Case No. D27/08

Profits tax – sale of property – intention at time of acquisition – subsequent change of intention – onus of proof on the appellant – sections 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Anna Chow Suk Han (chairman), Alan Ng Man Sang and Wong Fung Yi.

Dates of hearing: 4, 5, 6, 7 June 2007 and 24, 25 September 2007.
Date of decision: 23 September 2008.

In 1991, the Taxpayer acquired the Property which comprised of two buildings with one sitting tenant.

The Taxpayer applied in 1992 and accepted in 1993 the terms proposed by the Government for modification of the lease conditions of the Property.

Between 1994 and 1997, the Property was redeveloped and a new building known as Building D was erected with occupation permit issued on 14 August 1997.

On 16 January 1998, the Taxpayer decided that, due to the Asian financial crisis, it would be in its best interest to dispose of Building D at the best possible price.

The Taxpayer revalued the Property to its market value as at 16 January 1998 and credited the increment on the revaluation to the asset revaluation reserve, which was subsequently released as the Taxpayer's accounting profits when the Property was sold.

The Taxpayer contended that the Property was acquired as an investment asset on 28 September 1991. The Taxpayer only changed its intention from holding the Property as an investment asset to holding it as trading stock on 16 January 1998.

The Commissioner did not accept that the Property was acquired by the Taxpayer for long term purposes as an investment asset but all along it had been its trading stock. The Commissioner took the view that the Taxpayer's realized asset revaluation reserve was revenue in nature and thus chargeable to profits tax.

The Commissioner further contended that even if it was the Taxpayer's intention to acquire and hold the Property as an investment asset, once the Taxpayer applied for redevelopment of the

Property, it had changed its intention from holding it as an investment asset to holding it as trading stock or it had left it undecided until after redevelopment of the Property.

Held:

1. The question of intention cannot be dealt with in isolation only at the time of acquisition. The stated intention must be judged by the consideration of the whole of the surrounding circumstances: things said at the time, before and after, and things done at the time, before and after.

2. The Board has found a host of facts/ activities undertaken by the Taxpayer (subsequent to the acquisition in 1991; during and after redevelopment of the Property and until the change of intention on 16 January 1998) to support the Taxpayer's stated intention that the Property was acquired for rental purposes and such intention remained so notwithstanding the redevelopment of the Property.

3. From 1992 to 1997, the Property was consistently disclosed and described in the audited financial statements of the Taxpayer and its holding company, Company B in line with the Taxpayer's stated intention.

4. The subsequent preparation of the DMC for the redeveloped Property would have no relevance to the Taxpayer's stated intention and the DMC was not intended for use by the Taxpayer until the change of intention on 16 January 1998.

5. The Board found it as a fact that the share price of Company B, the holding company of the Taxpayer dropped throughout the year of 1997 and dramatically on 15 January 1998 such that Company B was asked by the Stock Exchange of Hong Kong Limited to make a press statement. Hong Kong was at that time experiencing one of its worst financial crisis.

6. The Property was a brand new building and at a prime location which would be easier and quicker to sell than the other main-stream properties. The Taxpayer's reason for the change of intention on 16 January 1998 was genuine.

7. The Property was a capital asset up to 16 January 1998.

Appeal allowed.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Marson v Morton [1986] STC 463
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR [1992] 3 HKTC 750
Wing On Cheong v Commissioner of Inland Revenue 3 HKTC 1
Stanwell Investments Ltd v Commissioner of Inland Revenue [2004] 2 HKLRD 1476
D74/91, IRBRD, vol 7, 16
D21/02, IRBRD, vol 17, 500
China Map Limited v Commissioner of Inland Revenue HCIA 4/2005
Leeming v Jones (HM Inspector of Taxes) (KBD and CD) [1930] 1KB 279 and (HL) [1930] AC 415
Hillerns and Fowler v Murray (HM Inspector of Taxes) (KBD) 47 TLR 553 and (CA) 48 TLR 213
Commissioner of Inland Revenue v Reinhold 1953 SLT 94
Shadford v H Fairweather & Co Ltd (1966) 43 TC 291
Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue [2007] 1 HKLRD 198
Commissioner of Inland Revenue v Common Expire Ltd [2007] 1 HKLRD 679
Brand Dragon Ltd (in Members' Voluntary Liquidation) v Commissioner of Inland Revenue (2001) 5 HKTC 502
D11/80, (1980) IRBRD, vol 1, 374
D65/87, (1988) IRBRD, vol 3, 66
D26/93, (1993) IRBRD, vol 8, 183
D54/98, (1998) IRBRD, vol 13, 314
D129/00, (2001) IRBRD, vol 15, 981
D21/01, (2001) IRBRD, vol 16, 206
American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue [1979] AC 676
Rangatira Ltd v Commissioner of Inland Revenue [1997] 1 NZLR 129
Lam Woo Shang v Commissioner of Inland Revenue (No 2) [1961] HKLR 609
Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177
Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue [2001] 1 HKLRD 489
Bowden Investments Pty Ltd v Federal Commissioner of Taxation (1987) 19 ATR 17
Yazhou Travel Investment Co Ltd v Bateson [2004] 1 HKLRD 969
Li Sau Keung v Maxcredit Engineering Ltd [2004] 1 HKC 434

Ambrose Ho Senior Counsel and Eugene Fung Counsel instructed by Messrs Baker & McKenzie for the taxpayer.

Rimsky Yuen Senior Counsel and Stewart Wong Counsel instructed by Cecilia Siu Government Counsel of the Department of Justice and Wong Ki Fong Senior Assessor for the Commissioner of Inland Revenue.

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I The appeal

1. This is an appeal by the Taxpayer against the determination of the Commissioner of Inland Revenue ('the Commissioner') of 20 July 2006 ('the Determination') whereby the Commissioner determined that :

(a) the profits tax assessment on the Taxpayer for the year of assessment 1998/99 dated 9 July 2003, showing net assessable profits of $1,617,532,890 (after loss set off of $17,886,783) with tax payable thereon of $258,805,262, be increased to net assessable profits of $1,620,423,606 (after loss set off of $14,996,067) with tax payable thereon of $259,267,776;

(b) the profits tax assessment on the Taxpayer for the year of assessment 1999/2000 dated 9 July 2003, showing assessable profits of $25,205,517 with tax payable thereon of $4,032,882 be confirmed; and

(c) the profits tax assessment on the Taxpayer for the year of assessment 2001/02 dated 10 July 2003 showing assessable profits of $3,751,105 with tax payable thereon of $600,176 be reduced to net assessable profits of $1,437,292 (after loss set off of $2,313,813) with tax payable thereon of $229,966.

2. In the Determination, the Commissioner concluded that the property at Address A ('the Property') was not acquired by the Taxpayer as a capital asset and the same was trading stock at all times and thus, the asset revaluation reserve realized on disposal of the Property, was revenue in nature and chargeable to profits tax and that the assessor's withdrawals of rebuilding allowances and the revision to the 1998/99 and 2001/02 profits tax assessments were correct.

3. In its notice of appeal, the Taxpayer gave the following grounds of appeal :

(a) the Property was a capital asset at all times and thus the profits derived from the disposal of the same, was not chargeable to profits tax under Section 14 of the Inland Revenue Ordinance ('IRO');

(b) alternatively, there was a change of intention from holding the Property as a capital asset to holding it as trading stock prior to the disposal of the Property and thus only the excess of the proceeds of sale over the market value of the Property on the date of change of intention was chargeable to profits tax under section 14 of the IRO; and

(c) it followed that the Taxpayer was entitled to the rebuilding allowances as claimed.

II The background

4. The Taxpayer is a private limited company incorporated in Hong Kong in 1991. Its holding company is Company B, a public company listed in Hong Kong. In 1991, the Taxpayer acquired the Property being Address A. There were then standing thereon two buildings. The Property was acquired with one sitting tenant. In 1992, the Taxpayer through Company C, applied to the Government for modification of the lease conditions of the Property. In 1993, the Taxpayer accepted the terms proposed by the Government for modification of the lease conditions of the Property. Consequently, the Property was redeveloped and was under construction between 1994 and 1997. A new building known as Building D was erected on the Property and the occupation permit to occupy the same was issued on 14 August 1997. At about the same time, the Asian financial crisis was setting in in Hong Kong and in about January 1998, there were rumours about the liquidity of Group E of companies. On 16 January 1998, the Taxpayer held a meeting and decided as stated in the minutes of the meeting that due to the Asian financial crisis and the unfounded rumour against Company B, in the best interest of the Taxpayer and Group E, instead of being held as an investment, Building D would be disposed of at the best possible price so as to improve the financial position and to reduce the gearing level of Group E. On the instructions of the Taxpayer, Surveying Company F revalued the Property to its market value as at 16 January 1998. The increment on the revaluation was credited by the Taxpayer to the Taxpayer' s asset revaluation reserve, which was subsequently released to become the Taxpayer' s accounting profits when the Property was sold. The Taxpayer asserted that as the Taxpayer' s asset revaluation reserve was attributable to an increase of the Property' s value before 16 January 1998 when the Property was still a capital asset, the realized asset revaluation reserve was capital in nature and was not assessable to profits tax. The Commissioner did not accept that the Property was acquired by the Taxpayer for long term investment purposes and that there was any change of intention on the part of the Taxpayer. The Commissioner took the view that the Taxpayer' s realized asset revaluation reserve was revenue in nature and thus chargeable to profits tax.

III Agreed facts

5. We have been provided with a statement of agreed facts by the parties hereto. Instead of being reproduced here again, those agreed facts are set out in the 'Appendix' hereto. It must be noted that the facts were agreed by the parties hereto without prejudice to their respective contention in relation to the capacity in which the acts and affairs were carried out or arranged by the various parties or the weight to be given thereto. In addition, the Revenue should not be taken to have agreed to the truth, accuracy, relevance or weight of any matters as stated or contained in any documents mentioned in the statement of agreed facts save for the fact that those matters have been so stated or contained in those documents.

6. We shall give weight to the agreed facts on the basis of the aforesaid and in the light of other evidence available to us.

IV The Taxpayer's case

7. It is the Taxpayer's case that the Property was acquired as an investment asset on 28 September 1991. The Taxpayer only changed its intention from holding the Property as an investment asset to holding it as trading stock on 16 January 1998.

V The Revenue's case

8. It is the Revenue's case that the Property was not acquired by the Taxpayer as an investment asset but all along it had been its trading stock.

9. Alternatively, the Revenue's case is that even if it was the Taxpayer's intention to acquire and hold the Property as an investment asset (which was not accepted by it), once the Taxpayer applied for redevelopment of the Property, it had changed its intention from holding it as an investment asset to holding it as trading stock or it had left it undecided until after redevelopment of the Property.

VI The issue under appeal

10. Section 14(1) of the IRO makes all assessable profits whether arising from a trade, profession or business, chargeable to profits tax. The only exception is 'profits arising from the sale of capital assets'. Thus, the issue under appeal is whether or not the Property was a capital asset prior to 16 January 1998.

VII The relevant law

11. Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1348 to 1349 and [1986] STC 463 at pages 470 to 471:

> *'……. The matters which are apparently treated as a badge of trading are as follows : (i) that the transaction in question was a one-off transaction. ……. (ii) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? ……. (iii) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realization. ……. (iv) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature? (v) What was the source of finance of the transaction? ……. (vi) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? ……. (vii) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? ……. (viii) What were*

the purchasers' intentions as to resale at the time of purchase? …… (ix) Did the item purchased either provide enjoyment for the purchaser, for example a picture, or pride of possession or produce income pending resale? ……'

12. Lord Wilberforce authoritatively stated in Simmons v IRC[1980] 1 WLR 1196 at page 1199:

'One must ask, first, what the commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax: see Sharkey v. Wernher [1956] A.C.58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situation are open to review.'

13. Mortimer J, as he then was, said in All Best Wishes Limited v CIR [1992] 3 HKTC 750 at page 771:

'…… The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said

at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.'

VIII The authorities produced by the Taxpayer and the Revenue

14. Authorities for the Taxpayer:

(a) Simmons v Inland Revenue Commissioners [1980] 1 WRL 1196

(b) Wing On Cheong v Commissioner of Inland Revenue 3 HKTC1

(c) All Best Wishes Ltd v Commissioner of Inland Revenue 3 HKTC 750

(d) Stanwell Investments Ltd v Commissioner of Inland Revenue [2004] 2 HKLRD 1476

(e) D74/91, IRBRD, vol 7, 16

(f) D21/02, IRBRD, vol 17, 500

(g) China Map Limited v Commissioner of Inland Revenue HCIA 4/2005

(h) Leeming v Jones (HM Inspector of Taxes) (KBD and CD) [1930] 1KB 279 and (HL) [1930] AC 415

(i) Hillerns and Fowler v Murray (HM Inspector of Taxes) (KBD) 47 TLR 553 and (CA) 48 TLR 213

(j) Commissioner of Inland Revenue v Reinhold 1953 SLT 94

(k) Phipson on Evidence 16th Edition [6-53]

(l) Allied Pastoral Holdings Pty Ltd

- v -

Federal Commissioner of Taxation Australian Law Reports SC (NSW)

(m) Willoughby & Halkyard: Encyclopaedia of Hong Kong Taxation 3 & 4 – Taxation of Income Issue 13 [5540]-[5586]

15. Authorities for the Revenue:

(a) Sections 14 and 68 and Part 1 of Schedule 5 of Inland Revenue Ordinance, Chapter 112

(b) Marson v Morton [1986] 1 WLR 1343

(c) Shadford v H Fairweather & Co Ltd (1966) 43 TC 291

(d) Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue [2007] 1 HKLRD 198

(e) Commissioner of Inland Revenue v Common Expire Ltd [2007] 1 HKLRD 679

(f) Brand Dragon Ltd (in Members' Voluntary Liquidation) v Commissioner of Inland Revenue (2001) 5 HKTC 502

(g) D11/80, (1980) IRBRD, vol 1, 374

(h) D65/87, (1988) IRBRD, vol 3, 66

(i) D26/93, (1993) IRBRD, vol 8, 183

(j) D54/98, (1998) IRBRD, vol 13, 314

(k) D129/00, (2001) IRBRD, vol 15, 981

(l) D21/01, (2001) IRBRD, vol 16, 206

(m) Inland Revenue Ordinance (Chapter 112), section 14

(n) American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue [1979] AC 676

(o) Rangatira Ltd v Commissioner of Inland Revenue [1997] 1 NZLR 129

(p) Lam Woo Shang v Commissioner of Inland Revenue (No 2) [1961] HKLR 609

(q) Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177

(r) Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue

[2001] 1 HKLRD 489

(s) Bowden Investments Pty Ltd v Federal Commissioner of Taxation (1987) 19 ATR 17

(t) Yazhou Travel Investment Co Ltd v Bateson [2004] 1 HKLRD 969

(u) Li Sau Keung v Maxcredit Engineering Ltd [2004] 1 HKC 434

IX The burden of proof and approaches to the issue

16. Lengthy submissions were made by the respective counsel for the Taxpayer and the Revenue on the questions of burden of proof to be discharged by the Taxpayer and the relevant approaches to the issue under appeal.

17. The Revenue submitted that the Taxpayer could only succeed if it could discharge the burden of proving to the Board's satisfaction that the Property was acquired and held as a capital asset at all times up to 16 January 1998. The Taxpayer contended that this proposition was wrong in law, in that it imposed a burden on the Taxpayer to prove that (a) its intention vis-à-vis the Property at the time of acquisition was to acquire it as a long-term investment property and (b) that original intention had not been changed. It contended that the Taxpayer only had to prove (a) but not (a) and (b) and that once (a) was proved, it was common sense that such an intention would remain until the asset was disposed of, unless the contrary was shown and that if anyone wanted to suggest that the Taxpayer had changed its intention in the interim, then it was up to that party to prove that there was such a change of intention, and the usual rule of evidence that 'he who asserts must prove' must apply.

18. We are of the view that the aforesaid supposed differences between the Taxpayer and the Revenue are more apparent than real. The law in cases of this nature is well settled. In the Simmons case, Lord Wilberforce focused the question of the taxpayer's intention at the time of acquisition of the property. Whether a property is acquired as a capital asset or trading stock depends on the intention of the taxpayer at the time of acquisition of the property. However, as expanded by Mortimer J. in the case of All Best Wishes, this question of intention cannot be dealt with in isolation only at the time of acquisition but has to be considered by examining all the circumstances of the case. A mere declaration of intention is of limited value. The stated intention must be judged by the consideration of the whole of the surrounding circumstances: things said at the time, before and after, and things done at the time, before and after.

