Case No. D32/09

Profits tax – sale of land – whether trading or sale of capital assets – sections 2, 14(1) and 68(4) of Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Francis IP Tak Kong and Wendy Wan Yee Ng.

Dates of hearing: 20, 23, 24, 27 March, 14, 15, 16 April and 18, 19, 20 May 2009.
Date of decision: 16 September 2009.

The Taxpayer was a private company. It acquired the properties ('Nos. D and F') in 1931 at a site. In 1986, it acquired another property ('No H') at the same site. In 1987, the Taxpayer commenced its plans to redevelop the site at Nos. D to H into a multi-storey commercial building. In 1991, before any redevelopment work had commenced, the Taxpayer had agreed to sell nineteen floors and a flat roof with the naming right of the building to Company T. In 1992, the Taxpayer further acquired another property ('No. B') at the same site. The re-development project was revised to include No. B and the sale of the relevant floors to Company T was revised to be the 6th to 19th floors of the building. The completed building at Nos. B to H was named as Tower W. The sale of the relevant floors of Tower W to Company T was completed on 7 December 1993. Shortly after the completion of the redevelopment, on 9 June 1994, the Taxpayer sold also the 3rd and 5th floors of Tower W to Company Y.

The Taxpayer claimed that it had intended to keep the redeveloped building for long term investment. The Taxpayer argued that its gains on disposal of the 3rd, 5th to 19th floors of Tower W were from sale of capital assets and thus were not subject to profits tax; and even if the gains on disposal of the relevant units were indeed subject to profits tax, computation of the profits on the sale in question, being the market value adopted by the Deputy Commissioner being the cost of sale, was incorrectly ascertained or valued on an incorrect basis and was below the fair and proper market value for tax purposes.

Held:

1. Under section 14(1) of the IRO, profits tax is chargeable on profits arising in or derived from Hong Kong for such trade, profession or business, excluding profits arising from a sale of capital assets. The definition of trade is very wide and includes 'every adventure and concern in the nature of trade' (section 2 of the IRO). The Board relied on the relevant statement of principle as set out in All Best Wishes Ltd V CIR [1992] 3 HKTC 750 (at 771) per Mortimer J. (Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196 at 1199A-D per Lord Wilberforce also considered).

2. The Board was of the view that the correct approach was that the intention had to be ascertained objectively by reference to whole of the surrounding circumstances including things said and things done not only at the time but also beforehand and afterwards. The Board needed to have regard to all facts and circumstances of each particular case and the interaction of the factors that are present in any given case (Marson v Morton [1986] 1 WLR 1343). (Real Estates Investment v CIR [2007] 1 HKLRD 198 (CA) and D58/06, (2006-07) IRBRD, vol 21, 1071 considered).

3. The Board also took the view and accepted that the Taxpayer's stated intention in itself could not be decisive (All Best Wishes Ltd V CIR [1992] 3 HKTC 750).

4. The Board emphasized that its task was to consider the evidence that was called and produced before the Board and in turn, decide whether or not the Taxpayer did have the intention to hold the investment for a long term purpose.

5. The authorities were clear that a property originally acquired as a capital asset could indeed change its characteristic. The Board needed to look at the facts and the circumstances that led to the change and come to its conclusions. The Board therefore needed to carefully consider the evidence and see exactly what did indeed take place with regard to the development of the various lots in the case before the Board.

6. Having considered the evidence and the badges of trade (in particular those identified by McHugh NPJ in Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51 at paragraph 60), the Board found that when the purchase of No. H was completed on 31 May 1986, the Taxpayer had clearly decided to and did take steps to embark on an adventure in the nature of trade, that is, to redevelop the properties at Nos. D – H and, with the addition of No. B if possible. The Taxpayer did not have the intention at any time to hold the entire building for long term investment after completion of the redevelopment. Instead, the intention was to sell at least substantial parts of the completed building after redevelopment was completed and the sales to Company T and Company Y were made pursuant to that intention.

7. In respect of the second ground of appeal, no evidence was adduced before the Board as to the fair and proper market value for tax purposes. Nor did the Taxpayer adduce any evidence to show why the cost of sales was incorrectly ascertained or in turn, valued on an incorrect basis.

8. The Taxpayer's appeal was dismissed. Having regard to the evidence given on behalf of the Taxpayer and the way in which the Taxpayer conducted itself in this appeal, the Board had no hesitation in awarding costs in the sum of $5,000 against the Taxpayer.

Appeal dismissed and costs order in the amount of $5,000 imposed.

