Case No. D30/01

Profits tax – acquisition and sale of property – intention at time of purchase – burden of proof on purchaser to establish that property purchased for long term investment – rationale behind tendering a ' witness' – credibility – sections 14(1) and 68(4) of the Inland Revenue Ordinance (' IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Colin Cohen and Michael Neale Somerville.

Date of hearing: 12 April 2001.
Date of decision: 11 May 2001.

In the years of assessment 1994/95 and 1995/96 respectively, the taxpayer sold certain properties which had previously been redeveloped by it and other parties that formed a joint venture.

On various dates between 1976 and 1990, the taxpayer had purchased various properties (' the Taxpayer' s Property'). By a joint venture dated 5 January 1989, the taxpayer (and other joint venture parties) agreed to redevelop the Taxpayer' s Property together with other adjacent lots (' the JV Properties').

On 4 July 1991, the parties agreed to cancel the joint venture agreement and entered into a new arrangement.

On 7 December 1991, under the new arrangement, the JV Properties were consolidated into one land lot at a premium of $17,810,000. The lot was redeveloped into two blocks of buildings with car parks (Housing Estate F). Units of Housing Estate F were sold for a sum of $534,365,446 (in the proportions held by the parties in the new arrangement) although the taxpayer did not offer his share of the profit for assessment.

On 3 May 1996, the assessor considered that Housing Estate F had been redeveloped for resale purposes. The taxpayer argued that the properties were capital assets, and had been held for a long time with the intention all along to hold it for long term and redevelopment purposes.

Held:

1. It was for the taxpayer to prove that the acquisition of the properties was for long term investment. A bare assertion was not decisive and must be viewed in the light of the

conduct of the parties and the surrounding circumstances (All Best Wishes Limited v CIR (1992) 3 HKTC 750 applied).

2. A witness was a person present at some event and able to give information about it. The taxpayer' s witness clearly had no material information to offer as regards the coming about of the intention. Further, she was unable to offer any substantial assistance to the Board: Leomark Holdings Co Ltd v Chik Ho Ming (HC Action No A3065 of 1997) applied.

3. The properties were not held as capital assets. There were no contemporaneous documents filed which supported such a finding.

4. There was an absence of any fundamental evidence raised to support the taxpayer' s assertion that the car parks were held for long term investment: Re ICS Computer Distribution Limited [1996] 3 HKC 440 applied.

5. The taxpayer had failed to discharge its onus under section 68(4) of the IRO.

6. Further, since the appeal was frivolous and vexatious, the taxpayer was required to pay the sum of $5,000 as costs of the Board.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750
Leomark Holdings Limited v Chik Ho Ming, HC Action No A3065 of 1997, 28 April 2000, unreported
Re ICS Computer Distribution Limited [1996] 3 HKC 440

Ambrose Ho Senior Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.
Richard Leung Counsel instructed by Messrs BDO McCabe Lo & Co for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 17 August 2000 whereby:

(1) Profits tax assessment for the year of assessment 1994/95 under charge number 1-5005744-95-7, dated 3 May 1996, showing net assessable profits of $532,173,534 (after set off of loss brought forward of $2,311,870) with tax payable thereon of $87,808,633 was increased to net assessable profits of $532,426,582 (after set off of loss brought forward of $2,311,870) with tax payable thereon of $87,850,386.

(2) Profits tax assessment for the year of assessment 1995/96 under charge number 1-3130565-96-3, dated 10 November 1997, showing assessable profits of $1,008,221 with tax payable thereon of $166,356 was increased to assessable profits of $1,170,139 with tax payable thereon of $193,072.

The agreed facts

2. Based on the statement of agreed facts, we make the following findings of fact.

3. The Taxpayer has objected to the profits tax assessments for the years of assessment 1994/95 and 1995/96 raised on it. The Taxpayer claims that the profits on sale of certain properties redeveloped by it in joint venture with other parties should not be chargeable to profits tax.

4. The Taxpayer is a private company incorporated in Hong Kong on 5 December 1975. Since incorporation, Mr A and Ms B were the directors of the Taxpayer. On 28 December 1984, Ms C and Ms D were also appointed as directors of the Taxpayer. The details of shareholders of the Taxpayer are as follows:

<u>From incorporation to 17-1-1989</u>

Mr A	one share of $1 each
Ms B	one share of $1 each

<u>18-1-1989 to 7-8-1996</u>

Mr A	2,000 shares of $1 each
Ms B	2,000 shares of $1 each
Ms D	2,000 shares of $1 each
Ms C	2,000 shares of $1 each
Mr E	2,000 shares of $1 each