19. On whether or not the Taxpayer needed to prove (a) but not (a) and (b) as contended by counsel for the Taxpayer, perhaps it is appropriate for us to quote here the following passage of Andrew Cheung J in the Real Estate case [2007] 1 HKLPD on page 215J and 216, A-C:

> *'….. in a case where there has been no change of intention throughout, logically one can look at the taxpayer's intention at any given point of time and the answer one gets must, by definition, be the same, whether it be an investment intention or trading intention. Ex hypothesis, the intention has remained the same throughout from day one to the date of sale. Thus, it must be legitimate to look at all the facts and happenings over the years to find out the intention of the taxpayer. Some of them may have happened on day one and some in subsequent years, yet others on the day of sale. This is the approach of the badges of trade – some of those badges focus on the time of acquisition whereas some others on events that happened subsequently (e.g. the reason for resale).'*

20. Following from the above, we see no inconsistency between the two approaches respectively urged upon us by counsel for the Taxpayer and the Revenue. Counsel for the Taxpayer argued that the nature of an asset, whether trading stock or capital asset, was to be ascertained only from the intention of the acquirer at the time of acquisition of the asset, and once the taxpayer had satisfied that the intention at the time of acquisition was to acquire it as a capital asset and that was the end of the matter and it was wrong to require the taxpayer to prove that it was holding the property at all times as a capital asset. However, since the intention of acquirer cannot be dealt with in isolation only at the time of acquisition, and can only be ascertained from all the surrounding circumstances, there is no real conflict between having to satisfy the enquiry as to intention of the acquirer at the time of the acquisition and having to prove that the acquirer was holding the asset at all times as a capital asset. The extent of proof which falls upon the Taxpayer remains the same because apart from having to prove its stated intention at the time of acquisition, the Taxpayer needs to satisfy us that the surrounding circumstances at before and after the acquisition were also consistent with its stated intention. That being the case, if the Taxpayer was to prove (a), effectively it was proving both (a) and (b).

21. The Taxpayer also disapproved the following approach adopted by the Revenue in dealing with the present enquiry. The Revenue submitted that the Taxpayer's case of change of intention on 16 January 1998 was incredible and therefore the natural inference was that the Taxpayer had the intention to sell the Property all along. The Taxpayer contended that nothing had been put forward by the Revenue to contradict the Taxpayer's unchallenged evidence of acquiring the Property on 28 September 1991 as a long-term investment property, but instead the Revenue just looked at and criticized the Taxpayer's reason for changing its intention on 16 January 1998 and asked the Board to work backward to draw an inference as to the Taxpayer's intention as at 28 September 1991. The Taxpayer submitted that this was a wrong approach to the issue. In this connection, we note the following dicta of Andrew Cheung J in the case of Real Estates on page 214, paragraph 67:

> *'…….. Section 68(4) places the burden of proving an assessment incorrect on the taxpayer. In other words, it is for the taxpayer to prove that the profits in question arose from the sale of a capital asset, and therefore they were not*

> *chargeable to tax and thus the assessment was wrong. If he fails to prove that the asset in question was a capital asset, his appeal against the assessment must fail. Put another way, for the purpose of an appeal, it is for the taxpayer to prove that an asset was a capital asset; it is not for the Commissioner to prove that it was a trading stock – he may, if he so chooses, simply sit back and put the taxpayer to proof. ……'*

22. We share the aforesaid view expressed by Andrew Cheung J.. We are of the view that the Revenue is not obliged to prove the Taxpayer' s assertions or evidence to the contrary. It may just raise criticism and cast doubts over the matter and leave it to the Taxpayer whether or not to prove such criticism and doubts incorrect.

23. As to the point raised by the Taxpayer that those parts of the witnesses' evidence which were not challenged by the Revenue, must be treated as having been accepted by the Revenue. In this regard, it is also relevant to note the following passage from the case of All Best Wishes at 773:

> *'A tribunal, which hears oral evidence and considers documents, is not in the position (as is submitted) that it had to find what the witness says is the fact, even if he is not cross-examined, and even if he is not contradicted by other evidence. A tribunal, in those circumstances, may look at the whole of the circumstances presented to it and may find that the oral evidence is not acceptable on particulars matters. Or, may find certain facts contrary to the evidence that has been given and, indeed, contrary to what appears in the documents and other material before it.'*

24. Consequently, we shall deal with the appeal according to the aforesaid legal principles on the burden of proof required to be discharged by the Taxpayer.

X The evidence of the witnesses

25. The Taxpayer called six witnesses to give evidence on its behalf namely Mr G, Mr H, Mr I, Mr J, Mr K and Mr L. They produced their respective witness statements and were respectively cross-examined by counsel for the Revenue.

26. A company' s state of mind must be found in the persons who are really the directing mind and will of the company. Mr G has been the chairman of Company B and Group E and a director of the Taxpayer since 1991. As chairman, he is the main controlling mind and has direct control on the policies and directions of the Group E He told us how the acquisition, the redevelopment and the sale of the Property, came about. Since he was the actual driving force behind the whole scheme, his evidence in this regard is important to the issue under appeal. Thus, we shall relate his evidence in detail below.

27. Mr H was an executive director of Company B and also a director of the Taxpayer at all the material times. He retired from Group E at the end of 1998. He was the financial controller of Group E. His main responsibility was looking after Group E's finance, accounts, and presentation of the published accounts. He explained to us the funding arrangements in respect of the acquisition and redevelopment of the Property and how Group E reacted to the Asian financial crisis and the drop of the share price of Company B on 15 January 1998. Mr H also gave us an account of the leasing campaign undertaken by the Taxpayer and the progress of works of the leasing committee set up by the Taxpayer in relation to the Property. However it appears that most of the matters on the leasing campaign which he related to us were not from his personal knowledge but from the minutes of the meetings of the leasing committee. Thus, his evidence in this connection will be assessed by us in this light.

28. Mr I has been the company secretary of Company B since 1989 and as such he has always been responsible for the day-to-day company secretarial affairs of the Taxpayer. Until 1997, he was also responsible for the legal affairs of Group E, which included appointments of legal firms and giving instructions to them. He was the person responsible for the appointment of Legal Firm M to prepare the legal documents including Deed of Mutual Covenant ('DMC') upon redevelopment of the Property.

29. Mr J before he joined Company B as an executive director in late 1997, was a partner of Legal Firm N supervising all conveyancing matters of Company B. In 1991, Legal Firm N acted for the Taxpayer in the acquisition of the Property. Mr J told us the role he played in the acquisition and the instructions he took from Mr G in this regard. He told us that he was informed by Mr G that the Property was acquired for lettings. He took instructions from Mr G to permit the sub-vendor to continue leasing out the Property before completion.

30. The auditors of Company B and Group E were Accounting Firm O and then Accounting Firm P. When Accounting Firm P merged with Accounting Firm O in 1997, Mr K was a senior partner of Accounting Firm O from 1 April 1976 to 31 March 1999 and then the senior audit and assurance partner of Accounting Firm P from 1 April 1999 to 31 May 2002. He was the senior partner in charge of the audit of Company B and Group E. Mr K gave us a detailed account of the audit requirements and the objectives and procedures of the audit programmes in relation to properties and also the accounting standards governing classification of assets. He then told us how the Property was classified in the Taxpayer's financial statements. He further confirmed that on the basis of the contemporaneous evidence available at the relevant times, both Accounting Firm O and Accounting Firm P, as auditors of Company B and the Taxpayer, were in the position to give at the relevant times an independent opinion and a true and fair view of the affairs of the companies.

31. Mr L is a qualified architect and an authorized person. He joined Group E in 1979 and later became a director of Company B. He was also a director of the Taxpayer from 1 August 1991 to 1 May 2002. He was called by the Taxpayer to give evidence on the issue of the state of

the Property as at about the end of 1997 which arose out of cross-examination of the other witnesses. He produced a witness statement. However, the Board was of the view that the matters referred to in paragraphs 7 to 11 of his statement, did not arise out of cross-examination of the other witnesses. Those matters were therefore not admitted by the Board. Mr L gave evidence as to the other matters and was cross-examined thereon.

32. We had the opportunities to observe the demeanors of the witnesses. We are satisfied that they were truthful and honest witnesses. They gave evidence in an open and straight-forward manners. We have no reason to doubt their testimony in most respects. Given that the matters took place so many years back, if there are inconsistencies in the evidence, we are prepared to give allowances in appropriate circumstances.

Mr G's evidence

33. Mr G gave evidence to the following effect.

34. Mr G had been the chairman of Company B and its group of companies and also a director of the Taxpayer, a wholly-owned subsidiary of Company B, since 1991. Mr G's family was the controlling shareholder of Group E. As chairman, Mr G had direct control on the policies and directions of Group E. Group E had always maintained an investment portfolio as well as a trading portfolio. It had always been Group E's policy to acquire premium properties for its investment portfolio. Mr G explained that a company's strength was based on its recurrent cash flow and thus by adding premium properties to its investment portfolio the current cash flow would be enhanced, but trading profits would fluctuate and were therefore uncertain.

35. The Property was introduced to Mr G by his friend Mr Q who was the first tenant there. In August 1991, Mr Q invited Mr G to visit him at his apartment at the Property. Mr G was impressed by the view that the Property commanded. He considered that since the Property was a new building and in a prime location, it would be a good investment property to be added to Group E's investment portfolio. The Property would be ideal for leasing to expatriates and senior executive of corporate tenants working in District AM. Mr Q knew Mr R of Company S, the owner of the Property. Mr Q contacted Mr R by phone that night and about a couple of weeks later a deal was struck between Mr G and Mr R on the Property.

36. Before the acquisition, Mr G discussed the matter with Mr H, an executive director of Company B, who was in charge of the company's financial matters. Mr H was instructed to handle the acquisition and to arrange for a loan to finance the acquisition of the Property. Mr G confirmed that there was no formal feasibility studies or financial or cash flow analysis before acquisition of the Property. So far as he was concerned, the acquisition was not in a big scale and the calculation involved were relatively simple.

37. Mr G confirmed that at the time of acquisition, the intention was to lease out all the

units of the Property and there was no intention to sell either the whole or any part of the Property. If there were such an intention, no tenancy would have been entertained since it would be costly to evict tenants. Mr J of Legal Firm N was instructed to deal with the acquisition and also the leasing of the units of the Property. In fact during the negotiations of the terms of the sale and purchase agreement of the Property, Mr J sought instructions from him as to whether the sub-vendor should be permitted to continue negotiation with prospective tenants on the terms of tenancies. Mr G gave his consent in this regard as he had no wish to lose any potential tenants. In support of this, it was pointed out to us that soon after the agreement for sale and purchase of 27 September 1991 and the assignment of 28 September 1991, of the Property, a tenancy commenced on 1 October 1991, which would not have been possible unless the negotiations were carried out by the sub-vendor, prior to completion of the sale and purchase of the Property.

38. On the possible relaxation of the height restriction of the Property, Mr G explained that a few days after the acquisition, he asked for the building plans of the Property. Upon inspection of the plans, he noted from the plans that the 'permissible plot ratio' of the Property was five. It occurred to him that the site area of the Property was 30,000 square feet which should produce floor area of 150,000 square feet and yet the Property consisted of floor area of only 61,000 square feet. At that point of time, he had no idea that the Property was not developed to the maximum plot ratio. This idea would have been inconceivable because the building purchased, was constructed by Group T and then sold to Mr R of Company S. Both of them were seasoned real estate developers. However, upon investigation, it was discovered that there was a height restriction of 35 feet on the Property which accounted for the shortage of floor area. He was then advised to engage a chartered surveyor to explore the possibility of lifting the height restriction and make the necessary application to the Hong Kong Government for modification of the lease conditions. If the Hong Kong Government agreed to lift the height restriction, the company could then redevelop the Property to its maximum plot ratio as to fetch higher rental income for Group E.

39. Subsequently an application was made and the Hong Kong Government agreed to remove the height restriction, upon the payment of a premium of $247,000,000. The offer was accepted by the Taxpayer. Mr H was instructed to arrange for the necessary finance for the redevelopment.

40. All the tenants vacated the Property by about April 1994, after which Mr G on the recommendation of Mr I, the company secretary, appointed Legal Firm M as the conveyancing solicitors in respect of the redevelopment. It was then still the company's intention to lease out the whole of the new building to be constructed at the Property.

41. We were referred to three letters of instructions to Legal Firm M, Legal firm N and Legal Firm U respectively all dated 21 July 1994 and signed by Mr G. We were asked to note how the instructions in those letters differed. He explained that in the letter to Legal Firm M, Legal Firm M were asked to prepare the relevant documents including the agreements to enter into tenancy agreements and the tenancy agreements because the redevelopment was for lease only, while the

ones to Legal Firm N and Legal Firm U, the solicitors were respectively asked to apply for consent for the pre-sale and pre-lease of the units of the buildings to be erected because those buildings were intended for sale. Mr G also explained that the note now appeared at the top right-hand corner of the letter to Legal Firm M would have been a covering note clipped onto the three letters of instructions, for Mr G's easy reference in signing those letters. It was also noted that on this note, there was the remarks 'No consent required, lease only', next to the description of the Property.

42. Mr G was referred to a letter from Legal Firm M to the Taxpayer of 27 July 1994 in which Legal Firm M was seeking instructions on, inter alia, whether or not to prepare a Deed of Mutual Covenant and sale documentation. Mr G explained that he was not aware of this letter and matters like this would go straight to Mr I and Ms V of the company secretarial department. In fact, he was not aware of the preparation of a Deed of Mutual Covenant and sale documentation until one or two days before he made his supplemental statement for the hearing of this appeal. However, he said he could understand why Mr I and Ms V gave the instruction to prepare those documents because they could be prepared at no extra costs and also they did not know the implication in giving those instructions. The preparations of a Deed of Mutual Covenant and sale documentation were not discussed at the level of the board. They were matters of day-to-day operations which went straight to Mr I and Ms V.

43. A leasing committee was set up for the purpose of leasing the units in the new development. It was headed by Mr W, the general manager of the leasing department. Mrs G, his wife was also a member of this leasing committee. Minutes of the leasing committee could have been copied to him but he did not read them in detail.

44. In September 1997, the Taxpayer applied to Bank X, the mortgagee bank, for consent to lease and subsequently, in October 1997 the Taxpayer confirmed to the bank that the new building would not be let at less then $45 per square feet, but the possible range would be around $50 to $70.

45. He confirmed that in about December 1997 he gave instructions to suspend the showings of the new building because he understood from either Mr L or Mr W that the new building then was not quite up to standard. There were defects needed to be rectified. The show flats had to be modified and upgraded to their satisfaction. Before they resumed the marketing activities for leasing, because of the Asian financial crisis and the attacks of hedge funds, the share price of Company B fell from $XX to $XX on 15 January 1998 and on 16 January 1998, the company passed a resolution to sell the Property which was intended to be held for long-term investment purposes, as Group E would need strong cash flow so as to withstand any future adverse financial turmoil against Group E. They considered that Building D was the appropriate property to sell because it was a brand new building and given its then market value in excess of HK$2,000,000,000 and the relatively small bank loan of HK$420,000,000, its sales would generate a desired level of additional liquidity without the need to sell other investment property of Group E.

46. On the Revenue' s contention that since they had sufficient funds to repay their loans, why would they need to sell the Property, Mr G explained that in time of crisis, bankers might not extend loans and the sale of the Property was a safeguard to their position against this eventuality.

Cross-examination of Mr G by counsel for the Revenue

47. Mr G had the following to say upon being cross-examined by Counsel for the Revenue.

48. Mr G agreed that in some cases when a property was acquired, it might have an indeterminate status but in the case of the Property, it was acquired as an investment from the outset.

49. Mr G discussed the acquisition of the Property with Mr H after he visited Mr Q at the Property but Mr L only came into the picture when they looked at the building plans after the acquisition.

