these circumstances.'

A schedule of the appellant's Joint Venture Development accounts for the years 1988/89 to 1995/96 supplied by the First Representatives is at B1, page 102.

26. In response to the assessor's enquiries, Company H elaborated the terms and conditions in the JV agreement as follows:

(a) Sharing of the profits

'Sale proceeds should be first used to reimburse [the appellant] for the interest on land premium paid by [the appellant] and then to [Company H] for the joint venture costs stipulated in clause 15.02 of the Agreement. The remaining sales proceeds should then be distributed equally between [the appellant] and [Company H] (clause 15.04).'

(b) Payment and reimbursement of expenses

'[Company H] should pay all the costs, expense and charges in connection with the development of the residential and industrial properties. Reimbursement should then be made to [Company H] in accordance with clause 15.02 of the Agreement.'

(c) Receipt of sales proceeds

'All sale proceeds should first be paid to [the appellant] and [the appellant] should pay the sales proceeds into stakeholders' accounts for reimbursement of expenses to [Company H] and sharing of profits.'

(d) Roles and responsibilities of [Company H] and [the appellant]

'[The appellant] was responsible for delivering vacant possession of the sites to [Company H] for property development. [Company H] was liable for funding and the construction of the properties specified in the Agreement.'

27. In respect of what was mentioned in paragraph 26(c) above, the appellant claimed that what occurred in practice was:

'(i) whenever an apartment was sold, the purchaser paid a deposit which was settled by a cheque paid to and cash by the solicitors acting for the vendor, namely [JSM];

(ii) when the sale of each apartment was ultimately completed, the balance of the purchase monies was paid to JSM;

(iii) JSM placed all monies in stakeholders accounts which were referred to as "No.1 Agency Account", "No.2 Agency Account" and "No.3 Agency Accounts";

(iv) these accounts were established so that different categories of expenditure could be settled at the appropriate juncture (see clauses 15.07(a), (c) and (d) of the JV Agreement;

(v) JSM issued statements to [Company H] with respect to the amounts collected from the purchasers from time to time;

(vi) no statements were issued to the appellant.'

28. The assessor raised on the appellant the following assessments for the years of assessment 1995/96 to 1997/98 per returns submitted:

Year of assessment 1995/96		
Profits per account		$109,097,107
Less: Offshore interest income		355,567
		108,741,540
Less: Loss brought forward		
1989/90 [$13,275-*$3,635]	$9,640	
1990/91	7,290	
1991/92	7,250	
1992/93	9,200	
1993/94	9,200	
1994/95	10,320	65,000
Assessable profits per return		$108,676,540
Tax payable		$17,931,629

* preliminary expenses

Assessor' s note

This assessment based on the returned profits has been raised subject to the acceptance of the accounts submitted which are being examined.

Year of assessment 1996/97	
Assessable profits	$191,083,391
Tax payable	$31,528,759

Assessor' s note

This assessment based on the returned profits has been raised subject to the acceptance of the accounts submitted which are being examined.

Year of assessment 1997/98	
Assessable profits	$35,975,173
Tax payable (after the 10% Tax rebate)	$5,342,312

The appellant did not object against the assessments for the years of assessment 1996/97 and 1997/98 but objected against the 1995/96 assessment claiming that the returned profits had been assessed under the estimated assessment raised for the year 1989/90 [paragraph 23 above].

29. On divers dates, the Assistant Commissioner exercised his power under section 61A(2) of the Inland Revenue Ordinance, Chapter 112, ('IRO') and raised on the appellant the following profits tax assessments:

Year of assessment 1990/91	
Estimated assessable profits	$15,000,000
Tax payable	$2,475,000
Year of assessment 1991/92	
Estimated assessable profits	$2,000,000
Tax payable	$330,000
Year of assessment 1992/93	
Estimated assessable profits	$131,225,000
Tax payable	$22,964,375
Year of assessment 1993/94	
Estimated assessable profits	$500,000
Tax payable	$87,500
Year of assessment 1994/95	
Estimated assessable profits	$500,000
Tax payable	$87,500
Year of assessment 1996/97 (Additional)	
Additional assessable profits	$190,000,000
Additional tax payable	$31,350,000
Year of assessment 1997/98 (Additional)	
Additional assessable profits	$36,000,000
Additional tax payable	$5,346,001

30. The appellant, either through the First Tax Representative or JSM/the Second Tax Representative objected against the assessments on the ground that the terms of section 61A of the IRO had no application to the circumstances and that the transactions entered into by the appellant were not entered into for the avoidance of tax nor to enable the company to obtain a tax benefit.

31. By letter dated 29 March 2000, the First Tax Representative notified the Inland Revenue Department that they had ceased to act as the tax representative of the appellant with immediate effect.

