

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D30/02

Profits tax – property – whether trading asset.

Panel: Anna Chow Suk Han (chairman), Robin M Bridge and Berry Hsu Fong Chung.

Date of hearing: 25 April 2001.

Date of decision: 18 July 2002.

The taxpayer company bought an industrial building ('the Building') in April 1992 and resold it in November 1993. It made substantial profit.

The taxpayer company contended that the Building was originally bought as an alternative warehouse for its connected company, Company G, which intended to redevelop its own warehouse. Afterwards, Company G found the Building unsuitable for its use. As a result, the Building was sold. Thus, the Building was not a trading asset and the taxpayer company was not liable for profits tax.

Held:

1. The Board did not believe that the Building was originally bought as the alternative warehouse for Company G. The documents produced by the taxpayer company did not support such intended redevelopment.
2. Furthermore, the Board did not believe that the Building was bought without any investigation whether it was suitable for the use of Company G beforehand.

Appeal dismissed.

Cases referred to:

Simmons v IRC [1980] 1196
All Best Wishes Limited v CIR 3 HKTC 750

Lee Yun Hung for the Commissioner of Inland Revenue.
Denis Gordon Yu Counsel instructed by Messrs Philip S W Chan & Co for the taxpayer.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Decision:

The appeal

1. This is an appeal by Company A ('the Company') against the determination of the Commissioner of Inland Revenue dated 27 September 1999 wherein the profits tax assessment on the Company for the year of assessment 1994/95 under charge number 1-5038009-95-4 dated 30 May 1997, showing net assessable profit of \$43,340,009 (after set-off of loss brought forward of \$400,543) with tax payable thereon of \$7,151,101 was confirmed. The Company has objected to the profits tax assessment raised on it. It claims that the profit derived by it from the sale of the building located at Address B ('the Building') is capital in nature and should not be assessable to tax.

Facts upon which the determination of the Commissioner was arrived at

2. The Company was incorporated as a private company in Hong Kong on 11 February 1992. In its profits tax return for the year of assessment 1994/95, the Company described the nature of its business as 'Investment in properties for rental income'.

3. At all relevant times, the Company's authorized and paid-up capital was \$10,000. Particulars of the shareholders of the Company were as follows:

Name of shareholder	Percentage of shareholding
	%
Company C	35
Company D	25
Company E	25
Company F	15

Companies D, E and F are shareholders of Company G. Company C is a wholly-owned subsidiary of Company G.

4. (a) By an agreement for sale and purchase dated 15 April 1992, the Company agreed to purchase the Building at a consideration of \$60,000,000. The Building is a 14-storey industrial building completed in 1973.
- (b) Clause 32 of the agreement provides that vacant possession of the Building on an 'as is' basis shall be given to the Company on completion.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) The fourth schedule to the agreement states that the date of completion is 31 December 1992 provided that the vendor shall be entitled to demand early completion by giving one month's prior notice to the purchaser and provided further that such notice shall not be served prior to 1 October 1992.
- (d) The Building was subsequently assigned to the Company on 6 November 1992.

5. By a letter dated 26 May 1992 from Bank H to the Company, Bank H agreed to grant to the Company a fixed interest rate loan of \$30,000,000 to finance the purchase of the Building. The letter contains certain terms which include, inter alia, the following:

- (a) Term : Five years from initial drawdown.
- (b) Availability : The loan will be drawn down on 2 November /Drawdown 1992 in full.
- (c) Repayment : To be fully repaid on a 'Straight Line' basis by 20 quarterly instalments. The first payment shall be made on 2 February 1993. Subsequent periodic instalments will be made on each day falling at three month interval thereafter.
- (d) Security
 - 1. : An 'all monies' legal charge together with an assignment of rental income over the Building with the Company as the mortgagor.
 - 2. : A corporate guarantee from Company G for \$10,500,000.
 - 3. : A corporate guarantee from Company E for \$7,500,000.
 - 4. : A corporate guarantee from Company F for \$4,500,000.
 - 5. : A corporate guarantee from Company D for \$7,500,000.

INLAND REVENUE BOARD OF REVIEW DECISIONS

On 6 November 1992, the assignment of rental income over the Building was entered into between the Company and Bank H. On 31 January 1994, the assignment of rental income was released.

6. The purchase consideration of the Building was financed in the following ways:
- (a) The loan of \$30,000,000 from Bank H was drawn down on 2 November 1992. The loan carried a fixed interest rate of 8.7% and was repayable by 20 quarterly instalments with principal repayment of \$1,500,000 per quarter on top of interest.
 - (b) The advance from the shareholders of the Company is as follows:

	\$
Company C	11,900,000
Company E	8,500,000
Company F	5,100,000
Company D	8,500,000

The advance from the shareholders was interest-free without specific repayment terms and classified as 'Current Liabilities' in the Company's balance sheets.

7. (a) By a provisional agreement for sale and purchase dated 20 November 1993, the Company agreed to sell to Company I the Building at a consideration of \$109,000,000. The sale was completed on 31 January 1994 when the Company assigned the Building to Company I.
- (b) The provisional agreement for sale and purchase provides, inter alia, that:
- (i) Upon completion, the Company shall deliver vacant possession of the G/F (except car parking space rented out as mentioned in (ii) below), 1/F, 2/F, 3/F, 4/F, 5/F, 6/F, 11/F, 13/F and the roof of the Building to Company I and the Company shall cause the existing tenancies (if any) of those floors to be cancelled and the existing tenants or occupier (if any) to vacate from these floors on or before completion.
 - (ii) The sale of the 7/F, 8/F, 9/F, 10/F and 12/F shall be subject to the following existing tenancies:

Floor	Lease terms	Monthly rent
		\$
Carpark No.1, G/F	Monthly	1,600

INLAND REVENUE BOARD OF REVIEW DECISIONS

Carpark No.2, G/F	Monthly	1,600
Carpark No.3, G/F	Monthly	1,600
Carpark No.4, G/F	Monthly	1,600
7/F	1-1-1994 to 31-12-1996	57,200 (1-1-1994 to 31-12-1995) 62,900 (1-1-1996 to 31-12-1996)
8/F	1-6-1993 to 31-5-1996	59,000 (1-6-1993 to 31-5-1995) 64,900 (1-6-1995 to 31-5-1996)
9/F (unit A)**	1-12-1993 to 30-11-1995	28,000
9/F (unit B)*	1-6-1993 to 31-5-1996	15,500 (1-6-1993 to 30-11-1993) 31,000 (1-12-1993 to 31-5-1995) 34,000 (1-6-1995 to 31-5-1996)
10/F***	1-12-1993 to 30-11-1996	57,200 (1-12-1993 to 30-11-1995) 63,000 (1-12-1995 to 30-11-1996)
12/F (unit A)	1-4-1993 to 31-3-1995	15,000
12/F (units B and C)*	1-8-1993 to 31-7-1996	24,750
12/F (unit D)*	1-8-1993 to 31-7-1996	17,050

Notes

- * With option to renew for two years
- ** Deposits received and execution of lease agreement in process
- *** Deposits received and execution of lease agreement in process and with option to renew for one year

8. The Company's financial statements for the years of assessment 1992/93 and 1993/94 showed the following particulars:

1992/93	1993/94
\$	\$

INLAND REVENUE BOARD OF REVIEW DECISIONS

Rental income	150,000	3,467,066
Building and management fee received	-	537,932
Sundry income	-	1,250
Bank interest received	<u>28,823</u>	<u>47,887</u>
	<u>178,823</u>	<u>4,054,135</u>
<u>Less:</u>		
Repairs and maintenance	1,290,842	1,926,600
Bank interest	429,045	2,328,263
Other expenses	<u>216,701</u>	<u>1,388,118</u>
	<u>1,936,588</u>	<u>5,642,981</u>
Loss	<u>1,757,765</u>	<u>1,588,846</u>

The Company did not claim deduction in respect of repairs and maintenance expenses amounting to \$1,255,480 and \$1,704,928 for the years of assessment 1992/93 and 1993/94 respectively.

9.
 - (a) On 30 May 1995, the Company submitted its profits tax return for the year of assessment 1994/95 together with the accounts for the year ended 31 December 1994 and a proposed tax computation.
 - (b) In the Company's account for the year ended 31 December 1994, the profit on sale of the Building amounting to \$46,516,259 was classified as an 'exceptional item'.
 - (c) The Company did not offer the profit on sale of the Building for assessment in its proposed tax computation.