Cases referred to:

All Best Wishes Ltd v CIR [1992] 3 HKTC 750
Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196
Marson v Morton [1986] 1 WLR 1343
Real Estates Investment v CIR [2007] 1 HKLRD 198
D58/06, (2006-07) IRBRD, vol 21, 1071
Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177
Crawford Realty Ltd v Commissioner of Inland Revenue (1991) 3 HKTC 674
Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue [2001] 1 HKLRD 489
Commissioners of Inland Revenue v Reinhold (1953) 34 TC 389
Bowden Investments Pty Ltd v Federal Commissioner of Taxation (1987) 19 ATR 17
D67/88, IRBRD, vol 4, 95
D21/02, IRBRD, vol 17, 500
D14/08, (2008-09) IRBRD, vol 23, 244
Wing On Cheong Investment Co Ltd v CIR (1987) 3 HKTC 1
Waylee Investment Ltd v CIR [1991] 1 HKLR 237
Chinachem Investment Co Ltd v CIR (1987) 2 HKTC 261
Kirkham v Williams [1991] 1 WLR 863
Hudson's Bay Co v Stevens (1909) 5 TC 424
CIR v Quitsubdue Ltd [1999] 2 HKLRD 481
Real Estate Investment (NT) Ltd v CIR (2007-08) IRBRD, vol 22, 913
D74/91, IRBRD, vol 7, 16
CIR v Secan Ltd & Anor (2000) 3 HKCFAR 411
Jones v Leeming [1930] AC 415
Commissioner of Taxes v British Australian Wool Realization Association [1931] AC 224
CH Rand v The Alberni Land Company Limited (1920) 7 TC 629
Lee Yee Shing v CIR [2008] 3 HKLRD 51
D11/80, IRBRD, vol 1, 374
D111/97, IRBRD, vol 13, 20

Chua Guan Hock Senior Counsel and Jonathan Chang Counsel instructed by Chiu, Szeto & Cheng Solicitors, for the taxpayer.
Stewart Wong Counsel instructed by the Department of Justice and Louie Wong Senior Government Counsel for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an Appeal by Company A ('the Taxpayer') against the Determination of the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') dated 17 January 2008. The Determination was as follows:

(a) Profits tax assessment for the year of assessment 1993/94 under charge number X-XXXXXXX-XX-X, dated 30 October 1997, showing net assessable profits of $10,016,680 (after set-off of loss brought forward of $1,450,864) with tax payable thereon of $1,752,919 is hereby reduced to net assessable profits of $5,891,450 (after set-off of loss brought forward of $1,450,864) with tax payable thereon of $1,031,003.

(b) Profits tax assessment for the year of assessment 1994/95 under charge number X-XXXXXXX-XX-X, dated 3 November 1997, showing net assessable profits of $22,202,712 with tax payable thereon of $3,663,447 is hereby reduced to assessable profits of $21,571,200 with tax payable thereon of $3,559,248.

2. On 6 February 2008, the Taxpayer filed Grounds of Appeal. There were two grounds:

(a) The Taxpayer contended that the units of the redeveloped property at Nos. B to H Road I that were sold during the relevant years of assessment were their capital asset and as such, any gains on disposal of those units were capital in nature and as such, not subject to profits tax; and

(b) That even if the gains on disposal of the relevant units were indeed subject to profits tax, computation of the profits on the sale in question, being the market value adopted by the Deputy Commissioner being the cost of sale was incorrectly ascertained or valued on an incorrect basis and was below the fair and proper market value for tax purposes.

Agreed facts

3. The following facts were agreed by the parties and we find them as facts:

(1) Company A ('**Taxpayer**') was a private company incorporated in Hong Kong on 31 March 1931. It closed its accounts on 31 March each year. For the years of assessment 1986/87 to 1994/95, the issued share capital of the Taxpayer was $500,000, comprising 500 ordinary shares of $1,000 each.

(2) On 1 April 1931, the Taxpayer acquired Nos. D to F Road I, Hong Kong on the Remaining Portion of Inland Lot No. XXXX and the Remaining

Portion of Section X of Inland Lot No. XXXX ('Nos. D and F') at a price of $159,500.

(3) By an agreement dated 21 March 1986, the Taxpayer purchased No. H Road I on Inland Lot No. XXXX ('No. H') with existing tenancies at $2,716,000. The purchase of No. H was completed on 31 May 1986.

(4) On 3 April 1987, the Taxpayer through Company J submitted building plans to the Building Authority for obtaining an approval to redevelop the site at Nos. D to H. The redevelopment project involved the construction of a XX-storeyed commercial building. By a letter dated 8 June 1987, the Building Authority consented to the commencement and carrying out of demolition work at Nos. D to H.

(5) By a letter dated 4 May 1988, Bank K agreed to grant to the Taxpayer an 18-month building loan of $13,300,000 and an overdraft facility of $3,600,000 against the security of first legal mortgage on Nos. D to H and the building to be built thereon, and a XX-storeyed commercial building at Nos. L to N Road P.

(6) On 30 June 1989, the Building Authority consented to the commencement and carrying out of piling work at Nos. D to H.

(7) By a letter dated 22 February 1991, the Taxpayer applied to Bank K for an increase in the overdraft facilities granted to the Taxpayer under a Legal Charge of the property at No. L Road P and No. Q Road R, in order to enable the Taxpayer to proceed with the acquisition of No. B Road I ('No. B').