5. In its profits tax returns, the Taxpayer described the nature of its business as ' Property Investment' .

6. On divers dates, the Taxpayer purchased the following properties (hereinafter collectively referred to as ' the Taxpayer' s Property'):

Location	**Inland lot number**	**Date of purchase**	**Purchase price** $
Property 1 at Housing Estate F	XXXX	)	)
Property 2 at Housing Estate F	XXXX	) 16-8-1985	) 5,200,000
Property 3 at Housing Estate F	XXXX	)	)
Property 4 at Housing Estate F	XXXX	25-10-1985	2,300,000
Property 5 at Housing Estate F	XXXX	25-10-1985	2,650,000
Property 6 at Housing Estate F	XXXX	25-10-1985	2,650,000
Property 7 on Street G (Note (1))	XXXX	25-10-1985	2,000,000
Property 8 on Street G	XXXX	21-11-1988	4,000,000
Property 9 on Street G	XXXX	6-11-1986	1,830,000
Property 10 on Street G	XXXX	13-4-1977	590,000
Property 11 on Street G	XXXX	18-9-1985	1,850,000
Property 12 on Street G	XXXX	13-8-1987	1,800,000
Property 13 on Street H	XXXX	8-9-1987	2,020,000
Property 14 on Street H	XXXX	15-10-1987	3,250,000
Property 15 on Street H	XXXX	30-9-1976	250,000
Property 16 on Street H	XXXX	2-1-1988	Note (2)
Property 17 on Street H	XXXX	3-5-1985	650,000
Property 18 on Street H, 1-3/F	XXXX	19-9-1985	270,000
Property 18 on Street H, G/F	XXXX	9-4-1990	4,100,000
Property 19 on Street H, 2/F	XXXX	11-11-1986	380,000
Property 19 on Street H, G, 1, 3/F	XXXX	26-08-1986	665,000
Property 20 on Street H	XXXX	10-10-1986	680,000

Note (1) Mr A purchased Property 7 at a consideration of $300,000 in 1975 and sold the property to the Taxpayer on 25 October 1985.

(2) Acquired by an exchange of land at Property 21 on Street I through a deed of exchange dated 2 January 1988.

A schedule together with a location map showing the time sequence of the land lots of the Taxpayer' s Property acquired by the Taxpayer were provided at appendix A of the determination (B1, pages 16 to 17).

7. To finance part of the purchase costs of the Taxpayer' s Property, the Taxpayer took out a loan of $10,000,000 from Bank J on 25 October 1985 and another loan also of $10,000,000 from Bank J on 25 November 1987. These loan facilities were secured by legal charges over the properties set out in paragraph 6 then held by the Taxpayer.

8. By a joint venture agreement dated 5 January 1989 ('the JV Agreement'), the Taxpayer, Company K, Mr A and Company L agreed to redevelop the Taxpayer' s Property (subject to paragraph 9(c) below) together with the following adjacent land lots owned by the other three parties:

Owner	**Location of property**	**Inland lot number**	**Date of purchase**	**Purchase price $**
Company K	Property 22 on Lane M	XXXX and RP of XXXX	25-1-1978	550,000
	Property 23 at Housing Estate F	XXXX	29-9-1984	1,200,000
Mr A	Property 24 on Lane M	XXXX and section A of XXXX	20-5-1980	1,250,000
Company L	Property 25 on Street H	XXXX	5-1-1989	(see paragraph 11)

9. The JV Agreement provided, among other things, the following:

(a) The JV Agreement replaced a Chinese agreement dated 19 November 1985 made between Company K and Mr N (see paragraph 11(b) below).

(b) The development cost should be contributed and borne by the parties in accordance with the agreed ratio of interest shown in the JV Agreement.

(c) The agreed ratio would be different dependent upon whether the land lots at Property 8 and/or Property 18 were to be included in the joint development.

(d) As soon as practicable, and not later than one month after completion of the new building, the parties should enter into a deed of exchange and a deed of mutual covenant for the purpose of effecting partition.

(e) Any party might [be] at liberty at any time prior to the issuance of the occupation permit in respect of the new building [to] sell the unit to which he was entitled under the terms and conditions set out in the JV Agreement.

A copy of the JV agreement is at appendix B of the determination (B1, pages 19 to 57).

10. Company K is a private company incorporated in Hong Kong on 12 December 1972. Since incorporation, Mr A and Ms B were the directors of Company K. On 27 December 1984, Ms C and Ms D were also appointed as directors of Company K. Company K was engaged in purchasing, letting, redeveloping and selling landed properties.

11. (a) Mr N purchased Property 25 on 11 October 1960.

