Case No. D126/98

Profits tax – business relocation – property transferred for redevelopment – whether capital receipt or trading revenue.

Panel: Christopher Chan Cheuk (chairman), Charles Chiu Chung Yee and Stephen Lau Man Lung.

Dates of hearing: 10, 11 and 19 June 1998.
Date of decision: 4 December 1998.

Company A was a chemicals manufacturers and distributor in Hong Kong. It carried on its business in District B since the establishment of its factory at the district (the Subject Property) in 1959. By the late 80's it was known that District B would be developed into a new town. Thus Company A had to relocate its business into a new site.

In early 1992, the board of Company A resolved to enter into a joint venture (JV) with a developer to redevelop the Subject Property into residential premises. As a result, Company A transferred the Subject Property to its wholly owned subsidiary, Company F at a price of $497,000,000.

In July 1993, Companies A, E, F and G (the Developer) enter into a formal JV Agreement. The Developer undertook to develop the Subject Property and the units built would be offered for sale. It was agreed that the Developer shall pay Company A $180,000,000 by two installments of $90,000,000 each upon signing the JV Agreement and on 31 March 1994 respectively (the Initial Payment). The Developer shall be entitled to reimbursement out of the proceeds of sale both the Initial Payment and all redevelopment costs. The remaining sale proceeds shall be distributed between Company F and the Developer as agreed.

The Commissioner assessed the Initial Payment to profits tax. Company A contended, inter alia, that the Initial Payment was part of the consideration for transferring the Subject Property to Company F. Thus the Subject Property was a capital asset and the Initial Payment should be regarded as part of the capital gain which is not liable to tax. Alternatively, the Initial Payment should be regarded as 'capital receipt' or as a compensation received for costs incurred by Company A for relocation of its business.

Held:

1. The Subject Property was a capital asset. However, the key question is whether the way of disposing the Subject Property and the receipt of the

Initial Payment amount to trading. The intention of Company A is an important factor to be considered.

2. The Board found the intention of Company A was to obtain sufficient money for relocation and to maximise the profit from sale or development. The Board found the transfer of the Subject Property to Company F was part of the whole arrangement for Company A to participate in the JV scheme.

3. The Initial Payment was for the purpose of helping Company A to relocate its business to the new site. However, the nature of the payment rather than the purpose it was intended to be used is the question to be answered in order to decide whether it was a capital receipt. (Walter W Saunders Ltd v Dixon applied, McLean v Needham, CIR v Coia considered.)

4. To enhance the capital asset of the purpose of sale does not necessarily amount to trading activities. (C H Rand v The Alberni Land Company Limited followed; West v Phillips, Scottish Australian Mining Co Ltd v FCT considered.)

5. The Board found the redevelopment scheme to be a massive one. Therefore the gain is not profit gained from the sale of the same original asset but an entirely different product that the JV partners will be selling after the redevelopment. (Crawford Realty Limited v CIR applied. Taylor v Good, Allied Pastoral Holdings Pty Limited v FCT considered.)

6. The Board found Company A received the Initial Payment because it participated in the JV Scheme. Hence, the Initial Payment was a trading revenue and not a capital receipt.

Appeal dismissed.

Cases referred to:

Walter W Saunders Ltd v Dixon [1962] 40 TC 329
McLean v Needham [1960] 39 TC 37
CIR v Coia [1959] 38 TC 334
C H Rand v The Alberni Land Company Limited (1920) 7 TC 629
West v Phillips (1958) 38 TC 203
Scottish Australian Mining Co Ltd v FCT (1950) 83 CLR 188
Crawford Realty Limited v CIR (1991) 3 HKTC 674
Taylor v Good [1974] 1 WLR 556
Allied Pastoral Holdings Pty Limited v FCT [1983] 83 ATC 4015

Joseph Fok instructed by Department of Justice for the Commissioner of Inland Revenue.
Michael Olesnicky of Messrs Baker & McKenzie for the taxpayer.