50. It was suggested to Mr G that at the time of the acquisition of the Property, there were high-rises in the vicinity of the Property and thus Mr G must have at that time considered the redevelopment potential of the Property. Mr G denied that he had at that time considered the redevelopment potential of the Property because when he acquired the Property, it was a brand new building constructed by Group T and bought by Mr R and it would have been absurd for him to think that the Property had not been built to its maximum plot ratio.

51. Mr G was questioned as to why he took a sudden look of the building plans after the acquisition of the Property. He explained that after having seen the inside of Mr Q' s flat, he wanted to see the configuration of the flats from the building plans, like reading the manual after buying a new car. It was also a normal course of business for him to examine the building plans after the acquisition of a property.

52. It was pointed out to Mr G that all but four units of the Property were let out after the application for redevelopment was made and this appeared to be contrary to his case that had he intended to redevelop the Property, he would not have let out the units of the Property. Mr G contended that at the time of acquisition of the Property, he had no intention to redevelop the Property and when the application for redevelopment was made, he had no idea whether the application would be approved, the Property was thus continued to be let out.

53. It was suggested to Mr G that a property with sitting tenants with good rental income would also be a selling point to investors. However, Mr G responded that this type of investors was rare and most people would prefer to have the flexibility to sell with vacant possession.

54. On the decision of suspending the viewings of the Property and upgrading the

showflats, Mr G confirmed that he did not inspect the showflats but he reached the decision relying on the feed-back of the unsatisfactory state of the Property from people like Mr W, being the person in charge of the Leasing Committee, Mr L, the architect in charge of the project or Mr Y, the interior designer. However, due to the long lapse of time, he could not remember whom he talked to.

55. Mr G was questioned as to why the viewings of the Property were suspended only in December 1997 when it was minuted that the showflats were already completed by 25 August 1997. His response was that it appeared from the minutes that the concerns not only related to the showflats but to the entire building as a whole.

56. Mr G was questioned as to why his wife, Mrs G, as recorded in the minutes of 8 December 1997, requested for the preparation of two sets of car park plans for the purpose of leasing or selling. Mr G was unable to offer an explanation to this. He told us that his wife only dealt with leasing matters and was never involved with sales of properties. Besides, his wife certainly knew that Building D was for leasing and not for sale.

57. Mr G confirmed that he was aware of the discussion of having a footbridge linking Road BL and Road BM, but he was uncertain of the reason why the idea was not proceeded with. He heard of some geotechnical problems at the time.

58. On the question of 'naming right' of the Property, Mr G told us that he never knew there was such an issue and could not think of a reason for it to be an issue. To him, 'naming right' was never important in the case of a residential property.

59. Mr G was referred to a letter from Legal Firm M to the Lands Department of 9 January 1998 and he agreed that there was a hint of urgency in the letter for the approval of the Deed of Mutual Covenant, but he could not remember the time when the thought of selling Building D could have come to his head. Since the Asian financial crisis was already hitting Hong Kong at the end of 1997, he said the thought might have occurred in December 1997 or early January 1998.

60. As to whether a calculation was made on how much cash was required, he replied that they required as much cash as possible. Within 2-1/2 years that was in 1998, 1999 and part of 2000, they sold about ten to twelve billions worth of properties. He disagreed that sale of their properties would send a negative message to the investors.

61. When he was asked to confirm that no bank in fact called loans as at 15 January 1998, Mr G could not recall whether any bank called any loan on or before that day. But he remembered he was not happy about a visit from a banker from Bank Z who called upon him at his office about a short term loan. Since then if they had a choice, they would prefer doing business with another bank rather than Bank Z.

62. On the assignment of 17 units and 60 car parking spaces of Building D to a fellow subsidiary, Mr G was questioned as to why they were not sold if, as claimed, they required as much cash as possible. Mr G guessed that perhaps the sale prices were not reached but he told us that Mr H would be the person to explain. However, he also told us that save for joint venture projects, it was their policy to retain ownerships of car parks so that more car parking spaces than those stipulated under the Government leases could be provided.

XI Our findings

A. The stated intention

63. Mr G is and was at the material times the chairman and the main controlling mind of Company B, Group E and the Taxpayer. More importantly, he was the master mind of the whole affair in question from the time when the Property was acquired up to the time when the decision to sell the same was made. From the evidence given by Mr G as summarized above, it is the Taxpayer's case that the Taxpayer's intention was to acquire the Property for rental purposes and the intention remained so notwithstanding the redevelopment of the Property.

64. The Revenue contended that the Taxpayer acquired the Property for redevelopment and then resale to make profits and how Mr G came about the possibility of redevelopment after the acquisition was simply not credible. It suggested that Mr G must have considered the redevelopment potential at the time or even before the acquisition and it was not credible that he could only have examined the building plans after the acquisition and discovered the redevelopment potential then and not before.

65. According to Mr G, he was introduced to the Property by his friend Mr Q who was also a friend of Mr R, the owner of the Property. He was invited by Mr Q to his rented apartment at the Property. On the very night when Mr G visited the apartment, Mr Q called Mr R about Mr G's interest in purchasing the Property and a deal was struck shortly afterwards. From this recount of the event which we find as a fact, Mr G's interest to purchase the Property was an inspiration of the moment rather than a deliberate plan of acquisition made before the visit to Mr Q. Thus, to say that Mr G must have considered and realized the redevelopment potential at that time is less than plausible because as we know, the building then to be acquired was only completed a few months earlier and it was unlikely that Mr G was then concerned about the redevelopment potential and contemplated acquisition for redevelopment. Mr G's evidence that he only examined the building plans after completion of the purchase, like reading a manual after buying a new car, and discovered the plot ratio upon examining the building plans and then the height restriction and consequently applied for removal of the height restriction and redevelopment of the Property, is readily accepted by us as facts.

66. The Revenue also contended that the continued lettings of the Property during and after the acquisition did not assist the Taxpayer's case because even after its application for

redevelopment of the Property, the Taxpayer had continued letting out the Property which is contrary to the Taxpayer's assertion that had it intended to redevelop the Property, it would not have let out the Property. Mr G explained that they had continued with the letting despite the application because they were uncertain about the application. We find this explanation convincing because it is a fact that at the end of the day, the amount of rents collected by the Taxpayer throughout the entire period of letting was less than the total amount of compensation paid to the tenants. Had the Taxpayer intended to redevelop the Property at the time of acquisition or had been certain about its application, it could have structured the terms of the lettings more beneficially as to avoid payments of compensation or a loss as a result. It is also a fact that when the Taxpayer acquired the Property, Mr H on its behalf arranged a mortgage loan from the Bank AB with a repayment term of five years. Mr H explained and we accept that a five year term was considered to be a long term which would only be adopted in the case where the Property was to be held on a long-term basis. He explained that had they intended to redevelop the Property when it was acquired, he would have arranged the mortgage terms differently so as to avoid the payment of a penalty. We find it a fact that upon redevelopment of the Property, the Taxpayer refinanced the long-term loan by repayment of the loan to Bank AB before the expiry of the five year term, together with a pre-payment penalty.

67. We recognize that the stated intention of the Taxpayer is not conclusive. It needs to be tested by the surrounding circumstances, including things said and done, at the time of acquisition, before and after.

B. Facts consistent with the Taxpayer's stated intention

68. We have considered closely the available evidence, both oral and documentary. In so doing, we have found that following facts which are consistent with the Taxpayer's stated intention that the Property was acquired as an investment asset for rental purpose and notwithstanding the redevelopment of the Property there had been no change of intention until 16 January 1998.

69. In the board meeting on 17 September 1991, the Taxpayer authorized the signing of tenancy agreements of the Property by any one director.

70. Mr H was informed by Mr G of the intention to acquire the Property for investment purpose and arranged a mortgage of a term of five years, in line with the intention of holding the Property as an investment property.

71. Mr J was also informed by Mr G of the intention to hold the Property as an investment asset and carried out the instructions from Mr G to allow the sub-vendor of the Property to continue negotiation of the terms of tenancies notwithstanding the imminent completion of the sale and purchase of the Property.

72. Letting of the Property commenced before the acquisition of the Property on 28 September 1991 and continued between 1991 and 1994 and ceased only upon redevelopment of the Property in 1994.

(a) By the Agreement for Sub-sale and Purchase dated 27 September 1991 ('the Sub-Sale Agreement') the Property was purchased by the Taxpayer with a sitting tenant of Flat A1 on 3/F with roof and car parking space no.12 for a term of 2 years from 1 September 1991 at a monthly rent of $69,176.25.

(b) By Clause 28(b) of the Sub-Sale Agreement, the vendor of the Property might let out vacant units and/or car parking spaces of the Property at such rents and on such terms as the Taxpayer might previously approve in writing after the signing of the Sub-Sale Agreement and before completion.

(c) A tenancy of Flat 3, 3/F of Block A and car parking space no.10 was granted to Bank AC for a term of 2 years from 1 October 1991 to 30 September 1993 at $50,000 per month.

(d) A tenancy of Flat 1, 3/F of Block B and car parking space no.15 was granted to Company AD for a term of 2 years from 1 April 1992 to 31 March 1994 at $90,000 per month.

(e) A tenancy of Flat 3, 2/F of Block A and car parking space to Company AE for a term of 2 years commencing 15 April 1992 to 14 April 1994 (with an option to renew for one year) at $40,000 per month.

(f) A list of nineteen tenants of the Property, including those mentioned above, was provided to us by Mr H in his witness statement of 16 May 2007. Among these tenancies, the earliest commencement date of a tenancy was 1 September 1991 and the last termination date of a tenancy was 30 April 1994.

(g) The Taxpayer's audited financial statements showed that the rental income derived from the Property during the period ended 30 June 1992 was $2,592,622 and the years ended 30 June 1993 and 30 June 1994 were $10,770,805 and $6,511,954 respectively.

73. On 24 September 1993, Mr H was quoted by Newspaper AF to have said that the Property would continue to be leased out after redevelopment.

74. A letter of instructions of 21 July 1994 from the Taxpayer to Legal Firm M appointing Legal Firm M as its solicitors to prepare agreement to enter into tenancy agreement of the Property.

75. On 27 July 1994, Legal Firm M wrote to the Taxpayer, seeking information for preparation of agreement for tenancy agreement.

76. On 17 May 1995, Legal Firm M wrote to the Taxpayer to suggest adding an additional clause into the draft tenancy agreement.

77. On 1 December 1995, Company BN (of Group E) was appointed as the Taxpayer's signing agent to execute all documents in relation to the leasing or licensing of the Property. Company BN accepted the appointment on 1 December 1995.

78. Events in 1996

(a) Internal memorandum of 17 April 1996 setting up two show flats and a leasing office.

(b) In December 1996, the Taxpayer received a request from an estate agent to reserve two penthouses for renting.

(c) In 1996, Company AG sent a proposal to the Taxpayer for the promotion of the proposed leasing of the Property.

79. Events from January to November 1997

(a) A leasing committee was set up in January 1997 ('Leasing Committee') to deal with the matters on leasing and building management of the Property. A checklist for the leasing and building management of the Property was prepared by Mr W, the general manager of the leasing department, as the basis of the agenda for discussion in the coming meetings of the Leasing Committee. Save for the item 'draft DMC', the other items on the checklist, such as 'landlord's provision (appliances) etc', 'draft offer to Rent', 'draft Tenancy Agreement', 'deposit account for rental' and 'rental flow projection', are matters for leasing purposes.

The minutes of the meetings of the Leasing Committee which took place between January 1997 and January 1998, shows that apart from the matters on building management, the other matters discussed were generally related to leasing matters, such as the terms and charges to be incorporated into the standard tenancy agreement, the landlord's provision of appliances, advertisement for leasing, preparation of the logo and brochure of 'Building D', determination of minimum rental for bank's consent to lease, the showflats and the leasing office and the proposed dates for viewing of showflats by prospective tenants and agents and the handover dates of the Property. Apart

from the seeking of approval on the DMC which was unnecessary for leasing purpose throughout the period from January 1997 to January 1998, the Leasing Committee was dealing with matters for the purpose of leasing the Property.

(b) On 5 February 1997, Group E prepared the leasing comparables for the properties in the vicinity of the Property.

(c) On 17 February 1997, Newspaper AH reported that Group E had started work for the pre-leasing of the Property and expected the rent to be HK$60 per square foot with an annual return of HK$150,000,000.

(d) A note from Mrs G to Ms AI of 20 February 1997 recommended their new development Building D for letting which would be ready in late Summer.

(e) On 1 May 1997 the Taxpayer applied, through Legal Firm M, for pre-lease consent from Bank AJ, and on 12 May 1997 received pre-lease consent.

(f) In the meeting of the Taxpayer on 6 May 1997, it was resolved to appoint Company BO (of Group E) as the manager to manage the Property for a term of 5 years and thereafter from year to year until terminated by either party.

(g) An undated but executed Property Management Agreement made between the Taxpayer as the owner and Company BO as the manager, of the Property was produced to us.

(h) Between 5 June 1997 and 10 June 1997, leasing information packs consisting of copies of Building D brochure and/or flyer, floor plans, leasing summary and rental price list together with a cover letter were sent to the Taxpayer's 19 direct clients and 17 property agencies.

(i) Numerous Prospective Tenant Registration Forms were received by the Leasing Department between 16 June 1997 and 31 October 1997.

(j) Offers on behalf of their clients for renting certain units of the Property were made by Company AK on 20 June 1997, 7 August 1997 and 18 November 1997.

(k) On 6 August 1997, Legal Firm M forwarded to the Leasing Department a schedule of Fixtures and Fittings to be provided by the landlord to the Tenant upon taking possession of the rented premises.

(l) A summary Rental Price of 1 September 1997 showing the expected rental for 7th to 40th floor with gross rental ranging from $143,800 to $264,000 at about $55 to $72 per square foot per month, was circulated to members of the Leasing Committee on 8 September 1997.

(m) A request from the Leasing Committee to Mrs G on 17 September 1997 for additional on-site leasing staff for the pre-launch and showings of the Property at weekends.

(n) On 26 September 1997, Mr AL on behalf of Company B applied to Bank X for consent to lease the Property at a minimum rent of HK$40 per square foot and on 3 October 1997, informed the bank that the current rent would not be less than HK$45 per square foot but the possible range would be from $50 to $70 per square foot per month.

(o) On 22 October 1997, 24 October 1997 and 27 October 1997, Building D was respectively advertised for lease in the newspaper AN, newspaper AH and newspaper AN.

(p) On 27 November 1997, the Leasing Department continued sending out a rental price list and floor plans to estate agents.

(q) The Minutes of the Leasing Committee meetings in November 1997 show that the following matters in relation to leasing had been discussed :

(1) dates for target leasing term commencement, agents preview tour, and clients preview tour,

(2) working out of new routing with leasing department,

(3) location of suitable location for onsite leasing office.

(r) Viewings of the Property by clients and agents took place on 18 October 1997, 19 October 1997, 25 October 1997, 26 October 1997, 15 November 1997, 16 November 1997, 22 November 1997, 29 November 1997 and 6 December 1997.

(s) As stated in the minutes of the meeting of Leasing Committee on 8 December 1997, Mr G instructed the Leasing Committee to suspend all future showings of the Property until further notice.

C. The annual reports and accounts

80. Apart from the aforesaid facts, we also have found the following facts which are consistent with the stated intention:

(a) In the Taxpayer's financial statements for the years ended 30 June 1992 and 30 June 1993, the Property was classified as a fixed asset and an investment property, and for the years ended 30 June 1994, 30 June 1995 and 30 June 1996, as a fixed asset and a property under redevelopment and that fixed assets included properties under redevelopment which were intended to be held for long-term rental income generating purposes.

(b) In the annual reports of Company B from 1992 to 1997, in the Chairman's statements, the Property was referred to as an investment property.

(i) 1992

'The company acquired four residential sites for development and one completed residential property [namely, Address A] for investment in this financial year.'

(ii) 1993

'… we firmly believe the Group's stated policy of expanding its investment property portfolio is a correct one. Because of shortage of well located commercial and residential sites, retaining quality properties for rental, as opposed to selling them for short-term gains, will provide greater long-term benefits to the Groups in future …

Other than those sites already earmarked for investment purpose, two completed properties, [Address A] and [Building AO], will be redeveloped to maximize their building floor area …'

(iii) 1994

'… The redevelopment of [Address A] into a luxurious residential building …. will yield additional gross floor area of 153,573 (existing 64,109) square feet … to the Group's investment portfolio in the coming year …'

(iv) 1997

> '… In addition, fresh contributions from several major investment properties will help to expand the recurrent income base of the Group. These include The [Building D], [Building AP] …'

(c) Apart from the Chairman's statements, the Property was also consistently described as an investment property in the annual reports of Company B.