32. Both the First Tax Representative and JSM made extensive representations with respect to the application of section 61A of the IRO. Copies of the letters dated 3 October 1997 and 21 May 1999 are at B1, pages 103 to 114 and B1, pages 115 to 128 respectively.

33. The Commissioner of Rating and Valuation was of the view that the open market value of Site I and Site II as at 18 December 1987 should be $600,000,000 and $200,000,000 respectively. The appellant agreed with the Commissioner's valuation.

Reasons given by the Commissioner

34. The reasons given by the Commissioner in the determination were as follows:

> '(1) [The appellant] claimed that in computing its assessable profits derived from the sale of [Housing Estate P], the land cost payable by it to its parent company in terms of the Site I and Site II agreement should be deductible and that section 61A of the IRO could not justify a denial of such a deduction.
>
> (2) According to the Site I and Site II agreement, [the appellant] agreed to purchase from [the parent company] these sites at a consideration comprising an initial sum of $346,309,452.06, an obligation to build or procure the building of a new industrial building not exceeding a construction cost of $193 million at Site III, a further sum of $400 million and an additional sum of $50% of the final net profits realized by [the appellant] from the development of the properties at Site I and Site II [see paragraph 11]. On the same date, [the appellant] entered into a joint venture agreement with [Company H] and [Company G] relating to the development of properties at Site I, Site II and Site III. It is common ground that the profits derived by [the appellant] from the sale of the redeveloped properties at Site I and Site II, namely the [Housing Estate P], should be chargeable to profits tax. The dispute is on how the land cost of the Site I and Site II should be computed.

(3) I shall consider the dispute in the context of sections 16, 61 and 61A of the IRO.

(4) Section 16 of the IRO provides that in ascertaining the profits in respect of which a person is chargeable to Profits Tax for any year of assessment, there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to profits tax for any period. Whether a sum was incurred in the production of chargeable profits has to be assessed objectively. I find support of this proposition in the Board of Review Decision No. D94/99, 14 IRBRD 603.

(5) In the present case, [the parent company] did not sell the land at Site I and Site II to [the appellant] at their market value. Rather, the sale consideration includes a variable dependent on the profits realized by [the appellant] from the development of the land. [The appellant] asserted that part of the payments was made to compensate [the parent company] for carrying with *(sic)* a risk of the redevelopment being unsuccessful [Note: The Commissioner referred to 'Fact (35)', but there was no 'Fact (35)' and it would appear that the intended reference was to Fact (34)]. In reality, I consider that the payments which exceed the market value of the two sites were not payments for the land but appropriation of the profits to [the parent company] which [the appellant] derived from the development of the [Housing Estate P]. Therefore such payments made to [the parent company] being in the nature of appropriation of profits were not deductible under section 16 of the IRO.

(6) In its audited account for the year period ended 31 March 1989, [the appellant] recognized the land cost of the development at $746,309,452. By that time, the development under the JV agreement had commenced. This figure should reflect both the actual price which [the appellant] was prepared to pay for the land and the cost of the land for the purpose of computing its profits from the development. Incidentally, this figure is also close to the estimation made by the Commissioner of Rating and Valuation of the then market value of the land [paragraph 33].

(7) Alternatively, section 61A of the IRO provides that having regard to matters referred to in its sub-section (1), if it can be concluded that the transaction was entered into or carried out for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with others, to obtain a tax benefit, the person shall be assessed as if the transaction or any part thereof had not been entered into or carried out, or in such other manner as

appropriate to counteract the tax benefit. On the facts before me, I conclude that the purchase of the land by [the appellant] from [the parent company] with the terms set out in the Site I and Site II agreement is a transaction within the scope of this section. In coming to this conclusion, I have had regard to the seven matters referred to in sub-section (1) of section 61A as follows:

(a) The manner in which the transaction was entered into or carried out

[The appellant] agreed to purchase the Site I and Site II from the parent company, [the parent company]. The consideration of the sites, instead of the *(sic)* being agreed at their market value, has included an element for the appropriation of profit derived from the development of the sites. It was unusual for a parent company to have entered into agreement with a wholly owned subsidiary with such terms.

(b) The form and substance of the transaction

The transaction took the form of [the parent company] selling the sites to [the appellant] at commercial terms, but the substance of the transaction was that the consideration was commercially unrealistic and grossly excessive. The fair market value of the land did not exceed $800 million but [the appellant] has paid a total amount of over 1,090 million [Appendix C at B1 page 95] for it.

(c) The result in relation to the operation of the IRO that, but for this section, would have achieved by the transaction

If the transaction were to be accepted at its face value, [the appellant] would be able to claim deduction of the excessive payments for the sites in computing its assessable profits derived from the development of the [Housing Estate P]. On the other hand, the corresponding receipts by [the parent company] would not be taxable for being capital in nature.