(b) On 19 November 1985, Company K and Mr N entered into the Chinese agreement (' the 1985 Agreement') referred to in paragraph 9(a) above to set out the terms and conditions for a joint redevelopment of Property 25 on Street H together with the nearby lots then owned by Company K. A copy of the 1985 Agreement (with English translation) is at appendix C of the determination (B1, pages 58 to 59).

(c) Company L was incorporated as a private company in Hong Kong on 16 December 1988. For the period up to 4 July 1991, the directors of Company L were Mr N and Ms O.

(d) On 5 January 1989, Mr N assigned Property 25 to Company L which, as consideration, allotted 9,998 shares of Company L to him.

12. On 4 July 1991, the following events took place:

(a) The Taxpayer, Company K, Mr A and Company L entered into a cancellation agreement to cancel the JV Agreement referred to in paragraph 8 above. A

copy of the cancellation agreement is at appendix D of the determination (B1, pages 60 to 65).

(b) The Taxpayer, Company K, Mr A as ' Party A' and Mr N and Ms O as ' Party B' entered into another Chinese agreement (' the 1991 Agreement') to cancel the JV Agreement and also to agree to transfer the entire share capital of Company L by Party B to the Taxpayer. In consideration of the share transfer, Party B would be assigned seven units with a total floor area of 3,816 square feet of the completed building of Housing Estate F. A copy of the 1991 Agreement (with English translation) is at appendix E of the determination (B1, pages 66 to 71).

(c) Mr N and Ms O resigned as directors and the four directors of the Taxpayer and Company K referred to in paragraphs 4 and 10 became the directors of Company L.

(d) The Taxpayer, Company K, Mr A and Company L entered into a deed of exchange to agree their respective share of ownership in the land lots set out in paragraphs 6 and 8. They agreed to hold these land lots as tenants-in-common in accordance with the following sharing ratio:

The Taxpayer	80,024/100,000
Company K	12,050/100,000
Mr A	6,070/100,000
Company L	1,856/100,000

13. On 7 December 1991, the Taxpayer, Company K, Mr A and Company L entered into a deed of exchange with the Hong Kong Government to consolidate the land lots set out in paragraphs 6 and 8 into a new land lot known as inland lot number XXXX at a premium of $17,810,000. The location plan of the consolidated site is at appendix A1 (B1, page 18).

14. The new site at inland lot number XXXX was redeveloped into two blocks of residential buildings (each consisting of 35 storeys) with car parks called Housing Estate F. The occupation permit of Housing Estate F was issued on 3 December 1993 and the certificate of compliance was issued on 8 March 1994.

15. The units of Housing Estate F were pre-sold to the public before the issue of occupation permit. Copies of sale brochure, price list and a sale report of the units of Housing Estate F sold during the period from November 1992 to March 1994 were provided at appendices F, G and H of the determination (B1, pages 72 to 115).

16. (a) The Taxpayer submitted its profits tax return for the year of assessment 1994/95 together with the accounts for the year ended 31 March 1995 and a proposed tax computation which are attached as appendices I, I1 and I2 (B1, pages 116 to 136).

(b) In its profits tax return for the year of assessment 1994/95, the Taxpayer declared assessable profits of $128,959.

(c) In the accounts, the Taxpayer showed an exceptional item representing the gain on disposal of the units of Housing Estate F in the amount of $534,356,446. The Taxpayer did not offer this profit for assessment.

(d) In the proposed tax computation, the Taxpayer claimed rebuilding allowance of $253,048 in respect of the unsold units and 80 car parks of Housing Estate F. The total cost of construction of these units and car parks was stated as $12,652,392.

17. On 24 November 1995, the assessor issued the following loss computation for the year of assessment 1994/95 to the Taxpayer:

	$
Profit per return	128,959
Less: Loss brought forward for set off	2,311,870
Loss carried forward	(2,182,911)

18. The assessor subsequently considered that Housing Estate F was redeveloped for resale purpose. On 3 May 1996, the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1994/95:

	$
Profit per return	128,959
Add: Profit on disposal of properties	534,356,445
Assessable profits	534,485,404
Less: Loss brought forward for set-off	2,311,870
Net assessable profits	532,173,534
Tax payable thereon	87,808,633

19. By letter dated 31 May 1996, Messrs K L Poon & Co objected on behalf of the Taxpayer against the assessment in the following terms:

‘ We do not agree with your view that the gain on disposal of properties is taxable. The property had been held by our client for a long time and the redevelopment was

intended to be held for long term purposes to generate rental income. The fact the property was subsequently disposed of does not necessarily mean that the property was for trading purposes. We should be grateful if you would revise the assessment in accordance with the Return previously submitted by our client.'