(d) In Company B's annual report for 1997 (dated 23 September 2007), it was stated that the Property 'is now actively planned for leasing.'

81. However, we note the Revenue's contention that the financial statements and the statements in the annual reports and accounts were self-serving and in the light of the surrounding circumstances they could not assist the Taxpayer.

82. It was further contended by the Revenue that the evidence of Mr K on the classification of the Property in the Taxpayer's accounts or the annual reports of Company B could not assist the Taxpayer's case in that in the absence of the audit files, Mr K was unable to tell us what information and instructions that the Taxpayer gave to its subordinates who did the presentation work or had conversations with the management, which would affect the view of the auditors in classifying the Property. However in this regard, we accept Mr K's evidence as true that auditing procedures were set up by his firms, and by following these procedures, a true and fair view of a taxpayer's affairs would be reached and while Mr K did not have the benefit of reviewing the audit files when he made his witness statement, the opinion that the financial statements of the Taxpayer gave a true and fair view of the state of the Taxpayer's affairs was reached on the basis of their having looked at the accounting records and the statutory books and having had discussions with the Taxpayer's management and having obtained written or oral presentations from the management.

83. The description of a property in the taxpayer's accounts is a relevant factor to be taken into account when determining the taxpayer's intention in relation to the property: see Real Estate Investments at 211E (per Cheung JA).

84. When considering the weight to be given by us to the description of the Property in the Taxpayer's financial statements and the annual reports of Company B, we also bear in mind what the Board of Review said in D74/91, (1992) IRBRD, vol 7, 16 at 30:

> *'It is well established law that the manner in which assets are treated in accounts does not and cannot change the actual nature of the assets. However, the manner in which the assets are treated in audited accounts is not something which can simply be ignored. Assuming that the accounts are genuine and have not been prepared for a particular tax or other specific purpose, they are evidence of how the individuals concerned at the material time viewed the*

> *nature of the assets. Although this does not make a trading asset into a capital asset or vice versa, it is strong evidence of what the individuals thought at the time and what was their intention at the time. In the case of a public company, the accounts gain greater significance because if a statement is made in the accounts which is not correct, it can have serious consequences for those who make or approve the statement.'*

85. Thus on the basis of the aforesaid facts found by us and the legal principles, the classification of the Property in the Taxpayer's financial statements and Company B's annual reports, is an important factor which we should take into account in determining the Taxpayer's intention.

D. DMC

86. The instructions to Legal Firm M to prepare the DMC, is the major stumbling block of the Taxpayer's case. It is not in dispute and as agreed by Mr J, a lawyer and also a witness of the Taxpayer that if the whole of the Property was intended to be held as an investment asset for rental purpose, the preparation of a DMC was not necessary. A DMC would only be required in the case of a sale of the whole or a part of the Property. Thus, the preparation of a DMC by Legal Firm M on behalf of the Taxpayer is apparently at odds with the Taxpayer's stated intention that the Property was to be held as an investment asset for rental purpose only.

87. We have evidence on the preparation of the DMC from (i) the correspondence between the Taxpayer and Legal Firm M (ii) the correspondence between Legal Firm M and the Lands Department (iii) the minutes of the meetings of the Leasing Committee and (iv) the testimonies of the witnesses, Mr I, Mr G, Mr H and Mr L.

88. We have carefully considered the evidence in this connection, the circumstances under which the instructions to prepare the DMC were given by the Taxpayer to Legal Firm M, how the preparation was proceeded with by the parties involved in the exercise and how the matter ended. Our final analysis is that the instructions to Legal Firm M to prepare the DMC were prompted by Legal Firm M and were given by the Taxpayer's staff members without the knowledge of the controlling minds of the Taxpayer and notwithstanding its preparation and the application for consent from the Director of Lands, the DMC was not intended for use by the Taxpayer until the change of intention on 16 January 1998. Thus, we are of the view that its presence had no relevance to the Taxpayer's stated intention.

Correspondence between the Taxpayer and Legal Firm M

89. We have the following correspondence between the Taxpayer and Legal Firm M, produced to us.

(i) 21 July 1994, a letter of instructions from the Taxpayer to Legal Firm M
(ii) 21 July 1994, a letter from Legal Firm M to the Taxpayer
(iii) 26 July 1994, a letter from the Taxpayer to Legal Firm M
(iv) 27 July 1994, a letter from Legal Firm M to the Taxpayer
(v) 13 September 1994, a letter from Legal Firm M to the Taxpayer
(vi) 20 September 1994, a fax from the Taxpayer to Legal Firm M

90. The matter all started from the letter of instructions of 21 July 1994 when Legal Firm M were appointed as the conveyancing solicitors in respect of the Property. This letter was prepared by Mr I and signed by Mr G on behalf of the Taxpayer, instructing Legal Firm M 'to prepare the relevant documents including the Agreement to enter into Tenancy Agreements and the Tenancy Agreements' for its comments. In the same letter, the Taxpayer also wrote and noted that 'under the Conditions of Exchange, no Director of Lands' consent is required for the pre-lease or pre-sale of the units' of the Property. At the end of the letter, the Taxpayer also asked Legal Firm M to contact its company secretary, Mr I, or the assistant company secretary, Ms V or the project manager, Mr AQ for further information or documents. In connection with this letter, a note from Mr I and Ms V to Mr G and Mr H of 19 July 1994 was also produced to us, in which three law firms were recommended to assist Group E in three projects, one of which was Legal Firm M to deal with the Property. On this note, there was also the remark 'no consent required, lease only' in connection with the Property. There were produced to us two other letters of instructions from the Taxpayer to two other firms of solicitors, respectively instructing them to apply on its behalf for consent from the Lands Department for pre-sale and pre-lease. We were asked to note how the instructions in these two letters differed from the ones in the Taxpayer's letter of instruction of 21 July 1994 when Legal Firm M were instructed to prepare lease documentation. From the reading of the letter and the note, it is apparent that the Property was at that time intended for leasing only and Legal Firm M were instructed to prepare the lease documentation and nothing further.

91. By its letter of 21 July 1994, marked for the attention of Mr I and Ms V, Legal Firm M requested for the title deeds of the Property and by its reply of 26 July 1994, the Taxpayer informed Legal Firm M that the title deeds were with the solicitors for the Bank AJ, the mortgagee of the Property.

92. By their letter of 27 July 1994 marked for the attention of Mr I, Legal Firm M posed nine questions to the Taxpayer seeking information for the purpose of assisting them to prepare 'Agreement for Tenancy Agreement and Tenancy Agreement'. However, among them, there were these two questions which, we find, were unrelated to the instructions given to them by the Taxpayer: '6. Is there to be a Deed of Mutual Covenant?' and '8. Do you wish us to prepare sale documentation as well? You should note that it will be necessary to obtain approval of the Deed of Mutual Covenant prior to any pre-sales.' On this copy letter produced to us, there was the word 'yes' and the initial 'XXX' appeared before question 6 and question 8 respectively and also the remarks 'to be prepared and not executed' and 'to apply for pre-sale and pre-lease consent' after question 6 and question 8 respectively.

93. By another letter of 13 September 1994, this time marked for the attention of Mr AQ, Legal Firm M referring to the Taxpayer's instructions, sent to the Taxpayer leasehold documentation: draft Agreement for Tenancy and draft tenancy agreement and sale documentation; draft agreement for sale and purchase and draft Deed of Mutual Covenant, for comments. By an internal memorandum of 15 September 1994 from Mr AQ to Mr AR/Ms AS of the Leasing Department and Ms V, the same documents were forwarded to Ms V and the Leasing Department for their comments.

94. By its fax of 20 September 1994, the Taxpayer replied to Legal Firm M on their nine questions. Its reply to question 6, was 'we have received drafts of the DMC, ASP etc and are reviewing the same and will let you have our comments in due course' and to question 8, was 'Sales Documentation – Please apply for the pre-sale and pre-lease consent of this Lot.' This fax was sent by Mr I and Ms V to Legal Firm M.

Correspondence between Legal Firm M and the Lands Department

95. We have been provided with copy correspondence exchanged between Legal Firm M and the Lands Department on the application for approval of the DMC which started on 31 January 1996 and ended on 12 March 1998. During the period of correspondence between them, except for the months of July 1997, January 1998 and March 1998, they exchanged letters regularly about once a month. In July 1997, there were four letters sent between them, three of which were on the proposed amendments made by each of them and one was when the Lands Department sent a demand note to the Taxpayer for giving its consent to the DMC. In August 1997, Legal Firm M wrote to the Lands Department and said they were looking forward to the consent of the DMC. In September 1997, Legal Firm M were asking for the reason for the delay of the consent of the DMC. In October 1997, the Lands Department informed Legal Firm M that the delay was due to the lease modification in view of the proposed 'footbridge'. It should be noted that this was the first time when the issue of 'the footbridge' was ever mentioned in the aforesaid correspondence between them. In November 1997, the Lands Department sent to a surveying company for the Taxpayer, the proposed lease modification on 'the footbridge' for acceptance by the Taxpayer. On 1 December 1997 Legal Firm M sent to Lands Department amendments on the DMC relating to 'the footbridge'. In January 1998, five letters were exchanged between them. By the first letter on 9 January 1998, Legal Firm M withdrew the proposed lease modification in relation to 'the footbridge' and requested for approval within the next few days. On 16 January 1998, Legal Firm M informed the Lands Department of the sale of the Property next week and by the subsequent two letters on 19 January 1998 and 20 January 1998, the Lands Department respectively sent its demand note and forwarded the conditions for the formal consent of the DMC. By its letter of 16 January 1998, Legal Firm M informed the Lands Department of the necessity to amend the DMC because Bank AJ had been replaced by Bank X, as the mortgagee of the Property since 24 September 1997. On 26 February 1998 Lands Department reminded Legal Firm M that the letter of approval was ready for collection. In March 1998, numerous letters were

exchanged between the two parties. On 4 March 1998 further amendments on the approved form of the DMC were proposed by Legal Firm M, some of which were requested by Legal Firm M, some by Bank X being the mortgagee of the Property and some by the Taxpayer due to some miscalculations on the undivided and management shares and a management issue on the use of the gondola cleaning apparatus. It should be noted that among these proposed amendments, no amendments were sought on 'the naming right' or 'the management deposits'. The several subsequent letters were all related to the proposed amendments. Very soon on 12 March 1998, a demand note and the formal consent of the DMC were issued and on the same date, the DMC was entered into and executed by all the parties concerned.

96. It is our observation from the aforesaid correspondence between Legal Firm M and the Lands Department that while the Taxpayer made its application for approval of the DMC, it did not appear to require the approval urgently. The parties only exchanged correspondence about once a month. The matter only appeared to be urgent as from January 1998 when the Taxpayer changed its intention and decided to sell the Property.

The Leasing Committee

97. The Leasing Committee was formed in January 1997. Apart from the draft Offer to Rent and draft Tenancy Agreement, the draft DMC was also a legal matter on the agenda for discussion. The Leasing Committee held meetings regularly about twice a month between January 1997 and January 1998.

98. In the first meeting on 13 January 1997, Mr AT, the then project manager, reported that there had been delay on the approval of the DMC. It was minuted that Mr AL, the in-house lawyer, undertook to review the situation with Mr I. The DMC was not brought up again until the meeting on 24 March 1997 when Mrs G asked whether there was a target approval date for the DMC and whether that date had passed. It was also in this meeting that Mr AT said he had sent a letter to Legal Firm M urging for early completion of DMC to allow option for sale or lease. Again the DMC was not brought up until the meeting on 5 May 1997 when the meeting was told that the target approval date for the DMC was on 15 July 1997. It was then reported for the first time in the meeting on 2 June 1997 that the issues on 'the naming right' and 'the management deposits' were holding up the approval of the DMC. In the next meeting of 9 June 1997, Mr AT reported that Legal Firm M recommended not to pursue the issues on 'the naming right' and 'the management deposits' until a later date since the issues were relevant only in case of sale of the development. Thereafter in each of the Committee meetings, it was reported that the approval of the DMC would be forthcoming and it was reported in the meeting of 25 August 1997 that the DMC was approved and in the meeting of 8 September 1997 that it was verbally approved. Subsequent to that meeting the DMC was no longer mentioned until the meeting on 24 November 1997 when Mr AT reported that he was in the process of registering the DMC and in the meeting of 5 January 1998 that the DMC was being registered. In this connection, we have no evidence as to how and why the DMC

not having been approved yet, came to be registered. Nevertheless, the absence of an explanation in this regard would not affect our findings on the DMC.

99. From the minutes of the meetings of the Leasing Committee, we do not find that the approval of the DMC was urgently required. We cannot detect a hint of urgency in the manners in which the matter was handled. Given that as early as in the first meeting on 13 January 1997, it was reported that there was a delay on the approval of the DMC, the matter was not persistently or vigorously pursued throughout the period when the Committee had its meetings. The Committee was more concerned with other matters, such as promotion and leasing of the Property, the conditions of the showflats and the Property and rectifications of the defects and the management of the Property. We are of the view that because the DMC was one of the matters on the agenda for discussion, as a matter of course and for the sake of good order, the subject matter was therefore brought up and reported upon by the Committee on a regular basis until completion of the same. Had the DMC been required more urgently, we suspect that greater effort to speed up its approval would have been made by the parties concerned.

Mr I' s evidence

100. Mr I gave evidence on the DMC to the following effect. He explained that when he prepared the letter of instructions to Legal Firm M of 21 July 1994, he was fully aware that the Property after redevelopment would be for leasing purpose only. Responding to the question from the Board on 'the relevant documents' referred to in the said letter of instructions, he confirmed that when he instructed Legal Firm M to prepare 'the relevant documents' , he had in mind only the agreement to enter into tenancy agreements and the tenancy agreement and no other documents. In the same letter he also wrote that under the Conditions of Exchange in relation to the Property, Director of Lands' consent was not required for the purpose of pre-sale or pre-lease of the Property. He specially mentioned this point because it was a rare case that consent for pre-sale and pre-lease was not required and he purposely did it for the benefit and information of the other people who would be involved in this project. When Mr I was cross-examined on the reason for the use of both 'pre-sale' and 'pre-lease' instead of just 'pre-lease' in the supposedly tailor-made letter of instructions of 21 July 1994, he explained that to their minds those two words always went together because it was a standard condition in any Government Grant that when consent was required from the Government, it would always apply to both 'pre-sale' and 'pre-lease'. In this regard, he disagreed with Counsel for the Revenue that when using the words 'pre-sale' and 'pre-lease' in the letter of instructions of 21 July 1994, the intention for the use of the Property was undecided. He explained that before replying to Legal Firm M on their nine questions, upon his request for the status on these questions Ms V circulated a copy of Legal Firm M's letter firstly to XXX, that is, the then project manager, and then to various other departments and persons for the relevant information. As to the remark on question 6, it was put in by Ms V and the one on question 8, it was given by Mr AQ. By a letter of 13 September 1994, Legal Firm M sent the drafts of Agreement for Tenancy, Tenancy Agreement and Agreement for sale and purchase and DMC, for their comments. After gathering the responses from all the parties involved, by the fax of 20

September 1994, the Taxpayer replied to Legal Firm M's letter of 27 July 1994, giving information on the nine questions posed by them. From the sequence of events, he believed that someone must have given instructions to Legal Firm M to prepare a DMC prior to their written reply by fax of 20 September 1994. Due to a lapse of 13 years he could not recall who was the first person to give the instructions to prepare the DMC nor the reason for so doing. However, he recalled that Legal Firm M did not charge for the preparation of the sales documentation, and this must be the reason why such instructions were given to Legal Firm M notwithstanding the Property was not for sale but for lease only. Not knowing the implications and believing that the preparation of these documents would do no harm to the matter, he said it was a natural reaction to accept the offer from Legal Firm M to prepare the DMC at no costs. He could not recall whether or not he discussed the preparation of DMC with Mr H but this was a minor matter which did not need Mr H' s instructions or guidance. They treated an application for approval of a DMC as a standard and procedural matter which needed no instructions from the board level. The preparation of DMC was handled by colleagues such as the project manager and the assistant company secretary and needed not involve personnel of a higher level. The project manager would be the main co-ordinator with the lawyers. He was of the view that the preparation and approval of a DMC for a residential property would probably take about 9 to 12 months and perhaps up to 3 years if it was a difficult and complicated case. In the case of a development like the Property, perhaps it would take 2 to 3 years. He explained that normally if they needed to sell a property, they would push the Government and colleagues for approval of the DMC quickly and the normal time would be within 1 year. Allowing 3 years to obtain the approval of a DMC in the case of pre-sale or sale, would be quite unusual. His guess was that if 3 years had been taken, it must mean that the DMC was not needed or it was not needed urgently.