(d) Any change in the financial position of [the appellant] that has resulted, will result, or may reasonable *(sic)* be expected to result from the transaction

[The appellant] would be able to claim a deduction of $1,030 million for the year of assessment 1995/96 and a deduction representing 50% of the share of profits in subsequent years as land cost.

(e) Any change in the financial position of any person who has, or has had, any connection with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction

As mentioned in (c) above, the purported sale of the land by [the parent company] at an exorbitant price would enable a substantial portion of the profits derived by [the appellant] be siphoned off to [the parent company] in the form of non-taxable capital gains.

(f) Whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under transaction of this kind in question

When persons dealing with each other at arm's length involving transaction *(sic)* of the kind in question, the vendor would not even contemplate to deal with a party without having satisfied *(sic)* that the other party has the financial resources to complete the transaction, in particular when assets with great value and which would take years to develop are being considered. In this case, the authorized, issued and paid-up share capital of [the appellant] has been remained at $10,000 at all relevant times [Appendix E at B1 pages 98 – 101]. Clearly, [the appellant] did not have any real resources to pay for the sites. The fact that [the parent company] agreed to sell the land to [the appellant] at a price to be determined years later and that [the appellant] agreed to share 50% of its profits was obviously due to the fact that [the appellant] was a wholly-owned subsidiary of [the parent company]. In my view, the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under transaction of the kind in question.

(g) The participation in the transaction of a corporation resident *(sic)*

Both [the appellant] and [the parent company] are resident in Hong Kong. This factor is not relevant in the present case.

(8) Therefore, I endorse the Assistant Commissioner's view that the purchase of the land by [the appellant] at the terms set out in the Site I and Site II agreement was entered into or carried out for the sole or dominant purpose of enabling [the appellant] and [the parent company] to obtain a tax benefit. It is apparent that the whole series of transactions, namely the Site I and Site II agreement, Site III agreement and the JV agreement were planned from the outset and that the said transactions were planned with a view to enabling the

development of [Housing Estate P] and to so arranging matters to achieve a result that if any profits were derived from the development, 50% of that profit would not attract liability to profits tax. Perhaps I should add that I also regard the transaction as being commercially unrealistic that comes within the meaning of "artificial" in terms of section 61.

(9) While I do not agree the full amount of the payments made by [the appellant] is deductible, I agree that in computing the assessable profits of [the appellant], the value of the land should be deducted. In view of what I have observed at paragraph (6) above, the 1995/96 Profits Tax assessment is to be revised as follows:

Profits per return	$108,676,540
Add: Excess land cost	
[$1,030,731,874 - $746,309,452]	284,422,422
	393,098,962
Tax Payable	$64,861,328

(10) For the above reasons, the objections fail. The assessments for the years 1989/90 to 1994/95 are to be annulled, the assessment for the year 1995/96 is to be revised as per paragraph (9) above and the additional assessments for the years 1996/97 and 1997/98 are to be confirmed.'

The appeal hearing

35. By letter dated 18 March 2002, JSM gave notice of appeal on behalf of the appellant.

36. The appellant's authorities comprised the following:

(a) British Sugar Manufacturers v Harris (1937) 21 TC 528

(b) Union Cold Storage v Adamson (1931) 16 TC 293

(c) Europa Oil v IRC [1976] 1 WLR 464

(d) Yick Fung Estates v CIR [2000] 1 HKLRD 381

(e) IRC v Brebner [1967] 2 AC 18

(f) Peabody v FCT (1993) 25 ATR 32

(g) FCT v Peabody (1994) 28 ATR 344

(h) Eastern Nitrogen v FCT (2001) 46 ATR 474

(i) FCT v Spotless (1996) 34 ATR 183

(j) D67/95, IRBRD, vol 11, 44

(k) D44/92, IRBRD, vol 7, 324

(l) Seramco Ltd Superannuation Fund v ITC [1977] AC 287

(m) CIR v Howe [1977] 1 HKTC 936

(n) Encyclopaedia of Hong Kong Taxation (Willoughby & Halkyard) vol 4 at II [18812] and [18820]-[18855] and [8464]

37. The respondent submitted a bundle of the following authorities:

(a) Seramco Ltd Superannuation Fund v ITC [1977] AC 287

(b) CIR v Howe [1977] HKLR 436

(c) FCT v Spotless Services Ltd (1996) 186 CLR 404

(d) Yick Fung Estates Ltd v CIR [2000] 1 HKLRD 381

(e) Cheung Wah Keung v CIR [2002] 3 HKLRD 773

(f) D44/92, IRBRD, vol 7, 324

(g) D94/99, IRBRD, vol 14, 603

(h) D154/01, IRBRD, vol 17, 213

(i) DIPN No 15 (Revised) (September 1992)

(j) Extract from Inland Revenue (Amendment) Bill 1986

(k) Encyclopaedia of Hong Kong Taxation (Willoughby & Halkyard) vol 3 at II [5585]-[5587]

(l) Halsbury' s Laws of England, 4th Edition, vol 23 Paragraph 211-215

(m) Bath and West Counties Property Trust Ltd v Thomas (Inspector of Taxes) [1978] 1 All ER 305

38. At the hearing of the appeal, the appellant was represented by Mr Clifford Smith, SC, and the respondent was represented by Mr Anselmo Reyes, SC.