10. In correspondence with the assessor, the Company, through Accountants' Firm J ('the Representatives'), provided the following arguments in relation to the purchase and sale of the Building:
 - (a) 'At early 1992, there was a good demand for workshop/warehouse and therefore our clients decided to purchase an industrial premises. Our clients acquired [the Building] with the only view to hold it as their fixed and investment asset for production of rental income.'
 - (b) The long period of completion of the purchase of the Building was agreed by both the Company and the vendor. When the agreement for sale and purchase was signed in April 1992, the Building was used by the vendor for the storage of their electronic goods. As the vendor's new godown was not yet ready, the vendor needed months before they could remove their goods to their new

INLAND REVENUE BOARD OF REVIEW DECISIONS

godown. Under the circumstance, both parties agreed that the final completion date was to be 31 December 1992.

- (c) 'After acquisition, our clients did carry out substantial renovation and improvement work in 1992 and 1993 to cause [the Building] to be suitable for leasing.'
- (d) 'The renovation work was started on 3 November 1992 immediately after completion of the purchase and ended on 15 February 1993.'
- (e) There were no activities to let out or sell the Building before the date of completion. After that, the Company put up advertisements in newspaper and sent leasing brochures to various property agents and prospective tenants for leasing the Building. The first lot of leasing brochures was sent out in December 1992.
- (f) 'The primary source of fund to repay quarterly loan instalments was from rental received from [the Building] and the shareholders were required to contribute for the balance in case of shortfalls.'
- (g) 'All the shareholders are companies within or related to [Company G] and are financially strong enough to lend the money to [the Company].'
- (h) 'Even our clients had tried every effort in leasing out [the Building], there was 50% vacancy in most of the time. ... In middle 1993, our clients were approached by a solicitor, [Mr K] of [Solicitors' Firm L] to offer on behalf of his clients to purchase [the Building] with the existing tenants, as the existing tenants condition at that time with 50% vacancy was suitable for the need of the intending buyers, who intended to occupy half of the property as their own warehouse and to lease the other half for rental income. As our clients experienced difficulties in leasing out the 50% vacant premises, they did wish to change their investment object from an industrial premises to office or residential premises and as offer did come to them after thorough thoughts by the directors, our clients decided to dispose of it.'
- (i) 'In February 1994, our clients decided to reinvest in a residential/office/retails composite development project at [Street M]. The total project cost would be about \$100 millions and our clients' share was 15% and they had to invest therein approx. \$15 millions. In April 1995, our clients acquired the office premises known as Offices 01, 02, 03, 05, 06, 07 (and the air-conditioning plant room appurtenant thereto) and 08 and 10th floor of [a plaza] at [Address N] at consideration of \$30,880,000.00.'

INLAND REVENUE BOARD OF REVIEW DECISIONS

11. In support of their claim that the Building was acquired for rental income, the Representatives submitted the following documents:

- (a) The projection for rental from the Building prepared by the Company and an undated advertisement showing leasing and selling particulars of factory premises.
- (b) A copy of the minutes of directors' meeting allegedly held on 4 November 1992 authorizing the acquisition of the Building.

12. In response to the assessor's enquiries, Company I provided the following information and documents:

- (a) 'We first got to know that [the Building] was offered for sale through the introduction of estate agent, [Agent O]. We enclose copies of the relevant properties information provided by the said agent for your reference. We did view [the Building] through the arrangement of the said agent in about February/early March 1993.'
- (b) 'After viewing [the Building] through the introduction of the said agent, we found it fit for our purpose. We requested [Mr K] [of Solicitors' Firm L], a good friend of our family liaise with the Owner to ascertain their bottom price and make offer for purchase of [the Building].'
- (c) Copies of correspondence in exchange between Company C and Solicitors' Firm L during the period from 18 March 1993 to 11 November 1993.

13. The assessor considered that the Building was the Company's trading stock *ab initio* and thus it should not be entitled to rebuilding allowance in respect of the Building. The assessor also considered that repair and maintenance expenses incurred on the Building were allowable deductions. Accordingly, the assessor issued to the Company a profits tax assessment for the year of assessment 1994/95 together with revised loss computations withdrawing rebuilding allowances with net assessable profits of \$43,340,009, with tax payable thereon of \$7,151,101.

14. By a letter dated 24 June 1997, the Representatives, on behalf of the Company, objected to the profits tax assessment for the year of assessment 1994/95 on the ground that profit on sale of the Building was derived from sale of the Company's own investment asset and was of capital nature. In support of their objection, the Representatives put forward the following arguments and contentions:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (a) 'Our clients confirm that in March 1993, they did receive a verbal offer from [Solicitors' Firm L] on behalf of an interested buyer to purchase [the Building] at \$70 millions and then the verbal offer was put into writing in the same month. Our clients did authorize [Company C], the management company, to discourage the offer. Due to the good and friendly relationship, [Company G] with [Solicitors' Firm L], [Company C] did not have directly said "no" to the solicitors, instead they counter offered a very high price of \$98 millions which was far exceeding the market price at that time to discourage the offer. [Company C] was authorized to make counter offers at a even much higher price to discourage any further offers from the solicitors. The counter offer by [Company C] at a price far exceeding the market price was, in fact, not an intention to sale of [the Building] but a more modest way to reject the offer from the friendly solicitors and to curb any further offers.'
- (b) 'We did forget to inform you that one of the most vital factors to acquire [the Building] was to provide storage space for [Company G] which needed godowns badly for storage of their merchandise during 1992 and 1993. In fact, once the vacant possession of [the Building] was delivered to our clients, [Company G] did take over the 1st to 3rd floors as their godown and did enter a lease agreement with our clients for 3 years with an option to renew for another 2 years ... our clients acquired [the Building] mainly for the storage requirement of [Company G] and secondly for leasing to others for rental income.'

15. The assessor has issued a statement of facts for the Representatives' comments. In reply, the Representatives stated:

- (a) The information provided by Company I in response to the assessor's enquiries (as set out in paragraph 12 above) was misleading and the Company denied it to be true.
- (b) 'The Company had never appointed [Agent O] as their estate agents to sell the Building and had given no authorization to [Agent O] to issue any pamphlets or information papers for sale of the Building.'
- (c) 'The alleged view to the Building by [Company I] through the arrangement of [Agent O] in about February/early March 1993 was not authorized by the Company and in fact, no directors of the Company had the knowledge of [Company I's] and [Agent O's] visit in those 2 months. However, should there was such a visit, the visit was considered by the Company as visit for the purpose of leasing part of the Building.'

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) 'Even though the Building was finally sold to [Company I], the sale was not the result of the offer from [Solicitors' Firm L] in March 1993. Due to the Company's tactful rejection as described in [paragraph 14 above], the offer in March and the subsequent offers by [Solicitors' Firm L] did have been withdrawn by [Solicitors' Firm L] in August 1993 by their letter dated 6 August 1993 to the Company. Sale of the Building was a result of the fresh offer in October 1993 by [Agent O], at the time, the Company decided to sell the Building...'
- (e) 'Ever since the Company signed the agreement to purchase the Building in April 1992, [Agent O] did approach the Company from time to time even before completion of the purchase to request the Company to sell the Building but the Company did have never responded [*sic*] [Agent O's] requests and have never authorized to do the sale.'
- (f) 'When the Company finally disposed of the Building in November 1993 the Company paid [Agent O] a sale commission of \$200,000 only. Had the Company officially authorize [Agent O] to sell the Building on their behalf, the commission demanded by [Agent O] would be about 1% of the selling price i.e. \$100 millions.'
- (g) 'The Company decided to sell the Building also due to the fact that [Company G] ... had no intention to renew the tenancy agreement upon expiration. A fax letter dated 5 August 1998 from [Company G] [to the Representatives] is attached hereto...'
- (h) Copies of correspondence regarding the early termination of the lease agreement entered with Company G in respect of 1/F to 3/F of the Building could not be provided as they had been mislaid.

Reasons for the determination

16. Notwithstanding the reply of the Representatives, the Commissioner confirmed the assessment and gave her reasons for the determination as follows:

- (a) In March 1993 when the Company received a purchase offer of \$70,000,000 from Solicitors' Firm L, the Company made a counter-offer of \$98,000,000. Further, the Company stated clearly in the letter dated 7 April 1993 from Company C to Agent O that it had definite interest to dispose of the Building at a satisfactory price level. The Commissioner took the view that all these indicated that shortly after the Building was assigned to it, the Company was

INLAND REVENUE BOARD OF REVIEW DECISIONS

willing and ready to sell the Building provided that the offer made to it was attractive.