20. In a letter dated 26 August 1997, Messrs BDO McCabe Lo & Company ('the Representatives') advanced the following contentions in relation to the development of Housing Estate F.

> ' The redevelopment was carried out to build luxurious furnished apartments for letting to businessmen from the PRC and Taiwan, who very often started their business in Hong Kong by using their place of accommodation as office. This can be supported by the tremendously [*sic*] increase in demand for such kind of commercial/residential apartments since mid 80's. Our client has identified this type of property as having good potential for long term investment.
>
> The subsequent disposal of the property was only due to the change in demand of commercial/residential apartment in Western District. The original intention of the redevelopment has at all relevant times been for long term investment.'

21. In relation to the development of Housing Estate F, the Representatives claimed the following:

(a) The Taxpayer's Property set out in paragraph 6 were blocks of buildings consisting of four storeys including G/F with the exception of Properties 5 and 6 which consisted of six storeys from G/F to 5/F.

(b) A schedule of the dates on which the Taxpayer obtained vacant possession of the Taxpayer's Property was provided at appendix J of the determination (B1, page 137).

(c) The development costs were partly financed by loan facilities of $120,000,000 taken from Bank J. The loan facilities comprised of Tranche A of $30,000,000 and Tranche B of 90,000,000, which were to be repaid in full within three months after the date of the occupation permit or 30 June 1994, whichever was the earlier. A copy of the facility letter dated 2 February 1992 is at appendix K of the determination (B1, pages 138 to 142). $30,000,000 of Tranche A loan was fully drawn down and only $29,250,000 of Tranche B loan was drawn down. In January 1993, these two loans were fully repaid.

(d) The Taxpayer and the other owners intermittently acquired the land lots bound by Street H, Street G and Lane P near Housing Estate F in an attempt to unite all of them into one big piece of land for redevelopment. The first set of building plans, which was a proposed development of Properties 7, 22 and 24, was submitted to the Building Authority on 15 June 1984. New sets of building plans were submitted when the site was enlarged. A schedule of the major building plans submitted to redevelop the various land lots was provided at appendix L of the determination (B1, pages 143 to 144).

(e) The final building plans in relation to the development of two blocks of 35 storey residential buildings with car parks were submitted on 6 April 1990. Approval of the building plans was given by the Building Authority on 4 June 1990. Application was made on 11 November 1991 to the Building Authority for approval of commencement of building works on 18 November 1991.

(f) No feasibility study report for the redevelopment project was ever conducted. No evidence regarding the initial plan for service apartment is available.

(g) Most of the units of Housing Estate F were pre-sold before the issue of occupation permit. The Taxpayer commenced to receive sales deposit in December 1992.

(h) The gain on disposal of the units of Housing Estate F was apportioned to the Taxpayer in accordance with the sharing ratio agreed among the joint venture partners referred to in paragraph 12(d).

(i) The sale proceeds were used to settle construction and other relevant expenses, repay the building loan and the balance was lent to the directors and a shareholder.

22. (a) The Taxpayer submitted profits tax return for the year of assessment 1995/96 together with the accounts for the year ended 31 March 1996 and a proposed tax computation which are attached as appendices M, M1 and M2 of the determination (B1, page 145 to 164). In its profits tax return for the year of assessment 1995/96, the Taxpayer declared an adjusted loss of $209,131.

(b) In the accounts for the year ended 31 March 1996, the Taxpayer showed, among other things, an exceptional item representing the gain on disposal of

units of Housing Estate F in the amount of $1,217,352. The Taxpayer did not offer the gain for assessment.

(c) The supporting schedules to the accounts showed that the gain of $1,217,352 represented the profit on sale of the following units of Housing Estate F:

Flat 28C, Tower 1
Flat 8E, 17B, 18B, 21B to D, 21F, 33D and 34B, Tower 2
Car park number 216, 2/F

(d) The Taxpayer claimed, among other things, a deduction of rebuilding allowance of $161,918 in respect of the unsold unit of Housing Estate F at Flat 19B of Tower 2 and 80 car parks in Housing Estate F. The claimed total cost of construction of the unit and car parks was $8,095,930.

23. (a) On 10 November 1997, the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1995/96:

	$
Loss per return	209,131
Less: Property on disposal of properties	1,217,352
Assessable profits	1,008,221
Tax payable thereon	166,356

(b) By a letter dated 5 December 1997, the Representatives objected to the assessment on the ground that it was not in accordance with the return submitted and was excessive. The Representatives claimed that the disposal of properties represented the disposal of capital assets which should not be subject to profits tax.