101. On the question of 'naming right' and 'management deposits to be paid by owners' under the DMC, he said that both were minor matters which needed no instructions from the directors. 'Naming right' was just an additional right to have but was not essential. In his memory, they had never exercised the right. Although the deposits to be paid was a monetary matter, the amount involved was not substantial. Thus, the directors would not be involved with the matters.

102. As to the remark on question 8 in Legal Firm M's letter of 27 July 1994 and their instructions to Legal Firm M of 20 September 1994 to apply for pre-sale and pre-lease consent of the Property, he said that these instructions must have been based on an incorrect assumption on the part of Ms V and furthered by an oversight on his part for failing to check the background of the case in which an application to the Government for pre-sale and pre-lease consent was not necessary. However, he was not surprised to see the instruction to apply for consent in the letter because an application for approval of a DMC would almost always go together with an application for consent to pre-sell and pre-lease.

103. Mr I was referred to question 9 posed by Legal Firm M where it said 'At what point will the car park layout plan be registered? No agreements whether for lease or sale can be effected until such time as the plan is registered', and was asked whether he was surprised to see

the reference of 'sale of carpark'. He explained that he was not surprised because registration of the carpark plan was always necessary before there could be any dealing, that is, sale or lease, of the Property. However, he would be very surprised if there were any sale of the car parks because it was their normal practice not to sell car parks but to retain them for investment purpose.

Evidence of the other witnesses

104. Mr G, Mr H, Mr L and Mr AV were the directors of the Taxpayer at the relevant times. Mr AV was not involved in the day-to-day administration of the Taxpayer and the other three directors were the ones to make decisions for the Taxpayer from time to time.

105. Mr G gave evidence that he never instructed anyone to prepare the sale documentation and was never consulted about the preparation of the DMC or the Agreement for Sale and Purchase. He knew about these documents only when he started looking into this case earlier in about May 2007.

106. Mr H gave evidence that as the matter occurred some 13 years ago, he could not recall having any discussion with Mr I or anyone else regarding the preparation of the sale documentation. He did not believe he instructed anyone to prepare those documents. As he now understood that Legal Firm M did not charge for the preparation of the documents, he believed that it would not have been an issue that required discussion with him at the time.

107. Mr L gave evidence that to his recollection, he had not been consulted about the DMC. He did not even know about the DMC at the time.

Our Findings of facts on the DMC

108. From the aforesaid evidence adduced on the DMC, we make the following findings of facts :

(a) By its letter of 21 July 1994, the Taxpayer only instructed Legal Firm M to prepare the lease documentation and nothing further.

(b) Legal Firm M, by posing questions 6 and 8 in their letter of 27 July 1994, prompted the instructions from the Taxpayer to prepare the DMC and to apply for pre-sale and pre-lease consent.

(c) At the time when the instructions were given to Legal Firm M to prepare the DMC, the Taxpayer did not intend to use it although it was to be prepared.

(d) As a general policy of Group E, the preparation of the DMC was handled by personnel such as the project manager, company secretary and assistant

company secretary and did not usually involve the board level.

(e) The directors of the Taxpayer did not give instructions for nor were aware of the preparation of the DMC at the material times. The instructions to Legal Firm M on the preparation of the DMC were given by the company secretary, the assistant company secretary and the project manager of the material times.

(f) Although an application for approval of the DMC was made by Legal Firm M on behalf of the Taxpayer, the approval was not urgently required by the Taxpayer until January 1998 when the Taxpayer changed its intention to hold it as an investment asset to trading stock.

(g) When the Taxpayer wrote in its letter of instructions to Legal Firm M of 21 July 1994 that the Director of Lands' consent was not required for the purpose of pre-sale or pre-lease of the Property, it was making a statement of fact that under the Conditions of Exchange in respect of the Property, the consent of the Director of Lands was not required for those two purposes. The statement was not indicative of an undecided intention as to the status of the Property on the part of the Taxpayer.

Our view on the Revenue' s contention on the DMC and the Sale Documentation

109. From the aforesaid oral and documentary evidence, we have found that when Legal Firm M were appointed as the solicitors to deal with the Property, they were only instructed to prepare the lease documentation and not the DMC and the sale documentation. We have also found it a fact that the question of whether or not to prepare the DMC and the sale documentation, was initiated by Legal Firm M and not the Taxpayer. Mr I explained how he thought the instruction to prepare the DMC came about. Mr I recalled that Legal Firm M did not charge for the work. Not knowing the implication at the time and believing that the documents would do no harm to the matter, it would be a natural response to accept Legal Firm M's offer. Counsel for the Revenue contended that this explanation was incredible because even if Legal Firm M did not charge for the work, the preparation of a DMC would involve substantial works for the architects engaged for the redevelopment and also the Taxpayer' s staff members. However, we incline to take a different view from the one expressed by Counsel. We can quite understand and accept Mr I' s explanation as to the pragmatic - no costs and no harm - approach which believed to have been taken by the Taxpayer in giving its instructions to Legal Firm M to prepare the DMC notwithstanding that the Property was only for lease. There might well be additional works for some parties involved in the project but we do not believe the additional works would be a deterrent to having the DMC prepared under the circumstances. As it were, this pragmatic approach was well taken by Mr G. He said he could quite understand why his staff members gave such instructions since Legal Firm M did not charge for the work.

110. As to the instructions to Legal Firm M to apply for pre-sale and pre-lease consent, the instructions were given as a result of Legal Firm M' question 8 'Do you wish us to prepare sale documentation as well? .....' in their letter of 27 July 1994. Counsel for the Revenue contended that the reply 'to apply for pre-sale and pre-lease consent' to this question could not have been an inadvertent mistake and an oversight on the part of Mr I and Ms V and that Mr I' s explanation as how this mistake arose, was not convincing. However, in this regard, we have checked the Deed of Conditions of Exchange of the Property produced to us, it is a fact that the condition to apply for pre-sale and pre-lease consent is not stipulated in the deed. We also agree with Mr I that the absence of this condition in the deed was rather unusual because this condition was almost a standard condition for a grant of land by the Government. Even if the Taxpayer then intended to sell the Property which we do not take was the case or to lease the Property, an application for consent to pre-sell or pre-lease was in fact not necessary. Thus the instruction given in this regard firstly by Mr AQ, the then project manager, when Legal Firm M's letter of 27 July 1994 was circulated to him for his comment on question 8 and later in the fax of 20 September 1994 to Legal Firm M, was an obvious error. In the premises, the Taxpayer's instructions to apply for pre-sale and pre-lease consent cannot be translated into an intention to sell on the part of the Taxpayer, or the intention was then undecided.

111. Counsel for the Revenue also contended that the approval of the DMC appeared to be urgently required by the Taxpayer in that the Lands Department had been pressed for the approval on several occasions and 'the footbridge', 'the naming right' and also the issue on 'the management deposits' had apparently been given up by the Taxpayer in order to speed up the approval. However, we see it differently from the correspondence exchanged between the parties.

112. The correspondence between the Taxpayer and Legal Firm M commenced in July 1994. Legal Firm M sent the first draft of the DMC to the Taxpayer for comments on 13 September 1994. Some sixteen months later, on 31 January 1996, Legal Firm M for the first time sent the draft DMC to the Lands Department for approval. The long gap between the two actions does not give us a picture of speed in the matter. Even after Legal Firm M commenced correspondence with the Lands Department, during the period of their correspondence between January 1996 and March 1998, save for three months: July 1997, January and March 1998, they communicated only about once a month. The matter did not appear to be urgent until about 9 January 1998 when Legal Firm M withdrew the proposed lease modification in relation to 'the footbridge'. In this connection, we should mention that we have no evidence as to the reason for its withdrawal, whether it was withdrawn for the sake of an early approval of the DMC or for geotechnical reason as suggested by Mr G in his testimony. However, we note that it was reported in the meeting of the Leasing Committee on 6 October 1997 that Mr AT was awaiting a reply from the geotechnical office on 'the footbridge'. It appears that the geotechnical office was involved at one point of time. In any event, for whatever reason ' the footbridge' was dropped, it was dropped as late as in January 1998. In January 1998, upon learning that the Taxpayer was to commence sale soon, the Lands Department respectively sent to the Taxpayer demand note and the formal consent on 19 January 1998 and 20 January 1998. However, only on 26 January 1998 Legal Firm

M requested the Lands Department to amend the name of the mortgagee from Bank AJ to Bank X even though the change had already taken place since 24 September 1997. On 26 February 1998, the Lands Department informed Legal Firm M that the approval letter was ready for collection. However, on 4 March 1998, further amendments were sought by Legal Firm M, some on behalf of the mortgagee and some on behalf of the Taxpayer. Numerous letters were then exchanged between Legal Firm M and the Lands Department and very quickly on 12 March 1998, the formal consent was given and the DMC was entered into and executed on the same day.

113. It appears from the aforesaid events that the approval of the DMC did not become urgent until about 9 January 1998 and only after the decision to sell on 16 January 1998, did Legal Firm M seriously look into the approved form of the DMC because of the imminent sale of the Property. As a result, the change of the mortgagee's name and further amendments were sought in the already approved form of the DMC. Then within the same month and after numerous letters exchanged between the parties, the consent was obtained within a short time, contrasting the time taken for the previous work.

114. Furthermore, we disagree that the issues of 'the naming right' and 'the management deposits' were dropped as to smoothen the approval as contended by Counsel for the Revenue. We accept Mr I's evidence that 'naming right' and 'the management deposits' were minor issues which did not warrant directions from personnel of an upper level. This evidence seems to be consistent with Mr G's evidence that he was not aware of the two issues at the relevant times and to him, 'naming right' was only meaningful in the context of commercial properties. On the basis of the aforesaid evidence, we find that the issues were not pursued not for the reason of speeding up the approval of the DMC but because the Taxpayer did not think they were important enough to be pursued and also as advised by Legal Firm M they were only relevant in the case of sale. As can be seen from the evidence now before us, notwithstanding other amendments were sought by the Taxpayer after the decision to sell was made, it is a fact that these two issues were never pursued by the Taxpayer even in the case of sale of the Property. Thus, they could not have been dropped for the sake of speeding up the approval.

115. We are also aware of the contention raised by the Revenue on the report in the minutes of the meeting of the Leasing Committee on 24 March 1997 that Mr AT sent a letter to Legal Firm M urging for early completion of DMC to allow an option for sale or lease. However, we do not accept that the request reported to have been made by Mr AT would have made any difference to the intention held by the Taxpayer on the Property. This request was simply to add an option and not to change the intention of the Taxpayer. Furthermore, it was only a request on the part of Mr AT. There is no evidence that the request came from anybody else, or indeed, from any of the controlling minds of the Taxpayer.

E. Show Flats

116. Mr G explained to us that he ordered the suspension of viewings of the show flats because he was informed by the senior management, like Mr W, or Mr L that the show flats lacked quality and needed to be rectified. The Revenue contended that this explanation was not credible in that the show flats were completed on 25 August 1997 and the item of 'Show Flats' had also been taken off from the schedule of matters for reporting in the Committee meetings as from 10 November 1997, which suggested that the show flats must have already been completed and approved by Mr W and Mr AT, the persons in charge. It was not convincing that Mr G should have only suspended the showings of the show flats as late as on 8 December 1997. Furthermore, there was no record of what needed to be done or rectified as to the show flats.

117. We have perused the minutes of the meetings of the Leasing Committee carefully. It was recorded in the minutes of the meeting on 25 August 1997 that the completion date of show flats was 25 August 1997. The item of 'Show Flats' was indeed taken off from the schedule of matters for reporting on 10 November 1997. It appears from the minutes that the state of the show flats was no longer a matter for reporting after 10 November 1997.

118. However, in his testimony, Mr L told us that at the time when Mr G ordered the suspension of the viewings of the show flats, he heard about the unsatisfactory state of the show flats. He further told us that apart from the show flats, the general state of the site and the building as a whole was also not in a proper condition for viewing by prospective tenants. He recalled that there were many defects needed to be rectified and at a very late stage, there were still water leakages and defects in the air-conditioning system, which were serious problems that could have prevented leasing. In this connection, we have the following documentary evidence.

119. The minutes of the meeting on 24 November 1997, being the first meeting after 10 November 1997 when the item of 'show flats' was taken off from the schedule of matters for reporting, recorded that there were the following outstanding matters on the development status:

(a) some refrigerators would arrive in late December or early January;

(b) 1 meter wide pathway for pedestrians would be hacked off at the ramps between G/F and 1/F;

(c) original contractor was dismissed for poor installation work on the air conditioning system which would take two months to rectify, test and commission;

(d) water leakage testing for the certain wall had been completed and leakage was found at some window openings, and

(e) Mr G's instructions to stop paving of the 'Caoper Stone' at 1/F level carpark, was continued.

120. It was also recorded in the same minutes that Mr W reported that he would hold off the press release until the 1st week of December, when the site would be in a better condition.

121. It was also recorded in the minutes of the next meeting on 8 December 1997 that there were the following outstanding items:

(a) condensation stacks were blocked which would be rectified in 10 days and also A/C works on all A units,

(b) 900 mm wide pathway for pedestrians would be hacked off at the circular ramps between G/F and 1/F,

(c) leakage at curtain wall was being now rectified,

(d) concrete with broomed finish completed at 1/F to 2/F carpark ramps, and

(e) marble work for the penthouses would be completed in 2 weeks and the renovation work at end of December.

122. It was reported in this meeting that there were four serious offers from clients and Mr G' s instruction to suspend future showings of the show flats until further notice. Mr AT reported that the press release would be postponed until further notice.

123. In the minutes of the final meeting held on 5 January 1998, it was reported that the renovation works for the penthouses and all major works would be completed by 15 January 1998 and the interior decoration of the staircase tower and the rectification of the external wall paint would be completed by 31 January 1998.

124. The target Lease Commencement Date was changed from 'late November 1997' to '1 January 1998' in the meeting held on 10 November 1997 and from '1 January 1998' to 'pending' on 22 December 1997.

125. It does appear from the above evidence that the site and the building were only due for completion at the earliest about the end of January 1998 long after the suspension of the viewings of the show flats on 8 December 1997. Objectively, we are prepared to subscribe to the view that even if the show flats were ready for viewings, such viewings could not be carried out in isolation from those of the site and the building and unless the show flats, the site and the building were all in a proper state and condition, viewings of the show flats alone would not render the leasing campaign proper justice. As we commented earlier, we find these witnesses truthful and honest. However, given the long lapse of time, there might have been matters which escaped their minds. Mr G gave evidence that he instructed the suspension because of the unsatisfactory state of

the show flats after the feed-backs from his staff members like Mr W, Mr L or even Mr AT. Mr W was the head of the Leasing Department. Mr AT was the then project manager. Mr W and Mr AT in their position should be concerned with all aspects of the development, such as the site and the building including the show flats while Mr L, an in-house architect, concerned himself with the site and the building and perhaps not the show flats of the Property. Since Mr G recalled the feed-backs came from them, or anyone of them, the suspension, on balance of probabilities, was ordered on account of not only the show flats but also the other outstanding matters as recorded in the aforesaid meetings. In this regard, also as minuted in the meeting on 24 November 1997, Mr W held off the press release until the first week of December when the site would be in a better condition. This shows that Mr W was at that time concerned about the condition of the site which caused him to postpone the press release and it is note-worthy that following that meeting, Mr G instructed the suspension of the viewings of the show flats and the press release was further postponed until further notice. Mr G ordered the suspension because of the feed-backs from his staff members. It may well be not a coincidence that Mr G ordered the suspension after Mr W held off the press release because of the unsatisfactory state of the site.