39. The appellant called two witnesses who gave evidence along the lines of their witness statements. The respondent did not call any.

40. The witness statement of Mr R was not as helpful as it should have been. Instead of confining the witness statement to matters of fact, the draftsman indulged in arguments.

41. The other witness, Mr S, felt able to conclude that:

> ' ... the transaction entered into between [the parent company] and [the appellant] insofar as it relates to the one half share of the profit payment in terms of clause 2(iii) of the Agreement dated 18th December 1987 is normal commercial practice. It is an arrangement that is commonly found in Hong Kong in cases where land is sold with a view to being redeveloped. In my view, there is nothing odd, unusual or uncommercial in the terms agreed between [the parent company] and [the appellant].'

42. The appellant applied in the course of the hearing for leave to add a ground of appeal. The respondent had no objection and we gave the appellant leave to add the following ground of appeal:

> ' That the CIR has disregarded the value of the land as the HK$800,000,000 as fixed by the Rating & Valuation Department and the figure of HK$800 million as fixed by the Rating & Valuation Department should be substituted for the figure of HK$746,309,452 used to calculate excess land cost in paragraph 9 (p. 23) of the Reasons for Determination of the Commissioner dated 5th March 2002.'

Our decision

The law

43. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.

44. Section 16(1) of the IRO provides that:

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

45. Section 61 of the IRO provides that:

> '*Where an assessor is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessable accordingly.*'

46. We remind ourselves of the observations made by Lord Diplock, delivering the advice of the Privy Council in Seramco Trustees v Income Tax Commissioner [1977] AC 287 at pages 297-8 in relation to section 10(1) of the Jamaican Income Tax Law 1954, in similar terms to our section 61:

> '*It is only when the method used for dividend stripping involves a transaction which can properly be described as "artificial" or "fictitious" that it comes within the ambit of section 10 (1). Whether it can properly be so described depends upon the terms of the particular transaction that is impugned and the circumstances in which it was made and carried out.*
>
> *"Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic, that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was*

made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.'

47. Lord Diplock considered whether the impugned transaction was 'unrealistic from a business point of view' (at page 294).

48. In Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441 [(1977) 1 HKTC 936 at 952], Cons J (as he then was) considered whether the impugned transaction was 'unrealistic from a business point of view' or 'commercially unrealistic':

'*What then are the arrangements and the circumstances in which they were made and carried out that I must examine in order to see whether or not they are artificial? Simply they are these. By two separate agreements the taxpayer effectively transferred all his existing and future earnings as an author to a limited company. The consideration in each case was valuable in the technical sense but by no stretch of the imagination otherwise. If that were all, the agreements would have been, as counsel for the Commissioner suggests, in the words of their Lordships (page 294) quite "unrealistic from a business point of view". But there is one other circumstance to consider. The limited company which is the beneficiary of the taxpayer's apparent generosity is controlled by the taxpayer himself. That was a fact found by the Board of Review and I assume it to mean that the taxpayer holds all or substantially all of the shares therein. In this situation it does not necessarily follow that the transactions are commercially unrealistic. The overall position remains the same. What the taxpayer loses on the roundabouts he makes up on the swings. Looked at purely from the aspect of gross income the transactions seem unnecessary and unproductive. But the taxpayer may well have other matters in mind. I find nothing on the face of things that makes the agreements artificial in the way that their Lordships approached the Seramco situation. To my mind they are artificial only in the sense for example that a limited company is artificial. It is not the product of nature, it is the outcome of man's inventive mind. I am satisfied that the Board of Review came to a correct conclusion on this question.*'

49. Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773, CA, is an interesting case. Woo JA, said at paragraph 41 that:

'*The term "commercially unrealistic" appears in CIR v Howe (1977) 1 HKTC 936 at p.952 in the sense of "unrealistic from a business point of view". We are of the view that whether a transaction which is commercially unrealistic must necessarily be regarded as being "artificial" depends on the circumstances of each particular case. We agree with the submission of Mr*

Cooney, however, that commercial realism or otherwise can be one of the considerations for deciding artificiality. In the present case, the Board found as a fact that there was no "commercial reality in the transaction" and that there "simply was no commercial sense in the transaction"; thus it was open to the Board to reach the conclusion that the transaction was artificial under s.61.'