24. In reply to the assessor' s enquiries, the Representatives further claimed the following:

(a) The claimed cost of $12,652,392 in respect of the unsold units and car parks of Housing Estate F as at 31 March 1995 referred to in paragraph 16(d) included land cost of $4,624,990.

(b) Units 28C of Tower 1, 17B, 18B, 21B, 21C, 21D, and 21F of Tower 2 and Car park number 216 referred to in paragraph 22(c) above were assigned to Mr N and Ms O, the former shareholders of Company L, in exchange for their shares in Company L pursuant to the 1991 Agreement mentioned in

paragraph 12(b). In the Taxpayer' s accounts, these units were transferred to them at cost.

(c) The profit of $1,217,352 represented the Taxpayer' s share of profit from sale to the third parties in respect of the units at 8E, 33D and 34B of Tower 2. These units were left vacant prior to sale.

25. The assessor also raised profits tax assessments for the years of assessment 1994/95 and 1995/96 on Company K and Company L to assess the gain arising from the sale of Housing Estate F and to disallow the claim for rebuilding allowance in respect of the unsold units. Both Company K and Company L objected to these assessments on the ground that Housing Estate F were their capital assets.

26. The assessor then considered that the profits tax assessments for the years of assessment 1994/95 and 1995/96 should be revised as follows:

(a) Year of assessment 1994/95

	$
Profit per return	128,959
Add: Profit on disposal of properties	534,356,445
Rebuilding allowance of Housing Estate F [paragraph 16(d)]	253,048
Assessable profits	534,738,452
Less: Loss brought forward for set-off	2,311,870
Net assessable profits	532,426,582
Tax payable thereon	87,850,386

(b) Year of assessment 1995/96

	$
Loss per return	209,131
Less: Profit on disposal of properties	1,217,352
Rebuilding allowance of Housing Estate F [paragraph 22(d)]	161,918
Assessable profits	1,170,139
Tax payable thereon	193,072

The appeal hearing

27. This appeal was heard together with Company L' s appeal (B/R 133/00).

28. The Taxpayer appealed on the ground that:

> ' The properties had been held by our client for a long time with the intention to hold it for long term and redevelopment purposes. The gain on disposal of properties of $534,356,445 and $1,217,352 in the years of assessment 1994/95 and 1995/96 respectively are capital in nature and are therefore not subject to profits tax. And further the rebuilding allowances claimed by our client in the amounts of $253,048 and $161,918 in the years of assessment 1994/95 and 1995/96 respectively should be allowed for the same reason.'

29. Mr Richard Leung, counsel for the Taxpayer, applied for leave to amend the ground of appeal by amending the last sentence to read as follows:

> ' And further the rebuilding allowances claimed by our client in the amounts of $253,048 and $161,918 in the years of assessment 1994/95 and 1995/96 respectively should be allowed for the reason that the assets in question, that is, the car parks have always been held for long term investment purposes.'

30. Mr Ambrose Ho, SC, leading counsel for the Respondent, opposed the application.

31. Having heard both counsels, we told the parties that we were proceeding *de bene esse* and would give our ruling on the application with our decision.

32. The only ' witness' called by Mr Richard Leung was Ms D.

33. At the end of Mr Richard Leung' s submissions, we asked him whether there was any reason why we should not order costs against the Taxpayer if we should dismiss the appeal. At the end of Mr Richard Leung' s submission on costs, we told the parties that we were not calling on Mr Ambrose Ho and that we would give our decision in writing.

Our decision

Relevant authorities

34. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant. Section 2 defines ' trade' as including ' *every trade and manufacture, and every adventure and concern in the nature of trade*' . Section 14(1) excludes profits arising from the sale of capital assets.

35. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to1349 and [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

36. In All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771, Mortimer J, as he then was, was reported to have said:

> *' Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.' (at page 770)*
>
> *The taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.*
>
> *I am unable to accept that submission quite in its entirety. I am, of course, bound by the decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute - was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.' (at page 771)*

Ms D as a ' witness'

37. We quote from Leomark Holdings Limited v Chik Ho Ming, HC Action No A3065 of 1997, 28 April 2000, unreported:

> *' "Witness" is a simple English word, but it is sensible to remind oneself of its meaning. According to the Concise Oxford Dictionary, a "witness" is "a person present at some event and able to give information about it"'*

38. (a) Ms D was not a director or shareholder of the Taxpayer from 1976 to 1978. She was not appointed a director until 28 December 1984 and did not become a shareholder until 18 January 1989. By 28 December 1984, the Taxpayer, Company K, and Mr A had already acquired Properties 10, 15, 22, 23 and 24.