126. On the basis of the above evidence, we find that the suspension of the viewings of the show flats was due to the undesirable state of the show flats, and the site and the building and not due to an intention to sell the Property. Even if Mr G did entertain the thought of selling the Property when suspension of viewing was instructed, unless such thought became decisive, it was no more than a reservation of an intention to change the character of the Property. As Lord Wilbeforce said in Simmons v IRC [1980] 1 WLR 1196 at 1199D:

> *'…. [it] seems to me legitimate and intelligible [that] the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact amount to a little more than making explicit what is necessarily implicit in all commercial operation, namely that situations are open to review.'*

F. No Lettings after redevelopment

127. The Revenue also contended that notwithstanding the launch of the leasing campaign commenced in June 1997, first viewing on 4 October 1997 and serious offers of lettings from clients recorded on 8 December 1997, no lettings were actually granted by the Taxpayer and thus, the Taxpayer's intention to lease the Property was not genuine. We have found that in addition to the unsatisfactory state of the show flats, the site and the building, it is also a fact that the rents offered by the interested tenants were all below the expected rentals of the Taxpayer. On the evidence before us, the highest offer of rent received by the Taxpayer was $125,000 per month while the Taxpayer's summary of the Rental Price of 1 September 1997 showed the gross rental ranged from $143,800 to $264,000 per month. Under the circumstances, we take the view that the Taxpayer was not ready to let rather than did not have an intention to let the Property at that time.

G. Reasons for sale of Building D in January 1998

128. It is the Taxpayer's case that the Asia financial crisis was clearly felt in Hong Kong towards the end of 1997 and the beginning of 1998. At that time, there were unfounded rumours against the financial integrity of Group E. As a result, the share price of Company B dropped by 45% on 15 January 1998 from $XX to $XX per share. The Stock Exchange of Hong Kong Limited requested Company B to publish a press announcement in the newspapers on 16 January 1998 declaring the directors' awareness of the reasons for such share price decrease. On XX January 1998, Mr H led a press announcement on behalf of Group E to rebut the unfounded rumours and to endorse the sound financial position of the Group. On 16 January 1998 the board of directors of the Taxpayer held a meeting and decided to sell the Property to strengthen the Group's financial position in order to withstand any further rumours against the financial integrity of the Group.

129. The Revenue contended that the Taxpayer's explanation for the change of intention was highly dubious. It gave the following reasons for our rejection of the Taxpayer's claim of a change of intention.

130. The Taxpayer did not make any calculations or studies as to the amount needed by Group E to savage the situation. Save for the Property, there was no evidence that Group E sold any other long-term investment for the purpose. If the Taxpayer claimed that Group E needed to sell as many properties as possible so as to build up a strong cash reserve to fight off rumours, why then the Taxpayer did not sell 17 units of the Property and the carpark. Since the Taxpayer already sold $10,000,000,000 to $12,000,000,000 worth of properties in 1998 and 1999, why then the Taxpayer needed to sell the Property. If the rumours were that Group E was in financial difficulties, a sudden sale of a long-term investment would make the matter worse as it would suggest that the Taxpayer was having liquidity problems. The Taxpayer could have relied on the sale of other properties such as Property AU and Property AW to pacify the rumours and the bankers. There was no other evidence that Bank Z or any other bankers in fact called loans as suggested by Mr G in his evidence. Mr G's evidence in this regard was contradicted by Mr H who testified that no banks called loans and all banks including Bank Z maintained good relationship with Group E. The attack by hedge funds which was not raised in the correspondence or in the witness statement was an after-thought of Mr G. If there had been an attack by hedge funds, it was incredible that Mr G did not discuss this with Mr H who gave evidence that he was not aware of it. Mrs G's mention of the sale of car parking spaces on 8 December 1997 and the staff members' concern about the approval of the DMC as recorded in the meetings of the Leasing Committee, especially on 9 January 1998, were both indicative of an intention to sell before 16 January 1998.

131. It is the Revenue's contention that the events on 15 January 1998 was just a pretext for the Taxpayer to finally decide to sell.

132. Having carefully considered the submission from both parties and the evidence before us, we do not accept the Revenue's aforesaid reasons for rejection of the Taxpayer's claim of a change of intention. Our views on them are as follows. To our minds, the sudden sale of the Property which was intended for long-term investment, was capable of different interpretations to different individuals. The Revenue argued that this action could send a negative message to some investors, but it is equally true that it was capable of reinforcing confidence to the others. Thus, we are not prepared to find fault in the Taxpayer's reason for the sale of the Property given in this respect.

133. As to the Revenue's claim that the Taxpayer's alleged need to build up a strong cash reserve was untrue since the Taxpayer did not even make calculations as to how much was needed. In this regard, we have evidence from Mr H that at the crucial time he kept a close eye on the bank balances and receivables and it was his daily business to check on the short-term loans and the daily cashflow position and at that time the short-term liabilities of Group E ranged from HK$200,000,000 to HK$300,000,000, not taking into the HK$1,500,000,000 bridging loan which would be replaced by the long-term syndicated loan. Thus, it is not true as asserted by the Revenue that the Taxpayer did not make calculations as to how much was needed.

134. As to the other reasons for rejection of the Taxpayer's case, we do not believe it matters whether or not there was evidence to show that Bank Z or any other bank did withdraw loans from the Taxpayer or Group E, or whether or not Group E was in fact attacked by hedge funds or whether or not Mr H was aware of it, because more importantly there was clear evidence and we find it as a fact that the share price of Company B dropped throughout the year of 1997 and dramatically on 15 January 1998 from $XX to $XX per share and so much so, Company B was asked by the Stock Exchange of Hong Kong Limited to make a press statement in this regard. Furthermore, Hong Kong was indeed at that time experiencing one of its worst financial crises. Group E was undoubtedly in a vulnerable position whereby some positive steps must be taken by it to restore confidence to the investors. In so doing, Group E opted to sell one of its long-term investment assets. We accept the explanation that the Property was considered to be the most appropriate to sell because at the time it was a brand new building at a prime location and would in the Taxpayer's opinion be easier and quicker to sell than the other main-stream properties owned by Group E.

135. Counsel for the Revenue contended that there had always been the intention to sell or the Taxpayer was undecided as to its intention upon redevelopment because as noted in the minutes of a meeting, Mrs G asked for the preparation of two sets of car park plans for the purposes of leasing or selling. In this regard, we believe it would be unsafe for us to find it so merely because of this note in the minutes when we have ample evidence of the intention to lease the Property and the evidence of Mr G and Mr H that it was Group E's policy, save for joint venture development, not to sell car parks but to retain them so that more spaces than those approved by the Government could be provided to the residents and also as a means to generate revenue for Group E. In this present case, this alleged policy of Group E was also reflected in the minutes of an earlier meeting

of the Leasing Committee where it was stated that it intended to divide the 60 car parking spaces of the Property to 92 spaces. We also have evidence from Mr I in cross-examination that he would be surprised if the car park of the Property was to be sold because it was Group E's policy to retain carparks for investment purposes. On the basis of the aforesaid evidence, we find it as a fact that it is a general policy of Group E not to sell car parks and the car park of the Property was not for sale. That being the case, it will be unsustainable for us to find that there was an intention to sell the Property or an uncertain intention because Mrs G was noted to ask for the preparation of two sets of car park plan for leasing or selling.

136. The Revenue queried why some units of the Property and the car park were not sold, if the Taxpayer contended that it needed as much cash as possible. Mr H upon cross-examination explained that it was because the crisis was then over. We also note the evidence that during the investigation stage, the Taxpayer explained to the Revenue that Group E put up Property AU and Property AW for sale in February and April 1998 which generated substantial amount of cash to enable them to repay an extensive part of their loans. That being the case, we accept that the Taxpayer's change of circumstances warranted the cessation of sale of the remaining units. As to the car-park, we have found as aforesaid that it was not for sale.

137. Consequently, on the basis of the aforesaid we find the Taxpayer's reason for the change of intention on 16 January 1998, bona fide.

XII Conclusion

138. We have expressed our views on the evidence before us and the submissions by counsel for both parties relevant to the issue under appeal. We have found a host of facts to support the Taxpayer's stated intention that the Property was acquired for rental purposes and such intention remained so notwithstanding the redevelopment of the Property. The stated intention was borne out by the activities undertaken by the Taxpayer subsequent to the acquisition in 1991, during and after the redevelopment of the Property and until the change of intention on 16 January 1998. We have also found the Taxpayer's reason for the change of intention on 16 January 1998 genuine. Consequently, we conclude that the Property was a capital asset up to 16 January 1998. Since the Property was a capital asset up to 16 January 1998, there is no room and is not necessary, for us to consider the Revenue's alternative case that once the Taxpayer applied for redevelopment of the Property, it had changed its intention or was undecided as to what to do with the Property until after completion of the redevelopment. We are satisfied that the Taxpayer has discharged the burden of proof placed upon it by section 68(4) of the IRO that the assessment appealed against is wrong and accordingly, the Taxpayer's appeal is allowed as claimed.

'APPENDIX'

INLAND REVENUE BOARD OF REVIEW

BETWEEN

THE TAXPAYER

AND

COMMISSIONER OF INLAND REVENUE

STATEMENT OF AGREED FACTS

For the avoidance of doubt, the facts set out here below are agreed without prejudice to the Taxpayer's or the Revenue's contention in relation to the capacity in which the acts or affairs were carried out or arranged by the various parties or the weight to be given thereto. In addition, the Revenue should not be taken to have agreed to the truth, accuracy, relevance or weight of any matters as stated or contained in any documents referred to below save for the fact that those matters have been so stated or contained in those documents.

(1) The Taxpayer has objected to the profits tax assessments for the years of assessment 1998/99, 1999/2000 and 2001/02 raised on it. The Taxpayer claims that the profits on disposal of its property (through the asset revaluation reserve realized) are capital in nature and should not be chargeable to Profits Tax.

Background about the Company

(2) The Taxpayer is a private limited company incorporated in Hong Kong in 1991 with an authorized and issued share capital of $10,000 and $2 respectively. It closes its accounts as at 30 June of each year.

(3) According to its Reports of the Directors, the directors of the Company were as follows:

	Appointment	**Resignation**
Ms AX	30-7-1991	7-8-1991
Mr AY	30-7-1991	7-8-1991
Mr G	7-8-1991	
Mr AV	7-8-1991	30-6-2001
Mr H	7-8-1991	1-1-1999
Mr L	7-8-1991	1-5-2002
Mr J	1-1-1999	

(4) Its holding company is Company B which is a subsidiary company of Company AZ, both of which are public limited companies incorporated and listed in Hong Kong.

(5) The Taxpayer's Reports of Directors stated the Taxpayer's principal activities over the years as follows:

Years ended 30 June	**Principal activities**
1992 to 1994	Property investment
1995 to 1997	Property development
1998	Property development, trading & investment
1999	Property trading
2000	Dormant
2001	Inactive

Chronology of events

(6) By an Agreement for Sub-sale and Purchase dated 27 September 1991 (the 'Sub-Sale Agreement'), the Taxpayer acquired the Remaining Portion of Inland Lot No XXXX ('the Old Lot') at Address A together with the whole of the residential development thereon, from Company BA, with a sitting tenant, at a consideration of $180,023,020.

(7) Clause 3 of the Sub-Sale Agreement provided that completion shall take place on or before 28 September 1991. Clause 4 provided that time shall in every respect be of essence of the agreement.

(8) Clause 21(a) of the Sub-Sale Agreement stated that the vendor warranted that the total gross floor area of the whole of the development was 61,562 square feet.

(9) Clause 28(b) of the Sub-Sale Agreement provided that after the signing of the Sub-Sale Agreement and before completion, the vendor might let out vacant units and/or car parking spaces of the property at the Old Lot at such rent and on such terms as the Taxpayer might previously approve in writing.

(10) Clause 30 of the Sub-Sale Agreement stated that the vendor would at its own cost finish the decoration and furnishing of the show flat of and in the property prior to completion of the sale.

(11) Clause 33 of the Sub-Sale Agreement provided as follows:

'The Vendor shall procure that the Authorized Person [Messrs BP] shall at the request of the Purchaser:

(a) supply at the Purchaser's expenses all necessary information and certificates to enable the Purchaser or his nominee(s) to sub-sell the Property or any part thereof including without limitation information on the saleable area of each part or portion of the Development; and

(b) supply at the Vendor's expense certified true copies of the Building Plans.'

(12) Clause 37 of the agreement for sale and purchase dated 20 July 1989 between the head vendor, Company BD, and the vendor, Company BA (the 'Head-Sale Agreement'), provided as follows:

'The Vendor shall procure that the Authorized Person [Messrs BP] shall at the request of the Purchaser and at the Purchaser's expense supply all necessary information and certificates to enable the Purchaser to sub-sell the Property or any part thereof under the "Non-consent" Scheme of the Law Society of Hong Kong established pursuant to Rule 5C of the Solicitors Practice Rules including not limited to the supply of:

(a) Saleable area of each part or portion of the Development;

(b) Architect's Certificates in respect of the progress of the Development;

(c) Any such other information as may be reasonably required by the Purchaser for the purpose of the abovementioned "Non-consent" Scheme only relating to the construction of the Development.'

(13) To finance the acquisition of the Old Lot, the Taxpayer obtained a term loan facility of up to $120,000,000 from the Bank AB Hong Kong branch, the terms of which were stated

in a letter dated 12 September 1991 [B1 – Appendix A] from the bank. AB Finance Limited was named as the facility agent in the proposal.

(14) According to the letter, the loan was for a term of 5 years and it was to be drawn down in one lump sum on 28 September 1991. Interest was to be charged at the Best Lending Rate quoted by the bank from time to time and payable quarterly in arrears. Further, the loan was repayable by 17 quarterly instalments of $5,000,000 each from the 1st to 16th instalments and $40,000,000 for the 17th instalement. The first instalment was payable 12 months after the drawdown date.

(15) On 28 September 1991, a debenture was executed in favour of AB Finance Limited for a consideration of $120,000,000.

(16) The Taxpayer subsequently completed the purchase of the Old Lot on 28 September 1991 by executing the Assignment dated 28 September 1991 between Company BD as Vendor, Company BA as Confirmor, and the Taxpayer as Purchaser.

The Old Lot

(17) The residential development on the Old Lot were 2 blocks of building having 2 flats on G/F of Block A, 3 flats on 1/F to 3/F of Block A and 2 flats on each floor of Block B (that is, 19 flats in total) and 19 car parking spaces. The occupation permit for the building erected on the Old Lot was issued on 25 April 1991.

(18) The existing tenancy in Fact (6) above was a tenancy of 2 years from 1 September 1991 at a monthly rent of $69,176.25 in relation to Flat A1 on 3/F together with roof and car parking space no 12 of the Old Lot.

(19) The Chairman's Statement in the interim report of Company B for the half year ended 31 December 1991 [B1 – Appendix Q2] stated as follows:

Report for year ended	**Page**	**Statement**
Interim report (for half year ended 31-12-1991) dated 9-3-1992	2	'In September 1991, the Group acquired, for rental income, a high class residential building at Address A (100% owned) with a gross floor area of 64,109 square feet.'

(20) According to the Taxpayer's audited financial statements, the rental income derived from the residential development on the Old Lot during the period ended 30 June 1992 and the

years ended 30 June 1993 and 1994 were $2,592,622, $10,770,805 and $6,511,954 respectively.

(21) On 16 March 1992, the Taxpayer applied to the Building Authority for approval of building plans in relation to the redevelopment of the Old Lot.

(22) On 20 March 1992, Company C, on behalf of the Taxpayer, applied to the District Lands Office for modification of the lease conditions governing the Old Lot to permit development to a plot ratio of 5 in accordance with the Outline Zoning Plan for that area.

(23) (a) One of the tenants of the Old Lot was Company AE. By a tenancy agreement dated 20 June 1992, the Taxpayer let Flat A3 on 2/F and car parking space no 7 of the Old Lot to Company AE at a monthly rent of $40,000 for 2 years from 15 April 1992 to 14 April 1994 with an option to renew for a one year lease at market rent. It was agreed that the said premises were rent-free for a period from 15 April 1992 to 31 May 1992.