Decision:

Appeal

1. This is an appeal by Company A against the determination made by the Commissioner of Inland Revenue on 21 April 1997 in respect of the additional profits tax assessment for the year of assessment 1993/94 and the profits tax assessment for the year of assessment 1994/95 in respect of a total sum of $180,000,000 paid by two instalments of $90,000,000 each to the Taxpayer on 28 July 1993 and 31 March 1994 respectively.

Proceedings

2.1 Both sides were legally represented. Pursuant to the direction made by this Board the parties have agreed a number of documents for production, which form the appeal bundle. Mr Olesnicky for the Taxpayer also prepared his own bundle which was very well organised; reference to the documents therein could easily be made. By contrast the Revenue's bundle was chaotic. The documents were neither in chronological order or in any order at all. We must thank Mr Olesnicky for his endeavour, who prepared a consolidated index of documents, without which we doubt very much how we can manage the thousand sheets in front of us.

2.2 Further, the Revenue was apparently not aware of the fact that the Board members on a much earlier day had been supplied with part of the appeal bundle up to page 336. We wonder whether those representing the Revenue could spare a few minutes of their time to check with the Clerk of the Board to avoid duplication. This is not the first time the Board has complained about paper wastage.

Summary of primary facts

3.1 Company A was a chemicals manufacturer and distributor in Hong Kong. It was formed by two companies in the same business.

3.2 It carried on its business in District B since the establishment of its factory at the district ('the Subject Property') in 1959, and later extended its manufacturing arm to District C in mid-1980's. Before its expansion the Taxpayer was fully aware of a reclamation proposal at District B. By the late 80's it was almost certain that District B would be redeveloped into a new town.

3.3 As a result, Company A had to face many problems which would adversely affect it including deterioration of water quality and limitation of sea access.

3.4 In early 1992 Company D was instructed to study the situation and to make proposals. The feasibility report proposed two options: (a) a straight-out sale of the Subject

Property and (b) entering into a joint venture with a developer to redevelop the Subject Property into residential premises.

3.5 In May 1992, the Government gave certain assurances to Company A to solve problems relating to water quality and sea access. In December 1992 the Subject Property and the surrounding areas were to be rezoned as residential zone.

3.6 In March 1993 Company A invited application from property developers to enter into joint venture for redevelopment. After some negotiation Company E became the successful bidder and entered into an agreement in principle with Company A on 2 July 1993.

3.7 On 28 July 1993 Company A transferred the Subject Property to its wholly owned subsidiary Company F at a price of $497,000,000 which was assessed by Company D as its open market value at that time.

3.8 Notwithstanding the sale Company A was allowed to stay and use the Subject Property site until either of the following days whichever is later: within 4 weeks of its chemicals production facility on its new site becoming fully operational or its moving into its new office block in District C. Company A had to pay a licence fee of $575,000 per month to Company F. The new site was also at District B about a mile away from the Subject Property.

3.9 On 1 August 1993 Company A and Company F entered into a management services agreement whereby Company A agreed to provide services to Company F at a monthly management fee of $150,000 from August 1993 to March 1995.

3.10 On 28 July 1993 Company A, Company E, Company F and Company G ('the Developer') entered into a formal joint venture agreement ('the JV Agreement'). The Developer undertook to redevelop the Subject Property and the units built would be offered for sale at an appropriate time.

3.11 The relevant clauses relating to financial benefits that would be received by the parties are clauses 3.01, 3.02, 3.04 and 17.04. In essence, the Developer shall pay Company A $180,000,000 ('the Initial Payment') by two instalments of $90,000,000 each upon signing of the JV Agreement and on 31 March respectively, the nature of which payments was the subject matter of this appeal. The Developer shall be entitled to reimbursement out of proceeds of sale both the Initial Payment and all redevelopment costs.

3.12 The remaining sales proceeds shall be distributed between Company F and the Developer as follows:

(a) to Company F, the first $320,000,000 representing the guaranteed profit;

then (b) to the Developer, the next $320,000,000;

then (c) any further amount of the said balance of sales proceeds in excess of the aforesaid $640,000,000 up to an aggregate of $900,000,000 in the proportion of fifty per cent (50%) to Company F and fifty per cent (50%) to the Developer; and

then (d) any further amount of the said balance of sales proceeds in excess of the aforesaid $900,000,000 in aggregate, in the proportion of forty five per cent (45%) to Company F and fifty five per cent (55%) to the Developer.