50. Section 61A(1) provides that:

'*(1) This section shall apply where any transaction has been entered into or effected after [14 March 1986] ... and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person (in this section referred to as 'the relevant person'), and, having regard to –*

(a) the manner in which the transaction was entered into or carried out;

(b) the form and substance of the transaction;

(c) the result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction;

(d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;

(e) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;

(f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and

(g) the participation in the transaction of a corporation resident or carrying on business outside Hong Kong,

it would be concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or

dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.'

51. Subsection (3) provides that 'tax benefit' means 'the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof' and 'transaction' includes a 'transaction, operation or scheme'.

52. As Rogers JA laid down in Yick Fung Estates Limited v CIR [2000] 1 HKLRD 381 at page 399:

'... the tests set out in s.61A have to be applied objectively.

There are seven matters (a) to (g) to which the section requires that regard must be had. On a clear construction of the subsection, the section would not be relevant or the subject matter of consideration unless there was a tax benefit, in other words, the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof. In this case, it is said that there has been an avoidance of tax in respect of HK$108,327,586 profits or at any rate, there has been a reduction in the amount of tax that would otherwise have been payable. On that basis, the various matters at (a) to (g) have to be considered and if upon that exercise, the conclusion would be arrived at that the person who entered into or carried out the transaction did so for the sole or dominant purpose of obtaining a tax benefit, the Assistant Commissioner may exercise one of the two powers set out in sub-s.(2).

In this Court, there was some discussion as to whether it is necessary for more than one item in matters (a) to (g) to indicate the sole or dominant purpose for it to be possible that that conclusion be arrived at. In my view, the posing of the question itself possibly indicates an erroneous approach to the section. Clearly, what must happen is that those matters must be considered and the strength or otherwise of the various resulting conclusions from considering those matters must be looked at globally. On the basis of that assessment, it must be decided whether the sole or dominant purpose was the obtaining of a tax benefit. It may be observed, for example, that one or other of the matters in (a) to (g) may be strongly or weakly suggestive of a purpose of obtaining a tax benefit or may be strongly or weakly suggestive of some other purpose. The Assistant Commissioner who undertakes such task has to use his own common sense and apply the results of his deliberations in respect of each matter and come to an overall conclusion.

... The Board approached the matter on the basis that the word "form" related to the legal effect or, as I would put it, the legal nature of the transaction and

that the substance related to the practical or commercial end result of the transaction. In that respect, I would have no cause to disagree with the way in which this was put.'

The position before 18 December 1987

53. We start by considering the position immediately before 18 December 1987 and then the position under the three agreements all dated 18 December 1987, that is, the Site I and Site II agreement, the Site III agreement, and the JV agreement. We shall next consider the three sections relied on by the respondent, that is, sections 16, 61, and 61A.

54. Immediately before 18 December 1987:

(a) since incorporation in 1957, the core business of the parent company had been cotton spinning and yarn manufacturing in Hong Kong;

(b) all three sites, that is, Site I, Site II and Site III, were owned by the parent company;

(c) an old industrial building on Site I was used by the parent company for its core business;

(d) the machinery was old, bulky, labour-intensive, becoming out-dated, and in need of constant and expensive repair and maintenance, and it was difficult to obtain spare parts; and

(e) a three-storey residential building and a six-storey residential building on Site II were used by the parent company for its employees.

Consideration for the sale and purchase of Site I and Site II

55. Before turning to the position under the three agreements, we must analyse the consideration for the sale and purchase of Site I and Site II under the Site I and Site II agreement, clause 2 of which provides that:

'The consideration for the sale and purchase shall be (i) a payment of THREE HUNDRED FORTY SIX MILLION THREE HUNDRED AND NINE THOUSAND FOUR HUNDRED AND FIFTY TWO AND CENTS SIX HONG KONG DOLLARS (HK$346,309,452.06) and interest thereon as set out in Clause 3(a) hereof ("the Initial Sum"), (ii) an obligation on the part of [the appellant] to build or to procure the building of an industrial building on [Site III] ("the Industrial Lot") which is presently owned by [the parent company] but is to be

> sold to [the co-subsidiary] (a wholly owned subsidiary of [the parent company]) on terms that [the parent company] will build or procure the building of such building, such industrial building to be constructed in a proper, sound and workmanlike manner and in accordance with plans and specifications annexed hereto as Appendix I (but subject to such amendments as [the parent company] may impose at any time prior to the 31st day of December 1988) and to involve an expenditure by [the appellant] of approximately HK$193,000,000 by way of construction costs and (iii) a further sum of HK$400,000,000 subject always to [the appellant] realising net profits of such amount and (subject again to [the appellant] realising net profits to meet such a payment) together also with an additional sum equal to 50% of any such profits realised by [the appellant] (collectively "the Balance Consideration") from the redevelopment of [Site I and Site II] and the sale thereof or parts thereof upon completion of an intended redevelopment by [the appellant], such net profit (if any) to be ascertained by reference to audited development accounts of [the appellant] delivered by [the appellant] to [the parent company] not later than 18 months after the issuance of the Certificate of Compliance by the relevant department of the Government of Hong Kong pursuant to the Conditions of Exchange relating to [Site I and Site II] (whichever shall be the later) confirming that all General and Special Conditions under the Conditions of Exchange for such Lots have been complied with.'