- (b) The Company's argument that the making of the counter-offer was to discourage Solicitors' Firm L's offer was not accepted. The facts were that the Company continued to bargain with Solicitors' Firm L and that it rejected Solicitors' Firm L's final offer of \$108,000,000 because the price Solicitors' Firm L offered was below the amount it asked for. These showed that the Company was only concerned with the price and it would have agreed to sell the Building if its asking price was accepted by Solicitors' Firm L.
- (c) The fact that the Company had made efforts to find tenants for the Building and parts of the Building were rented out for rental income was not conclusive that the asset was a capital investment. Property intended to be held as trading stock might be let out in the interim pending an opportune time for sale. It was considered that the Company was in fact taking a flexible approach towards the Building and was just waiting for an opportune time to sell it at the best price.
- (d) Despite the Company's claim that one of the vital factors to acquire the Building was to provide storage space for Company G, the Company had early terminated the three years' lease in respect of 1/F to 3/F of the Building it entered into with Company G on 30 November 1993. The Company produced Company G's fax letter dated 5 August 1998 so as to try to explain away the early termination of the lease. It was found that the reasons set out in Company G's fax letter not convincing. First, Company G's fax letter was not a contemporaneous document. Secondly, the Company had failed to provide the correspondence regarding the early termination of the lease. Thirdly, it was clearly stipulated in the provisional agreement for sale and purchase dated 20 November 1993 that the Company had to deliver vacant possession of those floors to Company I upon completion of the purchase of the Building.
- (e) The reason for sale of the Building suggested by the Company was not convincing. Regarding the unsatisfactory occupancy rate, it was noted that the Company was able to get new tenants and that there was a steady increase in the occupancy rate of the Building. Further, the provisional agreement for sale and purchase of 20 November 1993 showed that at the time of the sale of the Building, the execution of the lease agreements in respect of 9/F (unit A) and 10/F were in progress and the Company had already received rental deposits from the tenants. That the Building was sold because of the unsatisfactory occupancy rate did not seem justified.

INLAND REVENUE BOARD OF REVIEW DECISIONS

17. Furthermore, the Commissioner did not accept the Company's argument that the Building was its capital asset because part of the sale proceeds was used to finance the purchase of other investment. The Commissioner was not satisfied that the Building was the Company's capital asset. She took the view that in buying and selling the Building, the Company had embarked on a trade or an adventure in the nature of trade and that the application of sale proceeds of a trading property for long-term investment purpose could not alter its nature from trading stock to capital asset.

The grounds of appeal

18. The Company's grounds of appeal as provided by the Representatives on 25 October 1999 may be summarized as below.

19. The intention of acquiring the Building for rental purpose was proved by the facts that (1) there was a projection of rent in respect of the Building based on which the Building was acquired and (2) the placing of advertisements for lettings and the preparation and sending out of leasing brochures to estate agents and potential tenants.

20. The Company decided to sell the Building in November 1993 when it was disappointed with the poor leasing condition and the trend of factory operations being moved from Hong Kong to Mainland China.

21. The Commissioner had wrongly concluded that the letting of the Building was an interim measure taken by the Company pending sale of the Building at an opportune moment. The Company took no steps to sell the Building. On 23 March 1993, the Company received from Solicitors' Firm L a purchase offer of \$70,000,000 and on 24 March 1993, the Company made a discouraging counter-offer of \$98,000,000. The counter-offer of \$98,000,000 by the Company was meant to discourage further offers.

22. One of the main reasons for the Company to acquire the Building was to provide storage space for Company G. Company G incurred renovation and improvement costs so that the three floors rented from the Company could be used for storage of its stocks. Company G agreed to early determination of its tenancy agreement with the Company since it experienced difficulties in the transfers of goods within the Building and also traffic congestion in the neighbouring area of the Building.

23. The Commissioner had wrongly relied on the letter of 7 April 1993 (the letter by Mr P on behalf of Company C) which was unauthorized by the Company to reach the conclusion that the Company had a definite desire to sell the Building.

24. The occupancy rate of the Building was unsatisfactory. Between 1 January 1993 and 31 December 1993 the vacancy rate was up to nearly 50%.

INLAND REVENUE BOARD OF REVIEW DECISIONS

25. The Building was acquired for rental income and provision of storage space for Company G. The Building was sold because of the early termination of the tenancy by Company G and also because half of the units were being unlet. The Company had to sell the Building to recoup funds for re-investment in better rental production assets.

The Company's case

26. The Company's case was outlined by its counsel in his opening address at the hearing as below.

27. The Company was formed for the specific purpose of acquiring the Building. All its shareholders were connected through Company G.

28. Company G needed warehouse premises in place of its then warehouse in District Q.

29. The Building was acquired for long term investment, with part of it for use by Company G.

30. The name of the Building was changed to '[Centre C]'.

31. The Company seriously considered selling the Building for the first time in November 1993 because the price offered, \$109,000,000, was too attractive.

32. The Company did not see and was unaware of the correspondence containing or relating to some of the offers at the time they were received or written. In particular:

(a) The letters dated

- (i) 23 March 1993 sent by Solicitors' Firm L to the Company offering \$70,000,000;
- (ii) 24 March 1993 written by Mr P, in the name of Company C, to Solicitors' Firm L counter-offering \$98,000,000;
- (iii) 13 May 1993 sent by Solicitors' Firm L to Company C offering \$75,000,000; and
- (iv) 23 June 1993 sent by Agent O to Company C offering \$91,000,000.

These letters the Company became aware of for the first time after the senior assessor of the Inland Revenue Department had raised queries over the profits

INLAND REVENUE BOARD OF REVIEW DECISIONS

tax return filed by the Company, that is, after October 1995. They were in a file kept by Mr P.

- (b) The letter dated 7 April 1993 written by Mr P, in the name of Company C, to Agent O saying that an offer of \$85,000,000 had been received from another party – this letter the Company became aware of for the first time when a copy of the Commissioner’s determination dated 27 September 1999 was received, with that letter appearing as appendix M to it. By then, Mr P had already left Company C’s employment.

33. The Company never at any time instructed or authorized Company C or Mr P to place the Building on the market for sale or to inform any estate agent that the Building was for sale. And it never itself solicited any offers to purchase. The leasing brochure was the only one printed for the Building. There was no ‘sale’ brochure.

The evidence

34. For the purpose of the hearing of this appeal, the Company produced eight bundles of documents. They are:

- (a) Bundle 1 – Bundle of Correspondences between [the Representatives] and the Assessor.
- (b) Bundle 2 – Bundle of Correspondences between the Assessor and outside parties.
- (c) Bundle 3 – Bundle of [Company C] Documents.
- (d) Bundle 4 – Bundle of [the Company] Documents.
- (e) Bundle 5 – Bundle of Documents relating to ICAC Investigation of [Mr P].
- (f) Bundle 6 – Bundle of Correspondences Relating to Offers to Purchase Building from [the Company].
- (g) Bundle 7 – Bundle of Chronology of Events and Witnesses’ Statements.
- (h) Bundle 8 – Auditors’ Accounts of [Company E], [Company D] and [Company F] for the financial years of 1992, 1993 and 1994.

35. At the hearing, the Company called its directors, Mr R and Mr S, to give evidence on its behalf.

INLAND REVENUE BOARD OF REVIEW DECISIONS

36. Mr R gave evidence first. He confirmed the contents of his statement which was admitted as evidence in chief. He was then cross-examined by Mr Lee for the Revenue.