3.13 On 26 August 1994 the assessor issued additional profits tax assessment for year of assessment 1993/94 and assessed the first instalment of $90,000,000 of the Initial Payment to profits tax.

3.14 On 18 August 1995 the assessor issued a profits tax assessment for year of assessment 1994/95 which included the final instalment of $90,000,000 of the Initial Payment as assessable profits.

3.15 Company A through its tax representatives objected to such assessments. On 21 April 1997 the Commissioner issued a determination rejecting the two objections. On the determination Company A appealed.

Grounds of appeal

4.1 The grounds of appeal were clearly set out in the letter of 20 May 1997 from KPMG Peat Marwick, the then tax representatives for Company A, to the Clerk of the Board. The four grounds can be briefly summarised as follows:-

(1) The Initial Payment was part of the consideration received by Company A for transferring its interest in the Subject Property to Company F. The Subject Property was a capital asset and the Initial Payment should be regarded as part of the capital gain which is not liable to tax in Hong Kong.

(2) Alternatively, the Initial Payment should be treated as 'capital receipt' or as a compensation received for costs incurred by Company A for relocation of its business operations.

(3) *'The Commissioner was incorrect in finding that the Initial Payment represents an advance of sales proceeds received in respect of the future sale of the Subject Property as contemplated in the 28 July 1993 joint venture agreement. However, even if the Commissioner is correct – which fact is not conceded – the Initial Payment would form part of a profit arising from the sale of a capital asset (being the Subject Property which was used by the Company to house its main production facility for thirty five years) … …'*

(4) *'… … the Initial Payment would not be considered derived until such time as that future sale of the Subject Property incurred. Accordingly, the Initial Payment would not be taxable under section 14 or any other provision in the IRO, in the year of assessment 1993/94.'*

4.2 We appreciate that these are very crude grounds of appeal in comparison with the well organized and elaborate arguments put forward by Mr Olesnicky in his submission. Of all the four grounds, we would like to deal with the last two first.

4.3 In respect of Ground (3) above we doubt very much the assertion made by the then tax representative in respect of the Commissioner's finding was a true reflection of what the Commissioner had said in his determination. We have read the reasons for determination for several times. We do not find any statement to the effect that *'the Initial Payment represents an advance of sale proceeds received in respect of the future sale of the Subject Property.'* The sentence which can be found to have a meaning closest to the statement is the following: *'In other words, Company A/Company F contributed the site into the joint venture; the base cost is determined to be $496,000,000; the upfront receipt is $180,000,000 (paid to Company A); the guaranteed further receipt is $320,000,000. (payable to Company F) and then the final shared profits (payable to Company F) would depend on the success or otherwise of the sales. In my view, these three separate segments of receipts are of the same nature. They are all trading receipts, against which the cost of $496,000,000 may be set off. I do not think the fact that the upfront payment was made to Company A instead of Company F makes any difference.'* Most probably, the then tax representative's argument was that ***'sale proceeds'*** were not ***'trading receipts'***. We think what the Commissioner wanted to say was that it was trading receipt and not capital receipt. This ground could be grouped together with Ground (2) for consideration. On the other hand, if what the then tax representative sought to argue was that the Initial Payment was regarded by the Revenue as future sale proceeds which were paid in advance, the issue is whether the Initial Payment was a trading profit or proceeds from sale of a capital asset. We have not heard Mr Olesnicky particularly address this Ground (3). Most probably, he considered that Ground (3) was merged into other grounds, and did not require separate consideration.

4.4 Mr Olesnicky had hardly made any submission on Ground (4). We find as a fact that Company A had included the two instalments of the Initial Payment as profits made, though not trading profits, in the tax returns for the respective years. As the money is not refundable, we do not understand how Company A can sustain any argument relying on Ground (4) that *'the Initial Payment would not be considered derived until such time as that future sale of the Subject Property incurred.'* Ground (4) is on its own not sustainable.