56. The total amount of consideration depended on whether the appellant would make a net profit from the redevelopment and if so the extent of such net profit.

57. The minimum consideration (that is, in the event of the appellant making no net profit from the redevelopment) was $346,309,452.06 **and** the cost of construction of a new industrial building on Site III, approximately but not exceeding [clause 3(b)] $193,000,000. These two sums add up to approximately $539,309,452.06.

58. If the redevelopment was profitable, the whole of the appellant's net profit up to $400,000,000 would be payable by the appellant to the parent company. 50% of the appellant's net profit in excess of $400,000,000 would be payable by the appellant to the parent company.

59. Despite the fact that the paid up capital of the appellant was only $10,000, there was very little risk of default on the part of the appellant in satisfying the consideration:

(a) $196,309,452.06 (i.e. $6,000,000 + $90,309,452.06 + $100,000,000) had been paid by the date of the Site I and Site II agreement [clause 3(a)(i), (ii) and (iii)]. Company H was the source of these funds. By 18 December 1987, Company H had paid the appellant three payments totalling $196,309,452.06 (see B1 page 96 and the clauses in the JV agreement referred to).

(b) $150,000,000 would be payable by 30 September 1991 [clause 3(a)(iv)]. Company H would be the source of funds. Clause 2.03(b) of the JV agreement provided that $150,000,000 would be payable by Company H to the appellant on delivery of vacant possession to Company H of Site I. By clause 33.01 of the JV agreement, Company G guaranteed Company H's performance of its obligations under the JV agreement. $150,000,000 was in fact paid by Company H on 28 February 1991 (see B1 page 96).

(c) The appellant's obligation to build a new industrial building on Site III was backed by the agreement of Company H under clause 3.02 of the JV agreement to deliver the replacement industrial building to the appellant at no cost to the appellant. See also paragraph 13 above.

(d) Net profit up to $400,000,000 and 50% of the net profit in excess of $400,000,000 were both conditional upon the appellant making such net profit.

The position under the 3 agreements dated 18 December 1987

60. Although we have not been supplied with a copy of the Site III agreement, we are satisfied and find that all three agreements dated 18 December 1987, that is, the Site I and Site II agreement, the Site III agreement, and the JV agreement, formed part of a package agreed to by the parent company, the appellant, the co-subsidiary, Company G and Company H. The minutes of a meeting of the board of directors of the parent company held on 9 September 1987 recorded that discussions with Company G had resulted in concrete proposals being drawn up; that all three draft agreements were presented to the board for consideration; and that the board agreed to proceed. Although the formal resolutions covered only the Site I and Site II agreement and the Site III agreement, that was probably because approval of the JV agreement was a matter for the board of directors of the appellant. Support for our finding can also be found in the Commissioner's reference to the Site I and Site II agreement, the Site III agreement, and the JV agreement as 'the whole series of transactions ... planned from the outset' [see paragraph 34(8) above].

61. Under the three agreements, the parent company:

(a) would continue, without any stoppage, to carry on its core business of cotton spinning and yarn manufacturing in Hong Kong, initially at the old industrial building on Site I and subsequently at the new industrial building on Site III;

(b) would no longer own any of the three Sites, but would have two wholly owned subsidiaries, the appellant (carrying on business in property trading and investment) and the co-subsidiary (a property holding company);

(c) would have a residential estate (that is, Housing Estate P) in its name at Site I and Site II at no cost to the parent company;

(d) would receive a minimum of $346,309,452.06 **and** a new industrial building at a construction cost of approximately $193,000,000, and (if the redevelopment of Site I and Site II was profitable) the balance consideration under the Site I and Site II agreement for its sale of Site I and Site II to the appellant;

(e) would be put in funds under the Site I and Site II agreement, sourced from Company H, to acquire new, more compact and less labour-intensive machinery for use at the new industrial building; and

(f) would, presumably, receive consideration from the co-subsidiary for the parent company' s sale of Site III to the co-subsidiary.

62. Under the three agreements, the appellant:

(a) would acquire Site I and Site II at no cost to itself, the acquisition being financed by Company H;

(b) would probably go into liquidation if it should sustain any loss in the redevelopment, its paid up capital being $10,000; and

(c) would enjoy any net profit in excess of the balance consideration under the Site I and Site II agreement and would retain co-ownership (whether directly or through shareholding of another company) of the commercial portion of the redevelopment.