37. His evidence may be summarized as follows.

(a) In chief

- (i) He was a director of the Company and also the chairman of Company G. All the shareholders of the Company were connected through Company G.
- (ii) The Company's purchase and subsequent sale of the Building was closely related to Company G's need for warehouse premises at the time.
- (iii) Company G had owned and operated a warehouse at District Q since 1967. In the early nineties, the warehouse had reached its full capacity and at that time Company G also considered the possibility of redeveloping the warehouse into a residential building after alternative warehouse facilities had been located. Mr S, a director of Company G and an architect in practice, was commissioned to look into the feasibility of the redevelopment in District Q. The idea came to nothing because it was difficult to obtain Government's consent to change of user.
- (iv) In 1992, Agent T, an estate agent, approached them through Mr S with an offer for sale of the Building which at the time was owned by Company U. Company U was using the Building for storage of its products and its product lines were similar to theirs, being electrical appliances. They thought the Building was suitable for their use and District V would be a good location being not far from District Q.
- (v) It had been the policy of Company G to purchase properties for its own use and for long-term rental investment. There was a consensus among the shareholders of Company G to acquire the Building and the Company was incorporated in February 1992 for the purpose.
- (vi) Company G intended to utilize part of the Building as its warehouse and was minded to use up to five floors for storage and took up three floors to begin with.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (vii) To finance the purchase, the Company obtained a five-year fixed term loan of \$30,000,000 from Bank H and the balance by loans from the shareholders. The loan was secured by a rent assignment to Bank H.
- (viii) Company G entered into a tenancy agreement with the Company, leasing 1/F, 2/F and 3/F with an intention to rent 4/F and 5/F, on 1 December 1992. The area let was 30,000 square feet, representing 28% of the total area of the Building.
- (ix) Company C was formed for the purpose of managing the properties owned by Company G or in which Company G had an interest. A management agreement dated 1 November 1992 was entered between the Company and Company C and Mr P was employed as 'Chief Property Manager' for Company C with a monthly salary of \$30,000.
- (x) After possession taken of the Building, the Building's name was changed to '[Centre C]'. The Building was in a dilapidated condition and renovation works were carried out. The costs came to about \$3,200,000. Company G also incurred about \$600,000 in modifying the premises to suit its needs.
- (xi) Mr S was the executive director responsible for the management of Centre C and Mr P worked under his supervision. He was kept up to date with the progress of the works and the letting situation which was going on but he did not concern himself with the day-to-day management of the Building.
- (xii) He was informed by Mr S at the time that there were more enquiries on the sale than on the lettings of the Building.
- (xiii) Between March and July 1993, Mr S informed him of the various offers received for the purchase of the Building. Since it had always been the intention to purchase the Building for self-use and long-term rental investment, he did not pay much attention to those offers.
- (xiv) On 15 March 1993 a meeting was held to consider, among other things, an offer received to purchase the Building at \$70,000,000. It was unanimously resolved by the directors that the Building was not for sale.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (xv) In or about June 1993, he was informed by Mr S that the letting situation was below expectation and the asking rent had dropped to below \$7.5 per square foot. At the time of acquisition of the Building, Mr S had prepared a projection for rental for the Building at \$8 per square foot or higher all exclusive. In June, only 50% of the premises were rented out, including the three floors taken by Company G. The rental income was insufficient to cover the outgoings and the shareholders had to put up an extra of about \$1,000,000 every three months to make the mortgage payment.
- (xvi) After Company G had moved in and started operating the warehouse, it encountered difficulties such as suppliers and customers complaints about the inconvenience of making and taking delivery to and from the warehouse because of the traffic congestion in District V.
- (xvii) In about June 1993, he was informed by Mr S that an offer of \$90,000,000 to purchase the Building had been received. Notwithstanding the inconvenience experienced by Company G, he did not consider selling the Building.
- (xviii) Later in October 1993, Mr S told him that an offer of \$103,000,000 had been received. There were informal discussions among the directors and there was the consensus for the first time to consider the offer and to explore an increase in the price from the interested party. Mr S was instructed to deal with the matter.
- (xix) At the end of October 1993, he was informed by Mr S that an offer of \$108,000,000 was received but their target price was \$110,000,000. Mr S continued to negotiate with the purchaser.
- (xx) In about mid-November 1993, an offer of \$109,000,000 was received from Company I and Agent O agreed to accept a reduced commission of \$200,000 as opposed to 1% of the purchase price. Sometime between 15 and 20 November 1993, the directors met to consider the offer.
- (xxi) He agreed to sell the Building for the following reasons:
 - (1) The letting situation was not satisfactory as only 50% of the premises had been rented in November 1993 including the three floors taken up by Company G.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (2) The rental income received was insufficient to cover the mortgage payment each month.
- (3) The Building and its location were not exactly ideal for Company G to operate its warehouse.
- (4) Company G anticipated that the rent for industrial building was dropping and it would be more economical to rent other premises for its warehouse.
- (5) The net proceeds of sale receivable would only be marginally less than the target price of \$110,000,000.

The other directors agreed with him and they decided to accept the offer.

- (xxii) The overriding reason for the board's decision to sell was that the offer was simply too attractive to resist.
- (xxiii) Mr S was responsible to prepare board minutes. He gathered that the aforesaid directors' meeting was not minuted but he suspected that it was an oversight.
- (xxiv) Company G agreed to early termination of its tenancy agreement and moved its warehouse back to District Q temporarily because the purchaser requested for at least 50,000 square feet vacant premises on the lower floors.
- (xxv) The proceeds of sale were used to repay the shareholders' loans. A lump sum was set aside to repay the mortgage loan. No dividend was declared. The profit was used to finance the purchase of other properties which were held as long-term investment.
- (xxvi) Neither Company G nor any of its subsidiary companies had ever been involved in property speculation.
- (xxvii) He played no part in the Company's answering of the assessor's queries. Only recently he learnt that Mr S had not seen some of the letters written by Mr P in the name of Company C in 1993 relating to the offers received to purchase the Building at the time they were written.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (xxviii) In about November 1997, the Independent Commission Against Corruption ('ICAC') started investigations into dealings by Mr P during his employment with Company C. The subject matter of the investigation related not to the Building. He understood that Mr P was subsequently convicted of the offence of soliciting bribes from tenants but acquitted of a charge of criminal deception.
 - (xxix) Mr P's employment with Company C was terminated on 31 December 1997.
- (b) Cross-examination
- (i) Mr R was cross-examined at length by Mr Lee for the Revenue. Mr Lee challenged his claim that the Company intended the Building as a long term rental investment.
 - (ii) He was referred to the projection for rental and was asked whether he had seen it before. He replied that he had not seen it before. But he said in the normal course of event, before reaching a decision to purchase, they usually considered the investment return and its benefits. As to the contents of the projection for rental, they must have discussed it among themselves but as to the document shown to him, he could not say he had read it.
 - (iii) He was asked whether there was a board meeting to discuss the Building's rental yield or the financial viability to acquire the Building. He replied that there must have been a meeting but he could not remember whether it was a formal or informal one. He explained that the directors and shareholders of the Company were also directors and shareholders of Company G and they had been working together for two generations and were good family friends. They often had informal meetings for which they did not require minutes. Because they knew each other so well they did not need to properly minute everything they discussed.
 - (iv) He was referred to the Bank H loan of \$30,000,000 of which \$6,000,000 was classified as 'current liabilities' and \$24,000,000 as 'long-term liabilities' under the Company's accounts and was asked the reason for this method of accounting classification. He could not offer any explanation to this. But he said in this regard he relied on the accountants who took instruction from Mr S.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (v) He was asked how the Company intended to repay the shareholders' loans of \$34,000,000. He replied that they had no arrangement at the time. It was their objective to repay the bank loan first and then the shareholders' loans by means of the rents received.
- (vi) He was asked when the Company decided to sell the Building. He said it was in November 1993 when a board meeting was held. And as to the reason why the Company decided to sell it, he said that it was because the offer was too attractive to resist.
- (vii) He was referred to the Representatives' statement that the Company decided to sell the Building in the middle of 1993 for two reasons, firstly that the Company experienced difficulty in leasing out the Building and secondly that the Company wished to change investment from industrial premises to residential premises. He could not agree to the second reason for sale because he could not recall their wish to change investment and as to the first reason, he was aware that the leasing situation was not satisfactory at the time.
- (viii) He was further referred to the other two reasons for sale given by the Representatives in the grounds of appeal, the main reason was that the lease with Company G was early terminated and the second reason that the Company had to call back the funds for better rental production investment. He could not agree to the main reason. He said that Company G moved out because the Building was sold and not because Company G took the initiative to move out. As to the second reason, he could not explain why it was given as a reason for sale. Since he was not involved in the day-to-day operation of the Company, he had not read the grounds of appeal.
- (ix) He was reminded of a letter from Mr S to him of 29 October 1993 when he was informed that they were close to an agreement of renting out the 4/F, 5/F, 6/F and 10/F of the Building which, Mr Lee pointed out, could have caused a drop of the vacancy rate to 17.8%. He said he could not agree that this could have rendered the letting situation satisfactory, since the letting had not actually taken place at the signing of the sale agreement.
- (x) He was questioned as to when he became aware of the offer of \$70,000,000 of 23 March 1993. He said between March and July

INLAND REVENUE BOARD OF REVIEW DECISIONS

1993, he was informed by Mr S of offers of various amounts, and this offer of \$70,000,000 must be one of them.

- (xi) He was further questioned as to whether the Company held a meeting to authorize the rejection of that offer and whether he had seen the letter of 24 March 1993. He replied that they had a board meeting to discuss a particular offer of about \$70,000,000 which they rejected, but he could not recall whether it was in relation to that letter or other letter.
 - (xii) He was not aware of the meeting between Mr S, Mr P and Solicitors' Firm L on 2 or 3 June 1993. He did not have any contemporaneous documents to substantiate his claim that it had always been the intention of the Company to purchase the Building for self-use and long-term rental investment. He confirmed that letters sent out were not required to be signed by him but he did not know how it was arranged between Mr S and Mr P.
- (c) Re-examination by Mr Yu
- (i) He confirmed he never actually saw any letters of offer. The information came from Mr S.
 - (ii) He confirmed they had never authorized the letter by Mr P to forward an offer of \$98,000,000 for consideration by the intended purchaser of the Building.
- (d) Questions by this Board
- (i) He confirmed that Company C was wholly owned by Company G and that Company C was used to hold and to manage properties and whatever Company C purchased, the money would come from Company G. He agreed, as suggested by Mr Lee, Company C was only able to lend money to the Company because of its financial backing by Company G.
 - (ii) He was asked whether the Company in acquiring the Building considered it more convenient and beneficial to raise money apart from the bank, by an increase of share capital instead of by shareholders' loans. He replied that since the shareholders knew each other well, at the time they only focused on how to acquire the property and planned to pay half of the price within five years and as

INLAND REVENUE BOARD OF REVIEW DECISIONS

to the repayment of the shareholders' loans, it was a matter to be dealt with at a later day.