(b) Clause 13 of the agreement provided as follows:

'Notwithstanding anything to the contrary hereinbefore contained it is expressly agreed that if at any time during the tenancy hereby created the Landlord shall resolve to redevelop the said building or any part thereof whether wholly by demolition and rebuilding or otherwise or partially by renovation [refurbishment] or otherwise (which intention so to redevelop shall be sufficiently evidenced by a copy of a resolution of its Directors certified to be a true and correct copy by its Secretary) then in either of such events the Landlord shall be entitled to give six (6) calendar months' notice in writing expiring at the end of any calendar month during the tenancy hereby created terminating this Agreement and immediately upon the expiration of such notice this Agreement and everything herein contained shall cease and be void but without prejudice to the rights and remedies of either party against the other in respect of any antecedent claim or breach of any of the agreements stipulations and conditions herein set out.'

(c) Clause 15 of the agreement provided that the tenant was entitled to, at or after the first 12 months of the term granted, determine the tenancy by giving to the Taxpayer not less than 2 months' previous notice in writing or 2 months' rental in lieu of notice.

(24) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1992 [B1 – Appendix Q1] stated as follows:

Report

for year ended	Page	Statement
Annual report 30-6-1992 (dated 28-9-1992)	5	'The [Taxpayer] acquired … one completed residential property for investment in this financial year … (B) Completed property … [Address A] …'

(25) In the Taxpayer's own accounts for the year ended 30 June 1992 dated 28 September 1992 [B1 – Appendix D1], it stated the principal activities of the Taxpayer as 'Property Investment' and classified the Old Lot under 'fixed assets – investment properties' in the balance sheet. It stated under the principal accounting policies that 'investment properties' represented 'properties which are intended to be held for long term rental income generating purposes.'

Redevelopment of the Old Lot

(26) On 30 April 1993, the District Lands Officer advised Company C that he was prepared to recommend to the government the surrender of the Old Lot in exchange for Inland Lot No. XXXX ('the New Lot') at a premium of $247,440,000 and an administrative fee of $100,000. The basic terms were open for acceptance until 30 May 1993.

(27) On 17 May 1993, the Taxpayer advised the District Lands Office that it accepted the basic terms set out in Fact (26) above.

(28) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1993 [B1 – Appendices Q1, Q2] stated as follows:

Report for year ended	Page	Statement
Annual report 30-6-1993 (dated 29-9-1993)	9	'[Address A] … will be redeveloped to maximise (its) building floor area.'
Annual report 30-6-1993 (dated 29-9-1993)	20	In the section 'Investment Properties Highlights – Others': 'The Group's wholly-owned [Address A] … will be redeveloped to maximise (its) developable potential'

(29) In the Taxpayer's own accounts for the year ended 30 June 1993 dated 29 September 1993 [Appendix – D2], it stated the principal activities of the Taxpayer as 'Property Investment' and classified the Old Lot under 'fixed assets – investment properties' in the

balance sheet. It stated under the principal accounting policies that 'investment properties' represented 'properties which are intended to be held for long term rental income generating purposes.'

(30) On 1 July 1993, Company BF, on behalf of the Taxpayer, applied to the Building Authority for consent for demolition of the existing building on the Old Lot.

(31) On 31 July 1993, the Building Authority gave its consent to commence demolition works.

(32) (a) By a letter dated 15 October 1993 [B1 – Appendix B], Bank AJ Hong Kong branch confirmed to Company B its willingness to lead a group of lenders in providing a long term loan facility of up to $420,000,000 to the Taxpayer for the purpose of financing the redevelopment of the Old Lot into a XX-storey residential building of approximate total gross saleable floor area of 153,327 square feet.

(b) The loan was to be repaid in one lump sum on the date falling 3 years from the date of the loan agreement. The loan was divided into Tranche A (up to $310,000,000) and Tranche B (up to $110,000,000). $247,440,000 out of Tranche A was for the purpose of financing the payment of land premium for relaxation of the building height restriction stipulated in the original Government Lease and the balance of $62,560,000 was for re-financing in part the existing loan granted by AB Finance Limited. Tranche B was to be available for the purpose of financing 100% of the construction costs and other related professional fees of the redevelopment. Interest rate was to be charged at 1-15/16% p.a. above HIBOR quoted by the bank.

(c) On 19 October 1993, the Taxpayer (as borrower) and Company B (as guarantor) agreed and accepted the offer.

(33) On 20 October 1993, AB Finance Limited wrote to the Taxpayer in response to its letter of 12 October 1993. AB Finance Limited advised the Taxpayer that it had obtained the unanimous consent of the lenders of the $120,000,000 syndicated loan to the Taxpayer's prepayment of the whole of the loan under Fact (14) on 22 October 1993 subject to the payment of a prepayment fee. The prepayment amount on 22 October 1993 was $95,708,921.24 of which the outstanding principal was $95,000,000.

(34) On 22 October 1993, the debenture of $120,000,000 mentioned in Fact (15) above was released.

(35) On 30 October 1993, the premium of $247,440,000 in Fact (26) above was paid.

(36) On 17 November 1993, the Taxpayer surrendered the Old Lot to the government in exchange for the grant of the New Lot under Conditions of Exchange no. XXXXX.

(37) By an instrument dated 12 January 1994, a debenture was executed in favour of Bank AJ for a consideration of US$40,000,000 and HK$110,000,000.

(38) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1994 [B1 – Appendices Q1, Q2] stated as follows:

Report for year ended	**Page**	**Statement**
Annual report 30-6-1994 (dated 29-9-1994)	15	'The redevelopment of [Address A] into a luxurious residential building … will yield additional gross floor areas of 153,573 (existing 64,109) … square feet … to the Group's investment portfolio in the coming year'
Annual report 30-6-1994 (dated 29-9-1994)	27	'The Group's wholly-owned [Address A] … will be redeveloped to maximise its developmental potential. The project upon completion, will be held for rental purpose.'

(39) In the Taxpayer's own accounts for the year ended 30 June 1994 dated 29 September 1994 [B1 – Appendix D3], it stated the principal activities of the Taxpayer as 'Property Investment' and classified the property as 'fixed assets – properties under redevelopment'.

(40) On 12 August 1994, the Building Authority approved the building plans (revised scheme) submitted by Company BF on behalf of the Taxpayer on 7 July 1994.

(41) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1995 [B1 – Appendix Q1] stated as follows:

Report for year ended	**Page**	**Statement**
Annual report 30-6-1995 (dated 2-10-1995)	28	'The Group's wholly-owned [Address A] … (is) being redeveloped to maximise its development potential. Upon completion (this) development will be held for leasing.'

(42) In the Taxpayer's own accounts for the year ended 30 June 1995 dated 2 October 1995 [B1 – Appendix D4], it stated the principal activities of the Taxpayer as 'Property Development' and classified the property as 'fixed assets – properties under development' in the balance sheet. It stated under the principal accounting policies that 'properties under development' were intended to be held for long term rental income generating purposes.

(43) By a letter dated 14 July 1995, the District Lands Office advised the Taxpayer that the government had approved a modification of the Conditions of Exchange no XXXXX in consideration of payment by the Taxpayer of a premium of $800,000 and an administrative fee of $110,000. The modifications were in relation to the definitions of gross floor area and site coverage; and addition of a special condition in relation to maintenance of all land, slope treatment works, earth-retaining structures, drainage and any other works in and on the New Lot.

(44) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1996 [B1 – Appendix Q2] stated as follows:

Report for year ended	**Page**	**Statement**
Annual report 30-6-1996 (dated 1-10-1996)	38	'[Address A] … This redevelopment project will provide [XX] luxurious high-rise residential apartments … The location is within walking distance from [District AM], making it ideal residence for business executive tenants.'

(45) In the Taxpayer's own accounts for the year ended 30 June 1996 dated 1 October 1996 [B1 – Appendix D5], it stated the principal activities of the Taxpayer as 'Property Development' and classified the property as 'fixed assets – properties under development' in the balance sheet. It stated under the principal accounting policies that 'properties under development' were intended to be held for long term rental income generating purposes.

(46) By another letter dated 2 January 1997, the District Lands Office advised the Taxpayer that the government had approved a modification of the Conditions of Exchange no XXXXX in relation to the special condition on the deed of mutual covenant.

(47) After redevelopment of the New Lot, a residential building known as Building D was erected on the land. Building D had XX-storey of XX flats and XX duplex penthouse units surmounting a XX-level carport (XX car parking spaces) or clubhouse podium.

(48) The Chairman's Statement in the annual report of Company B for the year ended 30 June 1997 [B1 – Appendices Q1, Q2] stated as follows:

Report for year ended	Page	Statement
Annual report 30-6-1997 (dated 23-9-1997)	17	'In addition, fresh contributions from several major investment properties will help to expand the recurrent rental income base of the Group. These include [Building D] …'

Report for year ended	Page	Statement
Annual report 30-6-1997 (dated 23-9-1997)	39	'[Building D], a luxurious residential building, will be retained for investment purpose …'
Annual report 30-6-1997 (dated 23-9-1997)	47	'[Building D] … The development is now actively planned for leasing.'

(49) In the Taxpayer's own accounts for year ended 30 June 1997 dated 23 September 1997 [B1 – Appendix D6], it stated the principal activities of the Taxpayer as 'Property Development' and classified the property as 'fixed assets – properties under development' in the balance sheet. It stated under the principal accounting policies that 'properties under development' were intended to be held for long term rental income generating purposes.

(50) On 14 August 1997, the occupation permit in relation to Building D was issued.

(51) By a letter dated 30 August 1997 [B1 – Appendix C], Bank X (as lender) and Bank X Limited (as agent) confirmed to Company B their underwriting commitment to arrange (a) a HK$1,500,000,000 bridging loan facility for Company BG, a fellow subsidiary of the Taxpayer, and (b) a US$200,000,000 syndicated 5-year loan facility for another subsidiary of Company B.

(52) The principal terms and conditions of the bridging loan facility were as follows:

(a) Security for the loan facility included:

(i) An unconditional and irrevocable joint and several guarantee was to be provided by Company B, Company BH and the Taxpayer;

(ii) Assignment of all income in relation to Building D;

(iii) First ranking mortgages over all shares of Company BH, Company BI and the Taxpayer;

(iv) A first ranking building mortgage over Building D;

(v) Floating charges over all assets of Company BH and the Taxpayer.

(b) The facility of up to HK$1,500,000,000 was to be divided into 2 tranches:

(i) Tranche I of up to HK$400,000,000 was for on-lending to the Taxpayer for refinancing existing bank debt associated with the construction of Building D.

(ii) Tranche II of up to HK$1,100,000,000 was for on-lending to Company BH for acquisition of Company BI.

(c) Repayment was to be made in one lump sum on or before the final maturity. Final maturity was 4 months from the signing date of the facility agreement or upon the drawdown of a syndicated 5-year term loan facility for at least US$200,000,000 to be arranged by Bank X Limited and any other financial institutions for Company B or its subsidiary, whichever was earlier.

(d) The Taxpayer covenanted that it would not sell, transfer or dispose of any of its assets.

On 2 September 1997, Company B agreed and accepted the offer.

(53) By a letter dated 3 September 1997, the Taxpayer advised Bank AJ of its intention to prepay in full the loan under Fact (32) on 24 September 1997. A drawdown notice [B1 – Appendix C1] was given by Company BG to Bank X Limited on 22 September 1997 in respect of the Tranche I advance of HK$400,000,000. On 24 September 1997, final repayment to Bank AJ was made with the principal amounts under Tranche A and Tranche B at US$40,000,000 and HK$101,200,000 respectively.

(54) On 24 September 1997, a debenture and mortgage in respect of Building D was executed in favour of Bank X Limited at a consideration of $1,500,000,000.

(55) The Minutes of a board meeting of the Taxpayer said to have been held on 16 January 1998 [B1 – Appendix O1] stated as follows:

'The Chairman reported that:

(a) at all material times, the [Taxpayer's] investment property … known as "[Building D]", was intended to be held for long term investment purposes so as to provide a stable recurrent rental income to the [Taxpayer] which intention was evidenced, inter alia, by the formation of the Leasing Committee within the group and by all public documents and announcements;

(b) due to recent Asian financial crisis and the unfounded rumour against … [Company B] … the group would need to have a stronger cash flow so as to withstand any future adverse financial turmoil against the group; and

(c) consequently, it was in the best interest of the [Taxpayer] and the group as a whole that ([Building D]) be disposed of, instead of holding for long term investment, at the best possible price so as to improve the financial position and to reduce the gearing level of the group.'

The Minutes stated that the Taxpayer's board resolved that 'it was in the commercial interest of the Taxpayer to sell and dispose of [Building D]; either in whole or by way of strata titles, so as to obtain the best price for the Taxpayer with immediate effect'.

(56) Surveying Company F prepared the valuation of Building D [B1 – Appendix P] as at 16 January 1998 in the sum of $2,450,000,000.

(57) On 24 January 1998, a full page advertisement [B1 – Appendix N4] appeared in various Chinese and English newspapers offering Building D for sale.

(58) The minutes of a board meeting of the Taxpayer said to have been held on 26 January 1998 [B1 – Appendix O2] stated that the Taxpayer's board resolved that on the basis of the valuation prepared by Surveying Company F, Building D was to be transferred from investment property to stock of unsold property in the Taxpayer's books and records as at 16 January 1998.

(59) By a letter of 16 February 1998, Legal Firm M, on behalf of the Taxpayer, requested Bank X for its formal consent to the sale of the flats in Building D at a minimum price of $10,000 per square foot for each flat.

(60) By a letter dated 21 May 1998, Company BG advised Bank X Limited that it would fully repay the outstanding $1,500,000,000 bridging loan facility under Fact (51) at $69,479,491.56 on 22 May 1998.

(61) On 22 May 1998, the debenture and mortgage in Fact (54) above was released.

(62) The audited financial statements of the Taxpayer stated as follows:

Profit and loss accounts

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**	**1996/97**
For year ended 30-6-	16-7-1991 – 30-6-1992	1993	1994	1995	1996
Date of accounts	28-9-1992	29-9-1993	29-9-1994	2-10-1995	1-10-1996
	$	$	$	$	$
Income					
Gross rental income	2,592,622	10,770,805	6,511,954	-	-
Management fee income	191,159	826,007	558,722	-	-
Bank interest income	35,475	61,981	82,911	-	-
Interest income from tenants	5,410	8,842	11,160	-	-
Rental deposit forfeited	-	41,000	-	-	-
Sundry income	-	-	80,236	-	-
	2,824,666	11,708,635	7,244,983	-	-
Expenses					
Lease commission	222,000	125,000	-	-	-
Advertising	421,919	380,189	-	-	-
Lease promotion	15,000	-	-	-	-
Professional fee	441,600	2,576	28,225	-	-
Bank loan interest[1]	7,583,014	7,313,014	2,056,353	-	-
Bank loan interest[2]	-	-	6,061,209	-	-
Finance charges	[3]710,034	100,000	[3]4,738,006	-	-
Interest paid to fellow subsidiary[4]	560,318	819,113	977,564	-	-
Others	1,250,433	1,894,522	1,056,262	9,950	10,350
	11,204,318	10,634,414	14,917,619	9,950	10,350
Profit/(Loss) for the period	(8,379,652)	1,074,221	(7,672,636)	(9,950)	(10,350)

Profit and loss accounts

Year of assessment	**1997/98**	**1998/99**	**1999/2000**	**2000/01**	**2001/02**
For year ended 30-6-	1997	1998	1999	2000	2001
Date of accounts	23-9-1997	23-9-1998	21-9-1999	26-9-2000	25-9-2001
	$	$	$	$	$
Income					
Sales of properties		2,458,907,786	38,079,900		
Cost of properties sold		(2,356,093,127)	(45,906,873)		
Gross profit/(loss)		102,814,659	(7,826,973)		
Expenses		34,245,737	3,272,688		
Profit/(Loss) on sales of properties		68,568,922	(11,099,661)		