63. Under the three agreements, the co-subsidiary would acquire Site III with a new industrial building.

The impugned transaction

64. It would appear from paragraph 34(7) above that the Commissioner started off by impugning:

> ' the purchase of the land by [the appellant] from [the parent company] with the terms set out in the Site I and Site II agreement'.

Whilst on this paragraph, we must point out that the Commissioner clearly erred. The test under section 61A is not whether it 'can' be concluded, but whether it 'would' be concluded.

65. Applying the wrong test, the Commissioner went on to conclude that [see paragraph 34(8) above]:

> ' the whole series of transactions, namely the Site I and Site II agreement, Site III agreement and the JV agreement were planned from the outset and that the said transactions were planned with a view to enabling the development of [Housing Estate P] and to so arranging matters to achieve a result that if any profits were derived from the development, 50% of that profit would not attract liability to profits tax'.

66. At the hearing, Mr Anselmo Reyes helpfully told us that what was being impugned was:

> ' the entry into the Sale & Purchase Agreement dated [18] December'.

67. Essentially, the respondent argued that the terms of the Site I and Site II agreement looked odd and that a significant part of the income or profit which the appellant derived from the development of Site I and Site II was transformed into an expense in the appellant's hands and a capital gain in the hands of the parent company.

68. When asked whether the respondent was just impugning the consideration clause, Mr Anselmo Reyes stated categorically that:

> ' No, I am impugning, as I said the transaction I am challenging is the entry into the agreement, the whole agreement.'

Section 61A

69. The first question for our consideration is whether the impugned transaction has, or would have had but for this section, the effect of conferring a tax benefit (that is, avoidance or postponement of the liability to pay tax or the reduction in the amount thereof) on the appellant.

70. Unless we have misunderstood the respondent's case, the respondent did not address this issue but went straight into consideration of factors (a) to (f) in section 61A(1) on the question of dominant purpose. Paragraph 1 of the respondent's written submissions reads as follows:

> ' The entry into the Agreement dated 18.12.1987 for the sale and purchase of Site I and II had the dominant purpose of enabling [the parent company] and [the appellant] of obtaining a tax benefit in conjunction with each other. This conclusion follows from the matters specified in s. 61A(1)(a) – (f)'.

71. This is not the correct approach. Unless there was a tax benefit, section 61A would not be relevant or the subject matter of consideration, per Rogers JA in Yick Fung Estates Limited v CIR [2000] 1 HKLRD 381 at page 399.

72. We can hardly over-emphasise that the impugned transaction must be identified with precision.

73. The respondent' s case, as presented to us at the hearing, is that the **whole** of the Site I and Site II agreement (not just the consideration clause), and that agreement alone, constituted the impugned transaction.

74. In our decision, the impugned transaction did not have, and would not have had but for section 61A, the effect of conferring a tax benefit (that is, avoidance or postponement of the liability to pay tax or the reduction in the amount thereof) on the appellant. Thus, section 61A is not relevant.

75. No profit accrued to the appellant under the Site I and Site II agreement. In the absence of any profit, there is no question of a tax benefit.

76. Further, without the Site I and Site II agreement, the **whole** of which (not just the consideration clause) was impugned, the appellant would have had no interest in the land. Without any interest in the land, it is inconceivable that Company G and Company H would have entered into the JV agreement with the appellant. Without the JV agreement, the appellant would not have earned the profit which it did in this case.

77. We turn now to the question of sole or dominant purpose in case our decision on the tax benefit point is wrong.

78. The manner in which the transaction was entered into or carried out: the respondent contended that the Site I and Site II agreement was entered into in circumstances which were artificial and commercially unrealistic. For reasons given in paragraphs 53 to 63 above and below, we disagree.

79. At the time of making of the Site I and Site II agreement, both the parent company and the appellant did not know, and could not have known, whether the redevelopment of Site I and Site II would be profitable. In considering whether the Site I and Site II agreement was realistic from a business or commercial point of view, a businessman would not put on blinkers and look only at the Site I and Site II agreement. Both the parent company and the appellant knew that each of the three agreements dated 18 December 1987 was part and parcel of a package.

80. On a worst case scenerio, that is, if the redevelopment should turn out to be not profitable, the parent company would get what is set out in paragraph 61 (a), (b), (c), (e) and (f)

and the minimum condition referred to in (d). If the redevelopment should turn out to be profitable, it would get the balance consideration, or part thereof, depending on the amount of the profit. In our decision, from the parent company's point of view, the Site I and Site II agreement was realistic from a business or commercial point of view.

81. We turn now to the appellant's point of view. In our decision, the Site I and Site II agreement was also realistic from a business or commercial point of view. We refer to paragraph 62 above. What the appellant obtained, at a nominal cost to itself, was the opportunity to enjoy any net profit in excess of the balance consideration in the event of the redevelopment being profitable.