Mr H's evidence

5.1 Mr H was the managing director of Company A for the period from 1 April 1990 to 31 May 1998. After his appointment as managing director he was aware of the problem that the vicinity of the Subject Property would soon be redeveloped into a

residential area. In his 30 years of service with Company I, one of the two holding companies of Company A, he and his company had encountered similar problems before.

5.2 He knew very well that there was no legal or physical reason why Company A could not continue their activities there. However there were a number of factors which made him think that it would not be viable to stay where they were for the long term. Because of the potential safety hazards there would inevitably be complaints from nearby residents. The Government, though not by official documents, had made it quite plain that they wanted Company A to move and to be relocated from the Subject Property so that the part of District B could continue to be redeveloped a ***'residential zone'***.

5.3 Mr H discussed it with Company D and he was very frank to admit: *'My first thoughts, when addressing these problems associated with the site in District B were to relocate our activities at District B to a new site.'* He was pre-occupied with this. Company D set out two methods; the only criterion Mr H had in mind was which method could provide sufficient fund and timing for the relocation. He had worked for Company I for long enough to understand the intricacy of the corporate structure and the company strategy of Company A.

5.4 Company A had only two shareholders: Company I and Company J. Both were international giants in the same trade. The board of Company A consisted of five directors; each of the shareholders could nominate two and the remaining was the managing director with no voting right. The board was well-balanced and resolutions had to be passed by consensus. Mr H knew it full well that the board would not approve further major investment in Hong Kong and the only way was self-financing the relocation if that was the plan.

5.5 Company D's report ('the Report') offered two alternatives for the existing site: an outright sale and a joint venture. Company D's conclusion was that *'the former is unlikely to achieve the full recovery of costs'* because this method could only achieve a sales price of $115,000,000 and even using the cheapest method of relocation, that is, having lease grant from the Hong Kong Industrial Estates Corporation the total relocation costs (including land premium of $46,000,000 and cost of removal at an estimated figure of $100,000,000) would amount to about $146,000,000.

5.6 It is obvious and we find as a fact that Mr H was much attracted by the other alternative, that is, to enter into a joint venture scheme with a developer. The Report indicated that revenues generated from the joint venture scheme as set out in Appendix IV of the Report would amount to $305,000,000. The drawback was that the upfront payment of $57,000,000 as set out therein was too low to meet the relocation costs. Later Mr H suggested to the directors to have a tender for bids which included an upfront payment of $150,000,000, nearly treble the amount estimated by Company D. The other board members, particularly one of the directors in Company J, was very sceptical about this. The price for an outright sale was estimated to be $115,000,000 only while Mr H recommended an upfront payment of $150,000,000. It is reasonable for us to conclude that Mr H, an experienced administrator, would not have made such a bold suggestion without research or

on no reasonable basis. Mr H's main objective was to find a way to secure sufficient fund for relocation. We also find it as a fact that both Mr H and the board were mainly concerned about the feasibility of relocation. The method of obtaining sufficient fund, whether by way of sale or otherwise, was secondary. In the various documents we have examined it is quite clear that the board was not too concerned about the method as long as it was a safe method without affecting Company A's main business and the method we capable of raising sufficient fund for the relocation. The details were left to Mr H, managing director, and Mrs K, the financial director and company secretary.

5.7 Mr H consulted Coopers & Lybrand, and Mrs K consulted Johnson, Stokes & Master, the two reputable accountant and legal firms in HKSAR respectively. The advice they obtained was *'that we should transfer the land into a separate company and that the development should be done through the separate company.'* The conclusion we can draw from the analysis of Mr H's evidence and also that of the various documents is that Company A did not mind entering into a trade venture provided that:

(a) it did not affect their main business relating to chemicals production;

and (b) it provided sufficient fund for relocation.

5.8 Mr H with the assistance of Company D prepared and invited tender for a joint venture scheme. The tender was quite clear and we have no doubt at all that Company A was looking for a business partner for redevelopment of the existing site and subsequent sale of the units in the project. The points we have to consider later:

(a) By transfer of the Subject Property to a wholly-owned subsidiary would it be regarded as a change of intention by Company A in respect to the Subject Property?