- (iii) He confirmed that no study was carried out by the Company prior to the acquisition of the Building on the facilities of the Building as a warehouse and on the traffic condition of the area. They simply relied on the fact that it was used by Company U as a warehouse of its products which were similar to their products.
- (iv) He said that the warehouse at District Q was about 30,000 square feet. Company G moved back to the warehouse at District Q after they moved out from the Building and they continued using public warehouse for the excess goods. Company G was still using the warehouse at District Q.

38. Mr S was the Company's second witness. The salient points of his sworn testimony are as follows.

- (a) In chief
 - (i) He was a practicing architect and also a director of the Company. The directors of the Company were also the directors of Company G and Company C.
 - (ii) Mr R represented 60% of the interests in the Company and thus his voice carried the most weight on the board.
 - (iii) He was commissioned to carry out the preliminary investigation for the intended redevelopment of the warehouse at District Q. In preparation for the possible redevelopment, Company G looked for alternative premises for storage and considered the Building suitable for its purpose and decided to acquire the Building, intending it for long-term investment with floors reserved for their own use and remaining floors to be rented out to other tenants.
 - (iv) The Company was formed to purchase the Building prior to the signing of the purchase agreement with Company U on 15 April 1992. He prepared the schedule of rental projection dated 31 March 1992 for consideration by the other directors. He said as could be seen from the date of the schedule of rental projection, even at that time they were minded to change the name of the Building to '[Centre C]'.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (v) By a written agreement dated 1 November 1992, Company C was appointed the manager to act as letting and managing agent for the Building. Under the agreement, Company C had no authority or power to offer the Building for sale.
- (vi) Mr P was employed by Company C as 'Chief Property Manager' and was responsible for day-to-day operations and worked under his supervision and reported to him.
- (vii) He did not see and was unaware of the correspondence containing or relating to some of the offers at the time they were received or written, in particular the letters dated 23 March 1993 by Solicitors' Firm L to the Company offering \$70,000,000, 24 March 1993 by Mr P to Solicitors' Firm L counter-offering \$98,000,000, 13 May 1993 by Solicitors' Firm L to Company C offering \$75,000,000 and 23 June 1993 by Agent O to Company C offering \$91,000,000. He saw and became aware of for the first time these letters after the assessor had raised queries over the profits tax return, that is, after October 1995. He saw and became aware of for the first time the letter dated 7 April 1993 by Mr P to Agent O saying that an offer of \$85,000,000 had been received from another party, only when a copy of the determination dated 27 September 1999 was received and the said letter was attached to it as appendix M.
- (viii) In early 1993, and on more than one occasion Mr P reported to him that offers to purchase the Building had been received by him. He was not shown any correspondence and assumed that the offers mentioned were made orally. He remembered the mention of an offer of \$70,000,000 but was not certain whether other figures were also mentioned. He told Mr P that the Building was not for sale but the matter should be reported to the other directors. Thus, at a meeting of the board on 15 March 1993, Mr P reported that a verbal offer of \$70,000,000 had been received whereupon the board resolved unanimously to reject the offer, confirming expressly that the Building had been purchased 'for long-term rent collection investment'.
- (ix) He added that in 1992, after signing of the purchase agreement of 15 April 1992, he had received more than one unsolicited offer from Agent O to purchase the Building and he ignored them all.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (x) At the beginning of June 1993, he and Mr P were invited to lunch by Mr K of Solicitors' Firm L. He agreed to attend the lunch because it was his practice to meet with representatives from different firms and companies and to ascertain what was being proposed. A Mr W was also at the lunch but he did not introduce himself as an interested buyer of the Building nor did he mention anything about the purchase price. However, Mr K said he might be able to introduce a buyer and he expected a commission of 1% of the selling price. He told Mr K that the Building was not for sale but he would welcome introduction of tenants to the Building.
- (xi) Shortly after that meeting, a letter dated 5 June 1993 was received from Solicitors' Firm L offering \$90,000,000 for the Building on the condition that vacant possession of 50,000 square feet of floor area would be delivered. He informed Mr R of the offer by telephone but Mr R told him that the Building was not for sale. A letter in reply of 9 June 1993 declining the offer was sent. His reply did not say expressly that the Building was not for sale because it was not his style or habit to say 'no' directly. Also, it was not true that he did inform the other directors or that he was unable to obtain a unanimous decision of the board. As said before, he only informed Mr R.
- (xii) After the dispatch of the letter of 9 June 1993 there was no further communication from Solicitors' Firm L until their letter dated 6 August 1993 saying their clients were no longer interested. Those words 'due to the substantial price difference between our client's offer and your counter offer' in Solicitors' Firm L's letter did not strike him as being of any significance although when he received and read that letter, he was unaware of any offer or counter-offer having been made.
- (xiii) The letter dated 23 June 1993 from Agent O to Company C offering to purchase the Building for \$91,000,000 was not brought to his attention at the time it was received. On the other hand, Agent O's letter dated 24 August 1993 offering \$102,800,000 was brought to his attention by Mr P. He ignored this letter in view of the board's clear stance that the Building was not for sale. However, when he received Agent O's letter of 7 October 1993 offering \$103,000,000, he informed Mr R and Mr X. The upshot of their informal discussions was that it should be explored whether the

INLAND REVENUE BOARD OF REVIEW DECISIONS

interested party would increase the offer. He was instructed to deal with the matter.

- (xiv) Instructions were accordingly given to Mr P. He was told that the directors had a tentative target of \$110,000,000. He did not speak to Agent O directly. On 18 October 1993 he sent a note to Mr R and Mr X to keep them informed. Those negotiations yielded a written offer of \$108,000,000 from Agent O at the end of October 1993. Mr R and Mr X were again informed and negotiations continued. By a letter dated 8 November 1993, Company C on behalf of the Company offered to sell the Building at \$110,000,000.
- (xv) By a letter dated 9 November 1993, Solicitors' Firm L on behalf of Company I offered to purchase at \$108,000,000 but this offer was rejected by Company C. Company I made a counter-offer of \$109,000,000 by simply returning Company C's letter dated 8 November 1993 and amending the price of \$110,000,000 to \$109,000,000 with Company I's signature on it.
- (xvi) He had discussions with Mr R and Mr X on the counter-offer of \$109,000,000 and on the basis of the calculation set out in his note to them dated 13 November 1993, they decided to accept it if Agent O would agree to accept a lower commission of \$100,000. This was the first time they seriously considered selling the Building after having ascertained the best price.
- (xvii) Following further negotiation done through Mr P, Agent O came back with a letter dated 15 November 1993 confirming Company I's offer to purchase at \$109,000,000 and indicating their acceptance of a commission of \$200,000.
- (xviii) A board meeting was held and it was agreed to accept the offer mainly because the price was too attractive to decline, coupled with the fact that the Company had been unable to let out the Building in full. Besides, Company G was agreeable to early termination of its lease before completion as they had experienced some minor problems with the Building.
- (xix) He overlooked the preparation of the minutes of the meeting. Only in a very late stage in January 1994, he was reminded of it by the Company's solicitors. Accordingly, a meeting was convened on 28 January 1993 to pass the requisite resolution.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (xx) He or the Company never invited or solicited any of the offers to purchase the Building. He never instructed Mr P to invite offers. He did not know why Mr P did not bring to his attention those letters mentioned earlier on. He was only shown the letter dated 24 August 1993 and the subsequent correspondence and not the earlier ones.
- (xxi) The letter from Solicitors' Firm L dated 23 March 1993 was addressed to the Company and marked for his attention as well as Mr P's. It was possible for Mr P to intercept it since the Company and Company C shared the same office. The office of his architectural firm was on a different floor. As explained, he was frequently absent from Hong Kong in 1993.
- (xxii) The letters dated 23 March 1993 and 13 May 1993 from Solicitors' Firm L, Mr P's letter dated 24 March 1993 to Solicitors' Firm L and Agent O's letter dated 23 June 1993 came to light after the assessor raised queries on the profits tax return in October 1995. He believed that the Representatives replied the assessor's queries insofar as they related to the correspondence prior to August 1993 on the basis of the instructions they took from Mr P because he had not seen those letters apart from the one dated 9 June 1993 which he wrote to Solicitors' Firm L after the lunch meeting.
- (xxiii) It was true that the Representatives' letters to the assessor were sent to him first for approval. At the time he did not consider any of the correspondence he had not previously seen to be of importance because none of those offers had been accepted and he did not ask Mr P why he had been kept in the dark. As to Mr P's letter dated 24 March 1993 claiming