82. The respondent complained that 'a significant part of the income or profit which the appellant derived from the development of Site I and Site II was transformed into an expense in the appellant's hands and a capital gain in the hands of the parent company'. In doing so, the respondent must necessarily refer to the income or profit which the appellant derived from the JV agreement. The respondent could not look at the JV agreement and object to the appellant looking at it.

83. Returning to the respondent's complaint, it is not wrong in law for the consideration in a contract to be framed with reference to profit, British Sugar Manufacturers v Harris (1937) 21 TC 528 at pages 546 to 548.

84. If reference to profit was objectionable, the respondent should have complained (but did not complain) about the first $400,000,000 of the balance consideration. If the respondent was objecting to any sum in excess of market value, then the respondent should have taken (but did not take) the construction costs of approximately $193,000,000 into consideration. Clause 15.02(c) of the JV agreement provided for reimbursement to Company H of these construction costs, thereby reducing the balance available for division between the appellant and Company H under clause 15.04 of the JV agreement.

85. In any event, we find that the consideration under clause 2 of the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view. The relevant time must be the time of making of the Site I and Site II agreement. We reiterate that neither the appellant nor the parent company knew whether the redevelopment would be profitable. If the redevelopment should turn out to be very profitable, then the consideration would be increased accordingly. But, as Cons J said in Commissioner of Inland Revenue v D H Howe [1977] HKLR 436 at 441 [(1977) 1 HKTC 936 at page 952]:

'What the taxpayer loses on the roundabouts he makes up on the swings'.

We reiterate paragraph 81 above. We also take into account the effect of interest on the deferred payment of the balance consideration.

86. The form (legal nature) and substance (practical or commercial end result) of the transaction: there is no difference between form and substance – what you see is what you get. The respondent's submissions under factor (b) have been dealt with under factor (a) above.

87. The result in relation to the operation of this Ordinance that, but for this section, would have been achieved by the transaction: in the absence of section 61A, the appellant would be able to deduct the 50% profit portion of the balance consideration as an expense.

88. Any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction: the appellant would be able to deduct the 50% profit portion of the balance consideration as an expense and see paragraph 62 above.

89. Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction: see paragraph 61 above.

90. Whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question: see paragraphs 53 to 62 above.

91. The participation in the transaction of a corporation resident or carrying on business outside Hong Kong: it is common ground that factor (g) is inapplicable.

92. Having considered the strength or otherwise of the various resulting conclusions from considering the factors, we now look at the matter globally. Our overall conclusion is that the sole or dominant purpose was not the obtaining of a tax benefit. Any possible purpose of obtaining a tax benefit pales in significance to the purposes referred to in paragraphs 61, 62 and 63 above.

Section 61

93. For reasons given above on section 61A, section 61 is not applicable. Firstly, the impugned transaction did not reduce and would not reduce the amount of tax payable by any person. Secondly, the Site I and Site II agreement is neither artificial nor fictitious.

94. Further and in any event, section 61 does not assist the respondent. If we **disregard** the Site I and Site II agreement, the appellant would have no interest in land and neither Company G nor Company H would have entered into the JV agreement with the appellant, without which the appellant would not have earned any profit.

Section 16

95. No reference is made in the respondent' s written submissions to section 16.

96. In view of our finding that the consideration under the Site I and Site II agreement was not excessive and was realistic from a business or commercial point of view, section 16 does not assist the respondent.

97. Even if we had found (which we did not) that the consideration was excessive, section 16 confers no authority on the respondent or her assessors to reduce the amount of consideration to what she considers to be reasonable.

Conclusion

98. The appellant has discharged the onus under section 68(4) of proving that the assessments for the years of assessments 1995/96, 1996/97 and 1997/98 are excessive and incorrect.

Disposition

99. We remit the following assessments to the respondent to revise to give effect to our decision:

(a) Profits tax assessment for the year of assessment 1995/96 under charge number 1-3074424-96-4, dated 28 November 1996, showing assessable profits of $108,676,540 (after setting off loss brought forward of $65,000) with tax payable of $17,931,629 as increased by the Commissioner to assessable profits of $393,098,962 (after setting off loss brought forward of $65,000) with tax payable of $64,861,328;

(b) Additional profits tax assessment for the year of assessment 1996/97 under charge number 1-1140701-97-3, dated 23 March 1999, showing additional assessable profits of $190,000,000 with additional tax payable of $31,350,000 as confirmed by the Commissioner; and

(c) Additional profits tax assessment for the year of assessment 1997/98 under charge number 1-2875490-98-0, dated 29 March 1999, showing additional assessable profits of $36,000,000 with additional tax payable of $5,346,001 as confirmed by the Commissioner.