(b) When asked what her role in the Taxpayer was in 1985, she said:

> ' I was a director at that time in an old fashioned company. Besides, my father is my father. He is also my boss. Whatever he instructed me to do I would just do it.'

(c) She was not involved in the discussions between Mr A and Mr N. She was not appointed a director of Company L until 4 July 1991.

39. Further and in any event, she did not impress us as a credible witness and we reject her testimony.

The ' properties' in redevelopment cases

40. In cases such as this one where the stated intention is redevelopment for rental income, one should avoid indiscriminate or loose use of the word ' properties' .

41. The ' properties' first acquired chronologically might be a unit or units and/or a block of building or blocks of buildings and/or a piece or pieces of vacant land. In the course of time, more ' properties' comprising of units and/or more blocks and/or more pieces of vacant land would be acquired.

42. Old buildings which formed part of the ' properties' acquired would have been demolished in redevelopment cases.

43. New building(s) would have been constructed.

44. The ' properties' sold would have comprised of shares of and in the land and of and in the new building(s) and the exclusive right to occupy defined units of the new building(s).

45. If a person had in fact formed an intention to redevelop, he should be able to say when the intention was formed, identify the boundary of the land for the intended redevelopment, and describe the intended redevelopment and the intended new building(s).

What we have <u>not</u> been told about the ' stated intention'

46. The intention contended in the ground of appeal is that:

> ' The properties had been held by our client for a long time with the intention to hold it for long term and redevelopment purposes.'

47. We have not been told when the intention was said to have been formed.

48. We have not been told about the boundary of the land for the intended redevelopment.

49. We have not been told about the intended redevelopment or intended new building(s).

50. The acquisitions started with the acquisition of Property 15 on 30 September 1976. Mr Richard Leung submitted that the relevant time for considering the ' stated intention' was from 1976 to 1978. By the end of September 1976, the Taxpayer had acquired Property 15, but that was all the Taxpayer had. By 25 January 1978, the Taxpayer and Company K had acquired Properties 10, 15 and 22, but those were all they had. These three sites were **not** adjoining.

51. We have not been told about what was thought at the time when the ' stated intention' was said to have been formed to be the prospects of acquiring all the floors of all the blocks in the intended redevelopment. An owner of a floor might refuse or decline to sell or might demand a price which the Taxpayer was unwilling to pay. There might even be one or more rival bidder(s). As it happened, Mr N and Mr A agreed to co-operate. That is not the point. The relevant time is when the ' stated intention' was said to have been formed.

52. What if the Taxpayer should fail in acquiring any further floor at all? What if the Taxpayer should fail in acquiring all the floors in one block of old building? The Taxpayer would then be left with such block or blocks acquired at the time when the ' stated intention' was said to have been formed. Would it have been viable for the Taxpayer to redevelop these block(s) alone?

53. What if the Taxpayer should succeed in acquiring only some of the floors in some of the blocks in the intended redevelopment? What if the Taxpayer should succeed in acquiring only some of the blocks with or without some floors in the remaining blocks? Would it have been viable for the Taxpayer to redevelop only such of the blocks as the Taxpayer would have acquired?

54. We do not know the answers to these questions as we have not been told about whether there was any contingent plan, and if so what it was.

55. We have not been told about what was thought to be the costs of the redevelopment at the time when the ' stated intention' was said to have been formed. We do not know what the Taxpayer thought would be the purchase cost, legal fees, stamp duty, compensation to be paid to tenants, bank interests, construction costs, etc.

56. We have not been told how long the Taxpayer thought the redevelopment would take to complete all acquisitions, demolish old buildings, and complete the intended redevelopment.

57. It is one thing to claim that no written feasibility study was necessary or desired. It is another to tell us nothing whatsoever about the area of any proposed new building, nothing about the anticipated unit rental rate, nothing about the anticipated occupancy or vacancy rate, nothing about the costs of servicing the apartments, nothing about the costs of servicing the interest element of any long term loan, and nothing about repaying the principal of any long term loan. In short, there is simply no evidence on whether, and if so, how the intended redevelopment was thought to be a viable investment.

58. The Taxpayer relied on Mr A to finance the acquisition and holding of the redevelopment on a long term basis. There is no evidence of his financial ability to fund and keep the redevelopment on a long term basis. No bank statement had been put in. No statement of Mr A' s worth at any time during the acquisitions had been put before us.