'have received instructions from the Registered Owner to forward an offer, on a subject to contract basis, at HK\$98,000,000 to your client for consideration'

although the Company never authorized or instructed Mr P to make any counter-offer, he believed at the time that that was no more than his way of carrying out the board's instruction given at the meeting held on 15 March 1993 'to discourage any further offers from agents'. It did not occur to him to question Mr P's good faith in writing that letter.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (xxiv) As to having received an offer of \$85,000,000 from a prospective purchaser as referred to in Mr P's letter dated 7 April 1993 to Agent O, he could not say whether Mr P had received any offer in that sum except that if there was, neither he nor any of the directors knew about it at the time or now.
 - (xxv) He denied that in April 1993, the Company was considering any sale of the Building. The Company did not even begin to be interested in the level of purchase price offered until October 1993 and it was only in November 1993 that the directors began seriously to consider a sale.
 - (xxvi) He became aware of that letter dated 7 April 1993 for the first time at about the end of September 1999 and by then Mr P had long left Company C's employment.
 - (xxvii) In about November 1997, the ICAC started investigation into dealings by Mr P during his employment with Company C but the investigation was not in relation to the Building.
 - (xxviii) Mr P's employment with Company C was terminated on 31 December 1997.
- (b) Cross-examination
- (i) He was questioned on why the projection for rental was headed 'Projection for Rental from [Centre C]' while the Building at that time was still named '[Building Y]'. He explained that even before acquisition of the Building they decided if they could acquire it to change its name to '[Centre C]', because the name would reflect their corporate identity. They thought of naming it '[Centre G]', but no one liked this name so they decided on '[Centre C]'.
 - (ii) As to the absence of minutes of any board meetings of Company C or Company G to discuss the acquisition of the Building and the rental projection, he explained that since all the shareholders were family friends for two generations, they did not need to have everything on paper.
 - (iii) As to his projection of rental at \$8 per square foot, he explained that this assessment came from the information gathered from newspapers and magazines, his experience of 20 years in the

INLAND REVENUE BOARD OF REVIEW DECISIONS

business, discussion with friends and relatives who rented similar properties, and from connections through his practice as an architect. But he could not recall the newspapers or publications from which he obtained the information because it was so long ago.

- (iv) He was asked to explain why in the projection for rental, the area of the Building was said to be 106,250 square feet while in the revaluation report it was 79,000 square feet. He explained that in Hong Kong there were more ways than one to calculate areas of premises. He said 106,250 square feet ought to be the gross floor area of the Building and the projected rent was calculated on the basis of the gross floor area which was \$8 per square foot, the market rental at the time of the projection. He claimed his assessment turned out to be close to the then market price of \$7.5 per square foot. Apart from those floors rented to Company G which was a related company at \$7.5 per square foot, all the other floors rented out during the same year were also at \$7.5 per square foot.
- (v) As to how the Company planned to repay the shareholders' loans of \$34,000,000, he said that since the Building was a long-term investment, they were not concerned when they would recover their loans.
- (vi) On the reasons why the Company decided to sell the Building, he maintained that the decision to sell was induced by the attractive offer of over \$100,000,000 for the Building, and they also thought by selling it, they could reinvest in other type of properties.
- (vii) He was asked whether the other reasons given for the sale of the Building as contained in the grounds of appeal, such as the early termination of the lease by Company G and the vacancies in half of the premises, were true. He said he could not answer the question. He was then reminded that he gave evidence in chief that all the letters to the Representatives were first approved by him. He explained that since Mr P was then still with Company C and Mr P was the one to give instructions to the Representatives, he did not read the letters in detail. He was further reminded by Mr Lee that the grounds of appeal was provided in October 1999, almost two years after Mr P left Company C. He claimed that the statement contained in the grounds of appeal must have been a follow-up of what had been said previously and the Representatives only repeated what they knew

INLAND REVENUE BOARD OF REVIEW DECISIONS

from the previous correspondence. He explained that in October 1993, when they realized that Company G found problems with the Building and probably would not renew the tenancy, this factor induced them to reach a decision to sell. As to the other reason given in the grounds of appeal for the sale of the Building, he confirmed that the fact that half of the premises were vacant was also a supporting reason for the sale besides having an attractive offer.

- (viii) He was referred to the letter he wrote to Mr R and Mr X on 29 October 1993, informing them that the 4/F, 5/F, 6/F and 10/F were about to be rented out, and whether he would agree that taking those lettings into account the vacancy rate would drop to 17.8%. He answered that he was not sure whether that letter definitely was his letter and whether those floors could have been actually rented out. He was then asked whether knowing that the four floors could possibly be rented out would have made any difference to their decision to sell. He answered that he was not certain whether those floors could have been rented out but the directors were given options either to sell the Building or to go back renting the Building.
- (ix) He was asked whether it was true that, as stated in the grounds of appeal, the Building was sold because they 'had to sell it to get back funds for re-investment in better rental production project/assets'. He said this could also be a reason for sale. They were thinking of changing from industrial premises to office or residential premises. They eventually invested over \$10,000,000 or \$12,000,000 in residential developments in Street Z and Street M. He was reluctant to answer the question as to whether the project at Street M was intended for sale or for long-term. He answered that it was taken over by a bank.
- (x) He was asked to explain the discrepancy between his statement in chief that he was unaware of those letters of 23 March 1993 and 24 March 1993 until the assessor started his enquiries and the statement made by the Representatives in the grounds of appeal of 25 October 1999 that 'under special circumstances [Company C] was authorized specially by the board of the Company to write the discouraging counter-offer of 24 March 1993'. He maintained that there was no inconsistency between the two statements because it was true that he was unaware of those letters until the enquiries started and although the Representatives sent him the grounds of appeal for prior approval, he did not see it necessary to question

INLAND REVENUE BOARD OF REVIEW DECISIONS

about those letters even though he was unaware of and had not seen them before as he did not think they mattered.

- (xi) He was asked whether it was the termination of the tenancy with Company G which led to the sale of the Building or vice versa. He replied that the two matters linked together. They wished to sell the Building and then asked whether Company G was prepared to move out and when they agreed to move out, then they could sell the Building.
 - (xii) As to the letter of 7 April 1993, he reiterated that Mr P was not authorized to write it.
- (c) Re-examination
- (i) He was asked whether the grounds of appeal were sent to him in draft for approval. He did not give a direct answer to this question. He said since he was a layman in taxation matters, he left those taxation matters to the Representatives. He added that the documents were sent to him first and he took a look at them and then he would leave them to be taken care of by his own accountant and finance manager. When it was pointed out to him by the Board that the statements in the grounds of appeal were supposed to be factual and not accounting matters, he confirmed that he looked at them first and when he agreed with them, they were sent out.
 - (ii) He was asked whether he now disagreed with the statements in the grounds of appeal. He said that he saw nothing wrong with the grounds of appeal.
 - (iii) He was referred to the letter of 24 March 1993 and was asked whether the Company instructed Company C to make an offer to sell the Building at \$98,000,000. He said that the Company did not instruct Mr P to write in such a manner but Mr P was asked to discourage any counter-offer. He said that the statement in the grounds of appeal that '[Company C] was authorized by the board to write that discouraging counter-offer' was wrong. He did not instruct Mr P to write any letter in March 1993.
 - (iv) He was referred to the statement in the grounds of appeal where it said that the letter of 24 March 1993 was authorized by the Company whereas his subsequent stance was that the letter was not

INLAND REVENUE BOARD OF REVIEW DECISIONS

authorized. He explained that since at the board meeting on 15 March 1993 Mr P was asked to discourage any further offers and even though Mr P was not authorized to make any counter-offer, he saw that the counter-offer was a way used by Mr P 'to discourage the offer' and it was in this context he viewed the Representatives' correspondence and the grounds of appeal.

- (v) His architectural firm was on the 22/F and Company C on the 21/F. xxxx xxxx was his office fax number and yyy yyyy was Company C's fax number. His secretary would distribute the faxes. If a fax was sent to his office, he would receive it if it was for his attention but if it was marked for the attention of '[Mr P]', it would go to Mr P.
- (d) Questions by this Board
- (i) He was queried on the conflicting approaches taken by him, one to ignore all the unsolicited offers to purchase the Building from Agent O and the other to accept an invitation to lunch from someone unknown to him just to find out what that person wanted. He explained the difference was that Agent O was an estate agent and the other person was a solicitor from a legal firm. But before the meeting he had no idea that that solicitor wanted to introduce an interested party to acquire the Building.
 - (ii) It was pointed out to him that the letter by the Company to Solicitors' Firm L of 9 June 1993 wherein it was stated that unanimous decision was not reached was sent by fax, by post and also by hand and thus this letter must have meant an important letter to them. He said he was not aware that it was sent out in such manners. He would send letters out either by post or by hand. It was sent by hand perhaps because Solicitors' Firm L's office was close to theirs.
 - (iii) He confirmed there was no communication between him and Solicitors' Firm L during the period after the meeting and the letter of 23 June 1993.
 - (iv) He confirmed that traffic survey of District V was not done before the purchase of the Building. It was not done because they based on the assumption that Company U had been there for so long.