(b) Is the entering into an agreement relating to a scheme of joint redevelopment and subsequent sale regarded as trading activities carried out by Company A? Or, is it purely a disposal of capital asset by Company A?

In the meeting of 23 May 1993 the board approved the joint venture scheme which Company A did by entering into an agreement in principle with Company E on 2 July 1993. It is of interest to look at the exact wording of the minutes: *'The managing director had been requested to negotiate with Company E to provide the best deal for Company A.'* Suffice for us to say at this stage, the board entrusted Mr H with the full responsibility which they had rightly done to negotiate further. The subsequent events proved that Mr H had accomplished his work with great success.

5.9 Mr H was a good witness. He answered questions direct and knew exactly where to stop without committing himself one way or the other. As s former employee of Company A, understandably, he did not want to destroy the Taxpayer's case; neither did he overemphasize or over-state the taxpayer's case to lose the credibility of his evidence. The

board members of Company A unanimously agreed that he had done an admirable service to the Company. We are also greatly assisted by his evidence. With this note we now proceed to examine Mrs K's evidence.

Mrs K's evidence

6.1 Mrs K was a qualified accountant and has served Company A as finance director and company secretary since 1988 except for a short period as consultant in 1997/98. She was very loyal to the company and tried every possible way to defend the Taxpayer's case. Because of her anxiety to protect Company A's interests we find her answers to Mr Fok's questions were evasive. To give an example of this, Mr Fok had to ask seven different questions to elicit an obvious answer which could easily be found among the documents that a move was imminent by November 1990.

6.2 She was very anxious to give us her view about the Initial Payment of $180,000,000 and how the surplus, after deducting the cost of obsolete plant and machinery and the cost of dismantling, transporting and rebuilding the plants was regarded as ***relocating profits'***, a term which was invented by her together with the then tax representative.

6.3 She also emphasized the fact that Company E played the dominating and active role in the entire redevelopment scheme. Company E was the decision maker. The part played by Company A or Company F was a passive one; there were regular meetings held between the parties in which Company A's representative did nothing more than to review the reports. She concluded by saying: '*Company E effectively took complete charge of the redevelopment process, and the consultants were responsible for making the necessary submissions and preparing the necessary reports … … we relied on Company E and the consultants they worked with to take the necessary steps.'*

Intention

7.1 There is no dispute that the Subject Property was a capital asset. The key question is whether the way of disposing the Subject Property and the receipt of the Initial Payment amount to trading. The intention of Company A is an important factor for us to consider – the intention of Company A for sale of the Subject Property and the intention to join in as a party to the JV Agreement. The intention of a company is usually reflected in the resolutions of its board of directors and also by the actions taken by its staff.

7.2 On 21 May 1992 the board of Company A resolved in unambiguous term to progress with a move. Mr H was asked to pursue with the two options he presented to the board: straight-sale and development. The guiding principles for their decision as expressed in the board minutes extract were: to self fund relocation and to maximise the profit from sale or development. In other words, the company did not care which one of the two methods would be used and Company A wanted to obtain sufficient money for relocation and also to get some profits.

7.3 Mr H in his testimony clearly expressed that his primary concern at that time was to raise sufficient fund for the relocation. Once that was secured he would try to maximise the profit. This is what happened with Company E's offer; the monetary arrangement of the original offer can be briefly summarised as follows:

(a) Initial Payment of $180,000,000 by 2 instalments of $90,000,000 each to be paid on signing of the JV Agreement and 15 months thereafter respectively.

(b) Profits to be distributed at the following ratio:

Profit	**Company A's share**	**Company E's share**
First $400,000,000	50%	50%
Thereafter	35%	65%

7.4 After some negotiation the agreement reached and was subsequently approved by the board was as follows:

(a) Initial Payment clause remains the same with the only variation that the last instalment would be paid on March 1994.

(b) Profits were shared in the following manner:

Profit	**Company A's share**	**Company E's share**
First $900,000,000	50%	50%
Thereafter	45%	55%

The variations could fully comply with the guidelines of the board: to safely secure sufficient fund for relocation and to maximise the profits.