59. Thus, the Taxpayer has not proved any of the following:

(a) what its intention was at the time of the acquisition of Property 15 in September 1976;

(b) what its intention was from September 1976 to January 1978;

(c) that at the time of the acquisition in September 1976, the intention of the Taxpayer was to hold, on a long term basis, the land and the proposed new building(s) on a long term basis;

(d) that at the time of the acquisitions from September 1976 to January 1978, the intention of the Taxpayer was to hold, on a long term basis, the land and the proposed new building(s) on a long term basis;

(e) that at the time of any further acquisition after January 1978, the intention of the Taxpayer was to hold, on a long term basis, the land and the proposed new building(s) on a long term basis;

(f) its ability, with or without Mr A and Company K, to acquire all the blocks in the intended redevelopment or at least a sufficient number of adjoining blocks;

(g) its financial ability, with or without Mr A and Company K, to pay for the construction costs of the intended redevelopment;

(h) its financial ability, with or without Mr A and Company K, to keep the proposed new building(s) on a long term basis.

60. The Taxpayer has not proved that the ' stated intention' was in fact held, let alone genuinely held, realistic or realisable.

61. This appeal is bound to fail and fails.

Company L

62. Mr Richard Leung submitted that the relevant time for considering Company L' s intention was 5 January 1989 and that for this purpose we should consider the intention of Mr N.

63. Mr Richard Leung relied on the JV Agreement. For reasons given below, the JV Agreement does not assist the Taxpayer or Company L.

64. There is no evidence of Mr N' s intention and Company L' s appeal is doomed to failure.

Contemporaneous documents

65. Further and in any event, Mr Richard Leung was unable to draw our attention to any contemporaneous document which supported the case of capital assets.

66. On the contrary, the following contemporaneous documents evidenced an intention to trade.

67. The 1985 Agreement is an agreement in Chinese dated 19 November 1985 made between Company K as ' Party B' and Mr N as ' Party A' .

(a) Clause 5 provided that ' should Party A fail to pay the redevelopment cost in future, Party B shall help advance such payment on behalf of Party A. Certain number of units allotted to Party A may be sold for reimbursing Party B' . It is clear from this clause that Company K looked to the sale of Mr N' s units to reimburse advances on redevelopment cost. What it did not do was to

provide that Mr N should assign certain number of units to Company K to reimburse Company K.

(b) Clause 7 provided that ' in proceeding with the joint venture, in the event where there is genuine purchaser offering to purchase the site (including Property 25) with reasonable price, should both parties agree to accept offer and to dispose of the lot, the sale proceeds shall be split in proportion to each Party' s share of land contribution in terms of square feet.' There would have been no reason for this clause to have found its way into a one page document if the intention of both Mr A and Mr N were to redevelop for long term holding. The offer price need only be ' reasonable' .

68. The JV Agreement is an agreement in English dated 5 January 1989 made by the Taxpayer, Company K, Mr A and Company L.

(a) Clause 7.01 provided that ' the development cost shall be contributed, borne and paid by the Parties in accordance with the agreed ratio' . Clause 7.02 provided that ' if a Party shall fail to fund his share of the development cost as and when due, any Party not at fault may (but is not obliged to) fund such sum of money for and on behalf of the defaulting Party but without prejudice to any other rights which a Party not at fault may have in law and/or under this JV Agreement' . Clause 7.03 provided that ' notwithstanding anything to the contrary contained in clause 7.02 above, Company K shall, at the written request of Company L, fund for Company L its share of the development cost, if Company L shall prove to be unable financially to contribute the same as and when due' . Clause 7.04 provided that ' any amount paid or funded for the defaulting Party under clause 7.02 above or (as the case may be) for Company L under clause 7.03 above shall be treated as loan to the defaulting Party or (as the case may be) Company L and ... shall be repaid by the defaulting Party or (as the case may be) Company L to the advancing Party within 14 days after the sale of any of the unit to which the defaulting Party or (as the case may be) Company L is entitled under this JV Agreement or within one year from the date of the completion of the new building (whichever shall be the earlier)' . The contractual scheme was to provide for loans to Company L and for those loans to be repaid by sale of Company L' s units in the new building.

(b) Clause 8.01 provided that ' unless otherwise determined by the Parties, as soon as practicable but in any event not later than one month after the commencement of the building works of the new building: (a) the Parties shall consult with each other and agree on the then market selling price of each and every unit of and in the new building ... (b) Company L shall entitle to such

number of units of such value bears to the value of the whole new building equivalent to Company L share of the agreed ratio; (c) subject to the adjustment as provided in clause 8.01(d) below, Company L has elected to have the following units, namely, units A and B on the 17th, 18th and 19th floors, unit C on the 20th floor and unit C on the 28th floor (making a total of eight units) and one car parking space ...' . The provision on agreeing the market selling price of each and every unit evidenced the parties' intention to sell. Any support which clause 8.01(c) might give to Company L' s case of capital assets is removed by clauses 7 and 9.03.