The issue

INLAND REVENUE BOARD OF REVIEW DECISIONS

39. It is common ground that the only issue in this appeal is whether the Company purchased the Building as a long term investment or for resale and the determinative question is what the Company's intention at the time of acquisition of the Building was.

The law

40. Trade is defined as including every trade and manufacture, and every adventure and concern in the nature of trade (section 2 of the Inland Revenue Ordinance ('IRO')).

41. The onus of proving the assessment appealed against is excessive or incorrect shall be on the taxpayer (section 68(4) of the IRO).

42. In Simmons v IRC [1980] 1196, Lord Wilberforce stated at page 1199:

'Trade 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? ... What I think is not possible 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.'

43. In All Best Wishes Limited v CIR 3 HKTC 750, Mortimer J stated 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.'

Our findings

44. Mr Yu, Counsel for the Company, submitted that the following matters were not disputed and they were sufficient to establish that the Company on 15 April 1992, the date of the sale and purchase agreement, intended to hold the Building for long term investment and its intention

INLAND REVENUE BOARD OF REVIEW DECISIONS

remained unchanged on 15 March 1993 when a declaration of corporate intention was made. Those matters which had been suggested as establishing the Company's intention on 15 April 1992 are:

- (a) the acquisition of the Building originated in Company G's need for alternative warehouse premises;
- (b) after acquisition of the Building, the Company changed the name of the Building to Centre C;
- (c) the Company carried out extensive renovation works to the Building, incurring about \$3,200,000;
- (d) Company G entered into a tenancy agreement with the Company, taking up three floors of the Building and renovated those three floors at a cost of about \$600,000;
- (e) in seeking tenants for the remaining floors, the Company placed advertisements in newspapers at monthly intervals from December 1992 and well into the third quarter of 1993 and sent out leasing brochures to banks, estate agents and potential tenants; and
- (f) the minutes of a board meeting of the Company held on 15 March 1993 recorded that '[Mr P] reported that the management office received a verbal offer to purchase the building at HK\$70 million. The meeting unanimously rejected the offer and further reiterated that the objective to purchase the building was for long term rent collection investment. The meeting requested the *[sic]* more leasing activities with a view to lease out the building and instructed the management office to discourage any further offers from agents.'

45. It is the Company's case that it never at any time instructed or authorized Company C or Mr P to place the Building on the market for sale or inform any estate agent that the Building was for sale. And it never itself solicited any offer to purchase.

46. Mr Yu submitted that if the Board was not to accept the Company's explanation of the correspondence and to find that there was evidence that after 15 March 1993, the Company considered offers to purchase the Building or made counter-offers to sell it, none of that evidence detracted from the corporate intention made at the board meeting held on 15 March 1993 that 'the objective to purchase the building was for long term rent collection investment'. He contended that a decision to sell a capital asset did not by itself convert the asset into trading stock and the Company did nothing to change the character of its investment: the Building was not re-classified in its accounts; nor was it renovated with a view to resale.

INLAND REVENUE BOARD OF REVIEW DECISIONS

47. We agree with Mr Yu that a decision to sell a capital asset did not by itself convert the asset into trading stock. However, the onus is on the Company to prove that the Building was acquired as a capital asset and not otherwise. In respect of those matters which, as contended by Mr Yu, were sufficient to establish that the Company intended to hold the Building as a long term investment when it was acquired on 15 April 1992, we take the view that trading assets can be leased out for rental profits pending an opportune moment for resale and renovation works can be carried out to trading assets to enhance their resale value. Thus, the leasing and renovation works of the Building are factors also capable of establishing the intention that the Building was acquired as a trading asset. Hence, those matters, such as the change of the Building's name, the renovation works, the preparation and sending out of leasing brochures, periodical leasing advertisements, a tenancy agreement with Company G, are at their best only neutral factors in the Company's case.

48. As to the acquisition of the Building being originated in Company G's need for alternative warehouse premises, we have doubts as to the genuineness of this need. Firstly, it was asserted that Company G needed an alternative warehouse because they intended to redevelop the warehouse at District Q into residential premises but the plan was aborted because they found it difficult to obtain Government's consent to its proposed change of user from industrial to residential premises. However the documents produced by the Company in this connection show that little was done by the Company towards this intended redevelopment. Only one letter of enquiry of 7 November 1991 was written by Mr S to the Government authority in this regard. More so, we were informed by Mr R that after the Building was sold, Company G moved back to the warehouse at District Q and the warehouse in District Q was still being used by Company G. It was asserted that Company G's need for alternative warehouse was the main reason for the purchase of the Building. If it were true, it is amazing that this important factor could have been forgotten at the early stage of the enquires. This reason for the Company's purchase of the Building was only given after the assessor issued the assessment on the Company. Furthermore, it followed later that one of the reasons for the sale of the Building was that Company G found the Building's facilities unsuitable to its need and the traffic congestion in the area inconvenient to their customers. Evidence was given that before the acquisition, no investigation was carried out on the warehouse facilities or the nearby traffic condition and that the Company purchased the Building simply relying on the fact that Company U had used the Building as its warehouse for a long time. Since the directors involved in the acquisition are seasoned and sophisticated businessmen, we have doubts that they could have taken this over-simplified approach in an acquisition of this scale. Thus, the aforesaid evidence undermines the claim that Company G needed an alternative warehouse premises and that this need was the main reason for the acquisition.

49. As to the declaration of the corporate intention on 15 March 1993, we view it in the light of what Mortimer J said in the case of All Best Wishes – the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence.

INLAND REVENUE BOARD OF REVIEW DECISIONS

50. Thus, we cannot conclude on the basis of those matters referred to in paragraph 44 above that the Company has established its stated intention that on 15 April 1992 the Company acquired the Building as a long-term investment. We need to further consider the other evidence before us. We need to consider 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.

51. Among the surrounding circumstances of this appeal, it is our observation that the Company's case has undergone several changes since the assessor started the enquiries.

52. Initially the Representatives informed the assessor that the reason for the Company to purchase the Building was because in early 1992, there was a good demand for industrial premises and the Company acquired the Building with the only view to holding it as its fixed and investment asset for production of rental income. However, after the assessor issued the profits tax assessment for the year of assessment 1994/95 with net assessable profits of \$43,340,009, the Representatives objected to the assessment by putting forward further arguments. The Representatives then informed the assessor that the main reason to acquire the Building was to provide storage space for Company G and the second reason was for leasing for rental purpose.

53. It appears that there are also changes in respect of the reason for the sale of the Building and the time of the change of intention to hold the Building as a long-term investment.

54. In correspondence, the Representatives informed the assessor that notwithstanding the Company's effort to let out the Building, there was 50% vacancy most of the time. Thus, in the middle of 1993, when the Company received an offer to purchase the Building with the existing tenants, the Company decided to change its investment from industrial premises to office or residential premises and to dispose of the Building. Later on the Representatives informed the assessor that 'the Company decided to sell the Building also due to the fact that [Company G] had no intention to renew the tenancy agreement upon expiration'. Later in the grounds of appeal, the Representatives said that another offer was received in November 1993 when the Company was disappointed with the leasing condition of the Building and seeing the trend of factory operations in Hong Kong being moved to Mainland China, it decided to sell the Building. And yet at the hearing, it was the Company's case that the Company seriously considered selling the Building for the first time in November 1993 because the price offered, \$109,000,000, was too attractive.

55. Also only at the hearing, the Company put forward the case that Mr S did not see and was unaware of the correspondence containing or relating to some of the offers at the time they were received or written, in particular, the letter of 23 March 1993 from Solicitors' Firm L to the Company offering \$70,000,000, the letter of 24 March 1993 by Mr P counter-offering \$98,000,000, the letter of 13 May 1993 by Solicitors' Firm L offering to Company C \$75,000,000 and the letter of 23 June 1993 by Agent O to Company C offering \$91,000,000. It was also the Company's case only at the hearing that Mr S became aware of for the first time the

INLAND REVENUE BOARD OF REVIEW DECISIONS

letter of 7 April 1993 by Mr P saying that an offer of \$85,000,000 had been received from another party when a copy of the Commissioner's determination dated 27 September 1999 was received with that letter appearing as appendix M to it. These allegations were only raised for the first time at the hearing. The Representatives on the contrary said, in its letter to the assessor of 24 June 1997, that in March 1993 the Company received a verbal offer from Solicitors' Firm L acting on behalf of an interested buyer to purchase the Building at \$70,000,000 which offer was put into writing in the same month and the Company authorized Company C to discourage the offer by counter-offering a very high price of \$98,000,000.