7.5 In the board meeting held on 23 May 1993 Mr H made '***financial comparisons***' between Company L's proposal and Company E's proposal. The latter was found to be more favourable. The board gave its approval to proceed with entering into a joint venture agreement with Company E. The board was fully aware of the basic terms of the joint venture and Company A's involvement. At that time the board was not informed that a subsidiary would be set up for the purpose of participation in the joint venture. It is quite clear, and we have no reason to doubt, that Company A was prepared to take part in this joint venture; the subsidiary was nothing more than a vehicle to implement the joint venture scheme.

Transfer of the Subject Property to Company F

8.1 The board did not make any enquiry into the setting up of a wholly owned subsidiary and the transfer of the Subject Property to it. The evidence of the two witnesses was that they had been advised by Coopers & Lybrand and Johnson Stokes Master. Both were of the view that the transfer of the Subject Property to a wholly owned subsidiary for such joint venture scheme was normal. It would give comfort to the joint venture partner that the land was 'safe' and would not be affected by the risk of the normal operation. Equally Company A's business would not be affected by the property development and sale thereafter.

8.2 Evidence indicated that at the early stage no one paid much attention to the transfer. It was not shown in the earlier documents or in Mr H's report that a subsidiary company would be set up and the Subject Property would be transferred to the subsidiary. For example, in the invitation to submit proposal, no disclosure was made that the Subject Property would be so transferred. The board minutes of 23 May 1993 meeting, in which approval was given '*to proceed with entering into a joint venture agreement with Company E*' made no reference about the transfer. The first document which mentioned the use of a subsidiary was the letter dated 2 July 1993 from Company A to Company E which was regarded as '***agreement in principle***'. The letter was signed by Mr H on behalf of Company A. Ten days later, the board on 12 July 1993 approved the setting up of a wholly owned subsidiary and the transfer.

8.3 From this account of the event it is not unreasonable for us to conclude that the transfer was taken as a part of the whole arrangement for Company A to participate in the joint venture scheme. In May 1993 the board approved the participation in the joint venture; it did not give authority to Mr H or any other person to transfer the Subject Property. The board in July resolved it almost as a matter of course to set up a subsidiary and transfer the property to it. It is our findings that the board took the assignment and transfer as a normal course of event and that Company F was nothing but a vehicle for Company A to participate in the joint venture scheme.

Consideration for the transfer

9.1 In Ground (1) the Taxpayer submitted that the Initial Payment was part of the consideration received by Company A for transferring its interest in the Subject Property to Company F. The Initial Payment should be regarded as a profit from the sale of the Subject Property which is a capital asset. In his submission on point of law Mr Olesnicky pointed out to us the matters he regarded as irrelevant, what Company A had done and what Company A had not done. In his submission on evidence at paragraph 16 he submitted that '*Company A received the $180,000,000 as part and parcel of the agreement by which it agreed to transfer its capital asset to Company F. The amount was received by it for the purpose of funding the relocation of its business operations. Company A would not have agreed to dispose of its property but for the receipt of the upfront payment. In the circumstances, the $180,000,000 represents part of the profit that Company A made from the sale of its capital asset.*' This is the main thrust of his argument. It has some support from clause 3.01 of the JV Agreement, which states: '*The Developer shall pay to Company*

A, to enable it to relocate to the new site referred to in clause 10.01, a non-refundable Initial Payment of $180,000,000 … …'

9.2 Mr Olesnicky was very kind to supply us with the footnotes where he drew his conclusions. However, we can only find evidence to show that the Initial Payment was for the purpose of relocation but this does not necessarily follow that the money forms part of the consideration for the transfer. We also accept what Mr H and Mrs K told us that without the upfront money sufficient to effect relocation Company A would not be able to move and therefore would not have entered into the arrangement. But, this does not necessarily imply that the money forms part of the consideration for the sale to Company F.

9.3 We do not see any written document to the effect that the payment is part of the consideration. Neither have we heard any evidence to that effect. Mr Olesnicky solely relied on the argument that the payment was made for the purpose of relocation and Company A would not have entered into the arrangement had it not been paid. With due respect this argument was rather weak. That the payment could have been made as consideration for entering into a trading scheme – we understand – is the argument of the Revenue. We see no link between the Initial Payment and the consideration for the transfer.