Sales deposit forfeited		-	5,018,960		
Gross rental income		290,062	-		
Expenses		224,400			
Net rental income		65,662			
Interest income		2,153,614	127,436	7,303	1,189
Sundry income		113,900	369,289	76,915	120,641
Properties development costs W/B		-	-	-	4,322,727
		70,902,098	(5,583,976)	84,218	4,444,557
Expenses					
Finance, charges		48,816			
Interest on bank loan[2]		3,701,778			
Interest to fellow subsidiary[4]		52,576,746			
Other expenses	10,350	231,272	47,969	2,393,262	692,424
	10,350	56,558,612	47,969	2,393,262	692,424
Operating profit/(loss) Continuing operations excluding exceptional items		14,343,486	(5,631,945)	(2,309,044)	3,752,133
Exceptional item[5]		1,620,936,187	30,952,258	-	-
Profit/(Loss) for the period	(10,350)	1,635,279,673	25,320,313	(2,309,044)	3,752,133
Dividend	-	800,000,000	820,000,000	25,500,000	-

(1) interest on secured loan provided by Bank AB utilized to finance the acquisition of property

(2) (1994/95) interest payable to Bank AJ.
(1998/99) interest charged on secured loans provided by Bank AJ utilized to finance the Taxpayer's working capital

(3) expenses in connection with bank loan facilities

(4) (1992/93 to 1994/95) interest to Company BG on unsecured loan utilized to finance the acquisition of property and working capital
(1998/99) interest charged on unsecured loans provided by Company BG utilized to finance the Taxpayer's working capital

(5) asset revaluation reserve realized on disposal of properties

Balance sheets

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**	**1996/97**
As at 30-6-	1992	1993	1994	1995	1996
Date of accounts	28-9-1992	29-9-1993	29-9-1994	2-10-1995	1-10-1996
	$	$	$	$	$
Fixed assets					
Investment properties at cost	185,475,009	185,733,749	-	-	-
Additions	258,740	83,160	-	-	-
Properties under	-	-	185,816,909	457,609,261	505,683,058

redevelopment					
Additions[6]	-	-	271,792,352	48,073,797	58,377,853
Surplus on revaluation	64,266,251	164,183,091	609,390,739	644,316,942	1,107,939,089
	250,000,000	350,000,000	1,067,000,000	1,150,000,000	1,672,000,000
Current assets	2,149,378	4,710,648	4,012,463	357,671	620,109
Current liabilities					
Secured bank loan[7]	20,000,000	20,000,000	103,156,000	-	309,900,000
Accounts payable and accruals	1,096,445	696,377	5,245,954	6,896,260	5,376,238
Receipts in advances	-	177,017	-	-	-
Rental deposits from tenants	1,767,012	2,431,447	-	-	-
Amount due to fellow subsidiary	20,558	86,482	-	-	-
Temporary receipt	-	-	-	1,500	1,500
	22,884,015	23,391,323	108,401,954	6,897,760	315,277,738
Net current liabilities	(20,734,637)	(18,680,675)	(104,389,491)	(6,540,089)	(314,657,629)
	229,265,363	331,319,325	962,610,509	1,143,459,911	1,357,342,371
Share capital	2	2	2	2	2
Reserves	55,886,599	156,877,660	594,412,672	629,328,925	1,092,940,722
Bank loan, secured[7]	100,000,000	80,000,000	206,312,000	310,000,000	-
Amount due to fellow subsidiary[8]	73,378,762	94,441,663	161,885,835	204,130,984	264,401,647
	229,265,363	331,319,325	962,610,509	1,143,459,911	1,357,342,371

Balance sheets

Year of assessment	**1997/98**	**1998/99**	**1999/2000**	**2000/01**	**2001/02**
As at 30-6-	1997	1998	1999	2000	2001
Date of accounts	23-9-1997	23-9-1998	21-9-1999	26-9-2000	25-9-2001
	$	$	$	$	$
Fixed assets					
Properties under redevelopment	564,060,911	690,239,264			
Additions[6]	126,178,353	107,872,291			
Surplus on revaluation	1,815,760,736	1,651,888,445			
		2,450,000,000			
Transfer to stock of unsold flats		(2,402,000,000)			
Disposal		(48,000,000)			
	2,506,000,000	0			
Current assets					
Stock of unsold flats		45,906,873	-	-	-
Amount due from holding company		[9]674,093,982	40,310,405	5,395,289	4,409,055
Accounts receivable		162,854,289	262,998	-	30,330
Other current assets	3,424,733	6,336,394	269,830	224,643	58,144
	3,424,733	889,191,538	40,843,233	5,619,932	4,497,529
Current liabilities					
Secured bank loan[7]	385,780,000	-	-	-	
Accounts payable and accruals	13,348,144	32,641,736	15,251,962	7,837,705	2,963,169
Receipts in advances	-	5,226	-	-	-
Rental deposits from tenants	-	302,400	-	-	-
Customer deposit received	-	5,018,960	-	-	-
	399,128,144	37,968,322	15,251,962	7,837,705	2,963,169

Net current assets/(liabilities)	(395,703,411)	851,223,216	25,591,271	(2,217,773)	1,534,360
	2,110,296,589	851,223,216	25,591,271	(2,217,773)	1,534,360
Share capital	2	2	2	2	2
Reserves	1,800,752,019	851,223,214	25,591,269	(2,217,775)	1,534,358
Amount due to fellow subsidiary[8]	309,544,568	-	-	-	-
	2,110,296,589	851,223,216	25,591,271	(2,217,773)	1,534,360

(6) Addition to properties under redevelopment included such redevelopment expenditure as interest and other direct costs attributable to the redevelopment project.

Year of assessment	**1994/95**	**1995/96**	**1996/97**	**1997/98**	**1998/99**
	$	$	$	$	$
Interest on bank loan	10,109,604	23,933,941	24,332,991	26,069,893	7,429,474
Interest to fellow subsidiary	977,564	896,678	2,286,935	2,832,624	56,822,338
Total interest	11,087,168	24,890,619	26,619,926	28,902,517	64,251,812
Interest capitalized to properties under redevelopment	1,992,042	24,890,619	26,619,926	28,902,517	7,973,288
	9,095,126	0	0	0	56,278,524

(7) (1992/93, 1993/94)
The Taxpayer's investment properties and certain bank balances had been pledged to a bank to secure banking facilities to the extent of $120,000,000. All other assets of the Taxpayer were subjected to a floating charge for the same purpose. The portion of loan repayable within one year had been grouped under current liabilities.
(1994/95)
The Taxpayer's properties under redevelopment had been pledged to a bank to secure banking facilities to the extent of $420,000,000. All other assets of the Taxpayer were subjected to a floating charge for the same purpose. The portion of the loan repayable within one year had been grouped under current liabilities.
(1995/96, 1996/97, 1997/98)
The Taxpayer's properties under redevelopment had been pledged to a bank to secure banking facilities to the extent of $420,000,000. All other assets of the Taxpayer were subjected to a floating charge for the same purpose.

(8) The repayment of the interest and principal of the amount due to the fellow subsidiary was subordinated to that of the secured bank loan.

(9) The holding company was Company BJ, the Taxpayer's direct holding company.

Copies of the Taxpayer's profits tax returns, audited financial statements and tax computations for the years of assessment 1992/93 to 2001/02 are at [B1 – Appendices D1 – D10].

(63) In its profits tax returns for the years of assessment 1998/99, 1999/2000, 2000/01 and 2001/02, the Taxpayer declared the following assessable profits/adjusted loss after exclusion of asset revaluation reserve realized on disposal of property:

Year of assessment	**1998/99**	**1999/2000**	**2000/01**	**2001/02**
	$	$	$	$
Assessable profits declared	14,483,486			3,751,105
Adjusted loss declared		(5,746,741)	(2,313,813)	
after exclusion of Asset revaluation reserve realized on disposal of property	1,620,936,187	30,952,258		

(64) On divers dates, the assessor issued the following statements of loss for the years of assessment 1992/93 to 1997/98 and 2000/01 and raised the following profits tax assessments for the years of assessment 1998/99, 1999/2000 and 2001/02 on the Taxpayer:

Year of assessment	**1992/93**	**1993/94**	**1994/95**	**1995/96**	**1996/97**
Date of issue	4-1-1995	1-1995	28-7-1995	27-6-1996	3-2-1999
	$	$	$	$	$
Profits/(Loss) as per accounts/return	(8,376,952)	1,074,221	(7,672,636)		
Less: Rebuilding allowance	1,445,358	1,445,358			
Adjusted loss	(9,822,310)	(371,137)		0	(10,350)
Add: Adjusted loss c/f		(9,822,310)	(10,193,447)	(17,866,083)	(17,866,083)
Adjusted loss c/f		(10,193,447)	(17,866,083)	(17,866,083)	(17,876,433)
Assessable profits	NIL.	NIL.	NIL.	NIL.	NIL.
Tax payable thereon	NIL.	NIL.	NIL.	NIL.	NIL.

Year of assessment	**1997/98**	**1998/99**	**1999/2000**	**2000/01**	**2001/02**
Date of issue	3-2-1999	9-7-2003	9-7-2003	10-7-2003	10-7-2003
	$	$	$	$	$
Profits/(Loss) as per accounts/return		14,483,486	(5,746,741)		3,751,105
Adjusted loss	(10,350)			0	
Add: Asset revaluation reserve [(1)]		1,620,936,187	30,952,258		
Assessable profits		1,635,419,673	25,205,517		
Add: Adjusted loss b/f	(17,876,433)	(17,886,783)			
Adjusted loss c/f	(17,886,783)				
Assessable profits	NIL.			NIL.	3,751,105

Net assessable profits		1,617,532,890			
Tax payable thereon	NIL	258,805,262	4,032,882	NIL	600,176

(1) Asset revaluation reserve realized on disposal of property was considered as revenue in nature and taxable.

(65) The Taxpayer did not have any disagreement with the statements of loss for the years of assessment 1992/93 to 1997/98. However, the Taxpayer, through Accounting Firm BK ('the Representative'), objected to the profits tax assessments for the years of assessment 1998/99, 1999/2000 and 2001/02 and disagreed with, amongst other things, the statement of loss for the year of assessment 2000/01 on the following grounds:

(a) The amounts assessed were excessive and unwarranted in fact and in law.

(b) The Taxpayer did not earn the assessable profits or net assessable profits stated in the profits tax assessments for the years of assessment 1998/99, 1999/2000 and 2001/02.

(c) The asset revaluation reserve realized on disposal of Building D for the years of assessment 1998/99 and 1999/2000 stated in Fact (63) above should be capital in nature and not chargeable to profits tax under section 14 of the Inland Revenue Ordinance ('IRO').

(d) The Taxpayer should be entitled to deduct the tax losses brought forward from prior years against the assessable profits for the year of assessment 2001/02 under section 19C(4) of the IRO. Details of the tax losses were as stated below:

Year of assessment	**Tax loss available for carry forward**
	$
1998/99	(1) 3,403,297
1999/2000	(2) 5,746,741
2000/01	(2) 2,313,813
	11,463,851

(1) $14,483,486 Fact (63) - $17,886,783 Fact (64)
(2) Fact (63)

(e) The assessments were otherwise incorrect.

(f) As for the 2000/01 statement of loss, the Taxpayer was entitled to deduct the expense incurred during the year ended 30 June 2000 under section 16(1) of the IRO. The statement of loss was otherwise incorrect.

(66) In relation to its audited financial statements:

(a) The Taxpayer or the Representative on its behalf stated that the breakdown of 'additions to property under redevelopment' over the years was as stated below:

Year of assessment	**1994/95**	**1995/96**	**1996/97**	**1997/98**	**1998/99**
As at 30-6-	1994	1995	1996	1997	1998
	$	$	$	$	$
Land Premium	247,440,000	-	-	-	-
Modification premium	100,000	800,000	-	-	-
Stamp duty, adjudication fee etc.	19,924	-	-	-	-
Related land purchase expenses	-	74,216	-	-	-
Compensation to tenants	20,444,180	-	-	-	-
Architect fee	720,135	1,200,000	1,200,000	1,620,000	959,865
Consultant fee	497,500	896,250	470,143	257,775	524,625
Crown rent and rates	76,191	297,139	484,291	328,157	152,984
Professional fee	202,000	110,000	416,290	244,595	114,055
Professional report	-	-	15,960	54,212	21,414
Survey fee	40,000	-	-	-	-
Plan processing fee	177,320	-	-	-	190,400
Site sundry expenses	53,510	119,453	46,789	271,924	35,384
Project management fee	-	877,191	2,093,191	5,794,199	5,053,737
Hoarding	-	117,500	10,388	223,200	-
Demolition	-	15,923,000	1,009,055	-	-
Pile cap & substructure	-	1,080,900	6,309,499	159,410	-
Superstructure	-	-	15,111,000	44,128,000	33,560,553
Plumbing & drainage	-	-	7,200	3,266,380	900,979
Lithography fee	-	1,588	1,487	1,384	3,370
Insurance	-	981,176	1,410,734	-	403,673
Mock-up expenses	-	-	22,733	217,322	-
Electrical installation	-	-	254,700	4,466,500	4,558,006
Gas supply installation	-	-	122,000	247,870	328,410
Fire service installation	-	-	132,300	1,298,500	962,282
Lift/Escalators installation	-	-	632,000	2,316,492	2,242,745
Window wall – residential	-	-	840,600	7,159,900	8,574,015
Ironmongery installation	-	-	182,000	645,480	86,948
Air conditioning installation	-	-	96,300	6,372,700	5,302,144
Kitchen equipment installation	-	-	780,000	1,172,250	3,531,931
Sanitary wire fittings	-	-	-	1,846,000	1,008,951
Wardrobe/closet installation	-	-	-	1,715,700	4,217,301
Gondola system installation	-	-	-	61,110	698,890
Club House-Equip/Interior Decoration	-	-	-	1,691,980	6,700,148
Tile supply	-	-	-	9,272,800	11,157,790
Swimming pool installation	-	-	-	403,626	536,754
Spray painting works	-	-	-	441,720	2,792,240
Security guard charges	-	-	-	4,800	228,195
Playground equip installation	-	-	-	-	115,000
Landscaping work	-	-	-	-	3,489,529
Signage and graphic installation	-	-	-	-	475,230
Access and road construction	-	-	-	-	260,000

Interest after commencement of work	1,992,042	-	-	-	-
Interest paid – Bank loan/OD	-	23,993,941	24,332,991	26,069,893	3,727,696
Year of assessment	**1994/95**	**1995/96**	**1996/97**	**1997/98**	**1998/99**
As at 30-6-	1994	1995	1996	1997	1998
	$	$	$	$	$
Interest paid – Intercompanies	-	896,677	2,286,935	2,832,624	4,245,592
Finance charges	29,250	373,750	383,024	1,313,662	671,155
Exchange difference	-	532,000	(100,000)	180,000	-
Bank charges	-	680	365	130	-
Entertainment	300	-	1,975	5,147	40,300
Overseas traveling expenses	-	-	-	6,641	-
Interest received – deposit/sav a/c	-	(28,852)	(44)	(38)	-
Rental income	-	-	(153,290)	153,290	-
Sundry income	-	(172,812)	(22,763)	(66,982)	-
Additions to property under redevelopment	271,792,352	48,073,797	58,377,853	126,178,353	107,872,291

(b) The figure of $48,000,000 under 'Investment properties' in note 8 of the audited financial statements for the year of assessment 1998/99 [B1 – Appendix D7] was the 6-level carport in Building D.

(c) The amount of $48,000,000 was the market value of the carport as at 16 January 1998 and was valued by Surveying Company F.

(d) The Taxpayer or the Representative on its behalf stated that rental deposits from tenants ($302,400) for the year of assessment 1998/99 were in relation to the 30 car parking spaces at Building D.

(e) The Taxpayer or the Representative on its behalf stated that 'asset revaluation reserve' represented the excess of market value of Building D as at 16 January 1998 over its cost of construction.

(f) The market value of Building D on 16 January 1998 was based on the valuation report prepared by Surveying Company F.

(g) The Taxpayer or the Representative on its behalf stated that the Taxpayer then apportioned the asset revaluation reserve by reference to the listed selling price of the unsold units as at 30 June 1998 to the total listed selling price of all the units. The computation for the 1999/2000 asset revaluation reserve was as follows:

		$
Asset revaluation reserve (excluding carpark)	A	1,619,524,916
Listed selling price of the unsold units	B	50,189,600
Total listed selling price of all units	C	2,626,086,510

1999/2000 asset revaluation reserve	A x B / C	30,952,258