56. Mr S gave evidence at the hearing to explain the reasons for the inconsistencies of the Company's case. He blamed it on Mr P who was the one to give instructions to the Representatives. Although the letters by the Representatives to the assessor were first sent to him for approval, he said that at the time he did not read them thoroughly and even though he came across inaccurate account of events and matters, he did not see it necessary to raise questions on them since they did not strike him as important. We are unable to accept Mr S's explanation in this regard. Mr S is an experienced businessman and an architect by profession. In his position he ought to realize and respect the importance of precision and accuracy in all matters especially those of taxation. He must appreciate the consequence of failure to provide accurate information in matters of this nature. More so, we cannot accept his explanation that after Mr P left Company C's employment, he further left the tax enquiries to his accountant and finance manager. We take the view that even if the tax enquiries were left to Mr S's accountant and finance manager, the instructions given by them to the Representatives could only be according to Mr S's directions since the matters in relation to the sale of the Building was only handled by Mr S and Mr P alone.

57. Mr S gave evidence to the effect that the offers which he was aware of at the time they were received were (1) in 1992, after the signing of the purchase agreement of 15 April 1992, more than one unsolicited offer from Agent O which he ignored; (2) in early 1993, on more than one occasion he was informed by Mr P of offer, among them, one of \$70,000,000 which brought about the board meeting on 15 March 1993; (3) following the meeting with Mr K of Solicitors' Firm L, an offer of \$90,000,000 from Solicitors' Firm L in its letter of 5 June 1993, which the Company declined on 9 June 1993; (4) Agent O's letter of 24 August 1993 offering \$102,800,000 which he ignored due to the board's stance of not to sell; (5) Agent O's letter of 7 October 1993 offering \$103,000,000 which he brought to the attention of Mr R and Mr X, as a result of which instructions were given to him to explore an increase in price with a tentative target price of \$110,000,000; (6) at the end of October 1993, negotiations yielded a written offer of \$108,000,000 from Agent O which resulted their counter-offer of \$110,000,000 in a letter of 8 November 1993; (7) a letter of 9 November 1993 from Solicitors' Firm L on behalf of Company I offering \$108,000,000 which was rejected by the Company; (8) an offer of \$109,000,000 from Company I by way of amending their counter-offer of \$110,000,000 in their letter of 8 November 1993; and (9) finally Agent O's letter of 15 November 1993 offering \$109,000,000 by Company I which was accepted by the Company.

INLAND REVENUE BOARD OF REVIEW DECISIONS

58. He also said that there was no communication from Solicitors' Firm L after his letter of 9 June 1993 until Solicitors' Firm L's letter of 6 August 1993, intimating their client's withdrawal of offers due to the substantial price difference in the offer and the counter-offer.

59. Mr S claimed that he was not aware of those letters as mentioned in paragraph 32 above until after October 1995 and the letter of 7 April 1993 until the receipt of the determination of 27 September 1999.

60. It is our observation that the letter by Solicitors' Firm L of 23 March 1993 was addressed to the Company care of Company C at the 22/F and was marked for the attention of Mr S as well as Mr P. It was indicated thereon that it was sent by ordinary post and by fax and the fax number yyy yyyy also appeared thereon. Mr S gave evidence that his architectural firm was in the same building as that of Company C but on a different floor. Mr S's firm was on the 22/F and the office of Company C and the Company was on the 21/F. Mr S gave evidence that it was the duty of his secretary to distribute faxes received and the ones marked for his attention would be distributed to him and the ones for Mr P's attention would be distributed to Mr P. Although this letter was faxed to Company C's office (we take that it was the case since the number yyy yyyy being Company C's facsimile number appeared on the letter), it was also sent by post to the address of Mr S's firm at the 22/F and it was also marked for Mr S's attention. Thus, we see no reason why this letter did not reach him.

61. The letter of 13 May 1993 offering \$75,000,000 was sent by Solicitors' Firm L to Company C by post to Company C's address and by fax to the fax number yyy yyyy being Company C's facsimile number. But this letter was however neither marked for the attention of Mr P nor Mr S. The letter of 23 June 1993 by Agent O to Company C for the attention of Mr P was sent by fax to the fax number xxx xxxx of Mr S's architectural firm.

62. As to the letter of 7 April 1993 by Mr P to Agent O, in the last paragraph of this letter, the addressee was asked to contact the undersigned at zzz zzzz. We note from the memo from Mr S to Mr R and Mr X that this telephone number zzz zzzz was in fact that of Mr S's architectural firm. If Mr P indeed wrote this letter without Mr S's knowledge or consent and intended to conceal this letter from Mr S, we do not believe Mr P would have given the telephone number of Mr S's firm to the addressee of the letter.

63. Because of our aforesaid observations coupled with the fact that the letters by the Representatives to the Revenue which had firstly been approved by Mr S contained statements contradicting Mr S's claim, we are unable to accept Mr S's claim that he was not aware of those letters as referred to in paragraph 32 above and the offers in them at the time they were received, and that Mr P acted without the Company's authority.

64. We also have the following observations and hold the following views.

INLAND REVENUE BOARD OF REVIEW DECISIONS

65. The offers from Agent O allegedly unsolicited started coming in from July 1992. Among the correspondence produced, there were a letter by Agent O of 21 July 1992 and another of 27 August 1992 in relation to the Building and both were addressed to Mr S. The latter contained an offer to purchase the Building at \$76,000,000. As seen from a handwritten note on this letter, this letter was said to be faxed by Mr S to Mr R and Mr X for their information. As soon as the renovation works of the Building finished in about February or March 1993, on 18 March 1993 Mr P sent a letter to Solicitors' Firm L, in which a property brochure was enclosed and their previous telephone conversation was also referred to and in its last paragraph, it said 'please feel free to contact the undersigned should you have any concrete offer in hand'. Following this letter, Solicitors' Firm L sent a letter of 23 March 1993, marked for the attention of Mr S and Mr P, offering on behalf of its client to purchase the Building at \$70,000,000 with vacant possession of all floors except the 1/F, 2/F, 3/F and unit A of 12/F which were subject to existing tenancy at a monthly rental of \$7.5 per square foot and the name '[Mr K]' was given as the contacting person. Mr S's account of his accepting an invitation to lunch from a person whom he did not know and also not knowing the purpose of the meeting is not accepted by us. We do not believe that Mr S would accept an invitation simply because it came from a solicitor. Since this letter of 23 March 1993 was sent to S's firm and we are of the view that it should have been received by Mr S, it follows that when he was invited by Mr K for lunch on 2 or 3 June 1993, Mr S must have a good idea of the purpose of the meeting and thus accepted the invitation. Following this meeting, the Company received an offer of \$90,000,000 from Solicitors' Firm L made on behalf of its client. We do not accept Mr S's evidence that because it was not his style or habit to say 'no' directly, he therefore wrote in his letter of 9 June 1993 that he had informed the other directors of the proposed acquisition and that he was unable to obtain a unanimous decision even though they were not true. We believe Mr S meant what he wrote in the letter, especially since he said 'Should there be any further development, I shall keep you informed in due course'. We take that the letter was meant to keep the negotiations going. We do not believe that the quoted statement would have been added if Mr S actually had in mind to put this matter to its end. We are of the view that the Company intended to sell the Building but was bargaining for a good price.

66. We also do not accept that one of the reasons for selling the Building was due to the unsatisfactory leasing condition. Given that the renovation of the Building only completed in about February or March 1993 and the 4/F and 5/F of the Building were initially reserved (as stated in the leasing brochure), we are of the opinion that the Company was not doing too badly in the leasing of the premises. By June 1993, 50% of the premises were already let out. Had Company G not agreed to early terminate its tenancy agreement of the three floors which represented about 28% of the gross floor area of the Building, about 78% of the premises would have been let out at the signing of the sale agreement. We also believe that if it had not been for the condition specified by Company I that vacant possession of the lower floors must be given upon completion, some of the lower floors might well have been let out at the time of the signing of the sale agreement (see the letter referred to in paragraph 38(b)(viii) above).

INLAND REVENUE BOARD OF REVIEW DECISIONS

67. As to the projection for rental, its very existence does not necessarily support the claim that the Building was acquired for rental purposes. The rental projection could also be prepared for the purpose of ascertaining how much the Building was worth.

68. Neither the Company nor its witnesses offered us any valid reasons why Mr P should keep Mr S in the dark of some of the correspondence nor can we think of any benefits which Mr P could reap in deceiving Mr S and hiding letters from him. Thus, we do not accept the claim that Mr P acted or wrote some letters without the Company's authority.

69. Since the investigation by the ICAC against Mr P was not in relation to matters of the Building, we do not find that the investigation has any bearing on this appeal.

70. For the reasons as aforesaid, we find that the Company has failed to prove that the Building was acquired by the Company as a capital asset. Thus, we dismiss the appeal and confirm the assessment raised on the Company.