9.4 According to the evidence the consideration stated on the assignment of the Subject Property was $497,000,000 and in no part of the assignment the said sum of Initial Payment was mentioned. We have not been informed why in the assignment the Initial Payment was not stated as part of the consideration, particularly when it was clearly stated in clause 3.02 of the JV Agreement that the Initial Payment made by the Developer would be reimbursed by Company F to the Developer.

Capital receipt

10.1 Ground (2) of the appeal is that the Initial Payment should be treated as capital receipt. Mr Olesnicky cited three authorities; they are Walter W Saunders Ltd v Dixon [1962] 40 TC 329, McLean v Needham [1960] 39 TC 37 and CIR v Coia [1959] 38 TC 334. The facts in all these three cases are similar: the taxpayers operated garage business and needed money for repair, maintenance or extension of the existing garage. In each case a petroleum company agreed to pay a substantial sum to the taxpayer and in exchange the taxpayer sold no other brand of oil except that of the petrol company. In all these three cases the courts ruled that the receipt was not a revenue income and was not liable to tax.

10.2 Mr Olesnicky submitted that the Initial Payment which was received by Company A was similar to those in the three cases. In the present case it was for the purpose of helping Company A relocate its business to the new site as set out in clause 3.01 of the JV Agreement. The above three cases concluded that the garage companies received the moneys as capital receipts which were not classified as trading receipt. Whether it is a capital receipt is a question of fact. It goes back to the same question whether Company A should be regarded as participating in a scheme of profit making. If it was trading profit how it was used did not alter the nature of the receipt. This is the general proposition which has been accepted by Wilberforce J in the Walter W Saunders Ltd case at page 339: '*under*

an agreement, payments of a revenue character may be made, and they do not assume a capital character because of what the recipient does with them. That, of course, I entirely accept.' In other words, if we find that the receipt is an income from trading, the argument of capital receipt is not tenable. It is necessary for us to consider the nature of its payment and not for what purpose the money is intended to be used.

Redevelopment and sale of units

11.1 An important point of law we have to consider is whether the redevelopment of the site for the purpose of sale amounts to trading in property. Mr Olesnicky argued that it did not, and cited a number of cases in support. We have no problem with the proposition that to enhance the capital asset for the purpose of sale should not be construed as trading activities. In the case of C H Rand v The Alberni Land Company Limited (1920) 7 TC 629 where the taxpayer for the purpose of sale cleared the land and formed roads, the Court decided at page 638 that the taxpayer *'did more than a lazy or too conservative land owner would do.'* We accept that a taxpayer should not be made to pay purely because of his entrepenial diligence.

11.2 In the case of West v Phillips (1958) 38 TC 203 the taxpayer went further and set up an estate agency company to sell the assets but it was held that this does not change the nature of the asset itself. The case of Scottish Australian Mining Co Ltd v FCT (1950) 83 CLR 188 had facts similar to the present case: the taxpayer was a mining company. Certain land, purchased by the taxpayer for the purpose of coal mining, was after its operation for coal mining had ceased sold from time to time in parcels at a considerable profit. Before sale the land were subdivided; roads and a railway station were constructed; sites were made available for schools, churches and parks. The Court held that the taxpayer was not engaged in the business of selling land but was engaged in realizing a capital asset the profits from which should not be included in its assessable income. The present case we are now considering has certain similarities: Company A intended to redevelop the Subject Property into a composite development and then sell the units.