(c) Clause 9.01 provided that ' any Party may [be] at liberty at any time prior to the issuance of the occupation permit in respect of the new building [to] sell the unit to which he is entitled under clause 8 ...' . Clause 9.03 provided that ' notwithstanding anything to the contrary contained in this JV Agreement, the Parties shall forthwith sell the building site together with any building erected or to be erected thereon and do such acts and deeds as may be necessary to complete such sale, if and when an offer for the purchase of the building site together with the building erected or to be erected thereon is received by a Party, and if, in the reasonable opinion of [the Taxpayer] whose decision in this respect shall be final and conclusive and binding on the Parties, the offered price represents the then fair market value thereof. The proceeds of such sale, after deducting any expenses therefor, shall be distributed and paid to the Parties in the agreed ratio' . Clause 9 clearly evidenced trading intention on the part of all parties to the JV Agreement. The offer price need only represent ' the then fair market value' and did not have to be one which the parties could not refuse, and the decision making party on this point was the Taxpayer, not Company L.

69. The audited accounts of the Taxpayer for the year ended 31 March 1989 was signed by, inter alia, Ms D. Note (1)(B) to the accounts stated that:

> **' The above house properties, that is, all the properties referred to in paragraph 6 above, except Property 18, G/F, would be sold as trading stock after redevelopment.'**

70. The 1991 Agreement is an agreement in Chinese dated 4 July 1991 made by the Taxpayer, Company K and Mr A as ' Party A' and Mr N and Ms O as ' Party B' . One effect of this Agreement was that Mr A replaced Mr N as the controlling shareholder of Company L.

71. The facilities letter dated 8 January 1991 was from Bank J to the Taxpayer and countersigned by the Taxpayer and Mr A. Tranche A in the sum of $90,000,000 of the $100,000,000 facility was to finance the development and Tranche B of $10,000,000 was to

finance ' payment of interest for Tranche A Loan and Tranche B Loan' . No intelligible explanation had been offered for obtaining a $10,000,000 facility to finance payment of interest when Mr A was said to have the means to fund the whole redevelopment from his own resources. Clause 6 of this facility letter provided that the entire loan was to be repaid in full within three months from issue of the occupation permit of the new building or 30 June 1993 whichever was earlier. This evidenced that Bank J and the Taxpayer looked to the sale proceeds of units in the new building to repay Bank J loans.

72. The facilities letter dated 3 February 1992 was from Bank J to the Taxpayer, Company K, Mr A and Company L. Clause 6 provided that the loans totalling not more than $120,000,000 was to be repaid in full within three months from issue of the occupation permit of the new building or 30 June 1994 whichever was earlier. This evidenced that Bank J and the borrowers looked to sale proceeds of units in the new building to repay Bank J loans.

Application to amend ground of appeal

73. The original ground focused on intention. The proposed amendment had nothing to do with intention but relied on the fact of holding. We accept the contention of Mr Ambrose Ho that this was not a valid ground for claiming rebuilding allowance.

74. Mr Richard Leung did not refer to sections 36 or 40 or any other provision in the IRO and did not explain how the proposed amended ground is a valid ground for claiming rebuilding allowance.

75. If Mr Richard Leung was really contending that the ' intention' was to hold the car parks for long term investment purposes, then as Rogers J (as he then was) said in Re ICS Computer Distribution Limited [1996] 3 HKC 440 at page 449A, ' this seems to be an attempt to raise an argument without the fundamental evidence to support it' . There is no allegation and no evidence of what the intention in relation to the car parks was said to be.

76. Further and in any event, the assets in question also comprised Flat 19B Tower 2.

77. The relevant years of assessments are 1994/95 and 1995/96. The occupation permit to occupy Housing Estate F was issued on 3 December 1993 and the letter of compliance was issued on 8 March 1994. The allegation that the car parks ' have always been held ...' is hardly apposite.

78. The proposed amended ground fails and does not take the Taxpayer' s case any further. Allowing the ground of appeal to be thus amended is an exercise in futility, and in the exercise of our discretion, we disallow the proposed amendment.

Disposition

79. The Taxpayer has not begun to discharge the onus under section 68(4) of the IRO of proving that any of the assessments appealed against is excessive or incorrect and we confirm the assessments as increased by the Commissioner.

Costs

80. We consider that this appeal and the appeal of Company L are frivolous and vexatious.

81. Pursuant to section 68(9) of the IRO, we order the Taxpayer to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.