11.3 Hong Kong cases have also similar decision. Mr Justice Barnett in Crawford Realty Limited v CIR (1991) 3 HKTC 674 tried to make a distinction between sale of capital assets and trading in properties by using the analogy of motor car sale in a passage at page 693 which is often quoted: *'Enhancement of an asset, making it as attractive and saleable as reasonable expenditure of time and money can achieve, is one thing. The end product remains substantially the same. Substitution, however, is another matter. It is the taking of one's old car, removing the bodywork, engine and suspension from the chassis and replacing them with the latest styling and mechanical components. And that is effectively what happened here.'*

11.4 The main argument for Company A is that the sale of the units subsequently built do not amount to trading. It is just an enhancement of the capital asset for sale. Mr Olesnicky has quoted us a number of cases including Taylor v Good [1974] 1 WLR 556 where the taxpayer, not being property developer, brought a property with no intention of selling it for a profit but later took steps to enhance its value, by obtaining planning

permission for development, and later selling the land. Such activities did not amount to an adventure or concern in the nature of trade. It is decided in another case that revenue profit means *'a gain made in an operation of business in the carrying out of a scheme for profit-making … … The realisation is not converted into such a scheme by reason of the fact that it was of some magnitude … … or the fact that it was carried out in any enterprising way … … or so as to secure the best price.'* This is the general principle set out in the case of Allied Pastoral Holdings Pty Limited v FCT [1983] 83 ATC 4015 at 4041 and we have no reason to quarrel with it.

11.5 From what we have heard from the two witnesses and also what we have gathered from the documentary evidence, the whole redevelopment scheme is a massive one; it involves hundreds of millions of dollars in carrying out the project, it requires an in situ exchange of land and it takes a long time for the redevelopment. In the case of Scottish Australian Mining Co Ltd the land is the same old piece of land but subdivided with improvements on the surroundings to facilitate sale. In the present case the original site was surrendered and was regranted with a new site, though mainly falling within the same location but with additional land. Then, it will be developed and the units built will be sold. The gain is no longer a profit gained from the sale of the same original asset; it is an entirely different product that the joint venture partners will be selling after the redevelopment. In the words of Mr Justice Barnett, it is a ***'substitution'.***

11.6 There is no doubt in our mind that Company A intended to participate in the joint venture scheme which included exchange of land, development of the site and sale of units built. We do not consider that the participation in such scheme is purely for the enhancement of a capital asset for sale. The original Subject Property has lost its identity after exchange and the units which will be offered for sale pursuant to the JV Agreement are products completely different from the Subject Property.

11.7 Having reviewed and taken into consideration all the facts as a whole we find that Company A received the Initial Payment of $180,000,000 because it participated in the joint venture scheme. It participated by forming Company F, transferring the Subject Property to Company F, acting as its manager and guaranteeing its performance. As stated in clause 35.01 of the JV Agreement, *'whenever the Company (that is, Company F) fails as aforesaid to perform or fulfil any such obligations Company A shall on demand by the Developer perform or fulfil the same as if Company A were principal obligor under this Agreement.'* In other words Company A was ready, willing and prepared to take over the role of Company F whenever the latter was in default. Company A was the prime mover of the whole joint venture and it played a positive important role in the whole scheme, particularly at the beginning. Company A knew that by participation in the joint venture it carried on a different type of business. After consulting its legal advisors and its accounting consultants, to minimise its risk and also to give comfort to its joint venture partner it adopted the ***'normal'*** method of forming a wholly-owned subsidiary company and transferring the Subject Property to Company F. This does not mean that Company A was no longer a party to the joint venture. It played a part in the business – a part which would

give it an award, that is, the Initial Payment of $180,000,000 which Company A would use for relocation. The purpose for which the money would be used was not relevant in deciding whether it was a capital receipt. We have to consider why the money was paid to Company A. We find that the Initial Payment was the award it gained for participation in the joint venture. It was a trading revenue and not a capital receipt.

11.8 Neither do we have any evidence to show that the Initial Payment was part of the consideration received by Company A for transferring its interest in the Subject Property to Company F.

Conclusion

12.1 For reasons given above we dismiss Grounds (1), (2) and (3) of the appeal. We have already addressed Ground (4) of the appeal in paragraph 4.4 above and we do not intend to repeat it here.

12.2 Section 68(4) of the Inland Revenue Ordinance states that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer. We do not think that Company A has discharged its burden.

12.3 Company A does not dispute the quantum of tax in issue. Accordingly we dismiss the appeal and confirm the Commissioner's determination of 21 April 1997 relating to the additional profits tax of $15,750,000 and the profits tax of $36,900,548 imposed on Company A for the relevant years of assessment 1993/94 and 1994/95 respectively.