(8) By a letter dated 13 June 1991, Bank K granted to the Taxpayer banking facilities as follows:

(a) a 27-month term loan of $18,000,000 to part finance the construction cost of the development project at Nos. D to H;

(b) an overdraft facility of $5,000,000 to finance the miscellaneous and contingent expenses to the above;

(c) the above facilities were secured against, inter alia:

(i) first legal mortgage for unlimited amount over Nos. D to H and the building to be erected thereon;

(ii) first legal mortgage for unlimited amount over the building at No. L Road P;

(iii) personal guarantees from Mr U, for covering cost overruns and projection completion of the development, and for $23,000,000.

(9) The building mortgage pursuant to the facility letter [Fact (8) above] was executed on 16 December 1991 ('**First Building Mortgage**'). It provided, inter alia, that the term loan would be repaid in one lump sum 27 months from the date of the first drawdown of the loan or the issue of the occupation permit in respect of the building to be erected on Nos. D to H, whichever was the earlier.

(10) By an agreement dated 10 August 1992, the Taxpayer purchased No. B on the Remaining Portion of Inland Lot No. XXXX at a price of $13,000,000.

(11) By an agreement dated 10 August 1992 ('**1992 Agreement**'), the Taxpayer sold 4th Floor and Roof, and 5th to 20th Floors of the XX-storeyed building then under construction on Nos. D to H to Company T at $54,031,172. The sold portion represented 626 equal undivided 1,100th parts or shares of Nos. D to H. The agreement provided:

(a) It was the intention of the Taxpayer to complete the construction of the building on or before 30 September 1993.

(b) Company T should have the right to name and/or to change the name of the building under construction.

(12) By an agreement dated 10 August 1992, Company T sold all its rights under the 1992 Agreement to Company S at $65,500,000.

(13) On 12 August 1992, the Taxpayer through Company V submitted revised building plans to the Building Authority for obtaining an approval to redevelop Nos. B to H. The original building of a XX-storeyed building had been amended to a XX-storeyed building, comprising of 3 shops on the Ground Floor, Mezzanine Floor and the 1st to XXth upper floors.

(14) On 10 September 1992, the Taxpayer through Company V applied to the Building Authority for approval to demolish the then building works up to 4th Floor level down to Ground Floor level at Nos. D to H.

(15) The purchase of No. B was completed on 11 September 1992.

(16) On 9 October 1992, the Building Authority consented to the demolition work at Nos. B to H.

(17) By a letter dated 27 November 1992, Bank K granted to the Taxpayer banking facilities as follows:

(a) a term loan totalling $31,400,000 in two tranches:

(i) tranche A ($8,400,000): to partially re-finance the land cost of No. B;

(ii) tranche B ($23,000,000): to part finance the construction cost of the development project at Nos. B to H;

(b) an overdraft facility of $5,000,000 to finance the miscellaneous and contingent expenses to the above;

(c) the above facilities were secured against, inter alia:

(i) building mortgage over Nos. B to H and the building to be erected thereon;

(ii) personal guarantees from Mr U, for covering cost overruns and projection completion, and for $36,400,000.

(18) The First Building Mortgage was released on 2 December 1992.

(19) The building mortgage pursuant to the facility letter [Fact (17) above] was executed on 2 December 1992 ('Second Building Mortgage'). It provided, inter alia, that the term loan would be repaid in one lump sum 3 months after the issue of the occupation permit of the building to be erected on Nos. B to H, or 31 January 1994, whichever was the earlier.

(20) The construction of the building at the enlarged site at Nos. B to H commenced in January 1993.

(21) By a supplemental agreement to the 1992 Agreement dated 13 August 1993 ('Supplemental Agreement'), the premises sold to Company T changed to 6th to 19th Floors of the XX-storeyed building then under construction on the enlarged site at Nos. B to H. The price was $35,231,172. The sold portion represented 504 equal undivided 1,100th parts or shares of Nos. B to H. The agreement provided:

(a) It was the intention of the Taxpayer to complete the construction of the building on or before 30 October 1993.

(b) The right of Company T to name the building then under construction should be deleted.

(22) Company T and Company S entered into a supplemental agreement dated 13 August 1993 to reflect the above change in the premises purchased by Company T [Fact (21) above], with the price reduced to $46,700,000.

(23) The completed building at Nos. B to H was named as Tower W, and the occupation permit was issued on XX-XX-1993.

(24) Under the Deed of Mutual Covenant dated 7 December 1993, the lots at Nos. B, D, F and H and Tower W had been divided into 1,100 equal undivided shares as follows:

Floor	Allocated shares
G/F: shops 1-3 (3 shops), each 30	90
Mezzanine Floor	60
1st to 3rd Floors (3 floors), each 60	180
4th Floor	50
5th Floor to 20th Floors (16 floors), each 36	576
21st Floor to 24th Floor (4 floors), each 30	120
25th Floor	24
Total	1,100

(25) The sale of 6th to 19th Floors of Tower W to Company T was completed on 7 December 1993.

(26) By a Partial Release dated 7 December 1993, the 6th to 25th Floors of Tower W mortgaged to Bank K under the Second Building Mortgage were released for reassignment on the condition that the general banking facilities granted to the Taxpayer under the Second Building Mortgage was reduced from $28,400,000 to $12,680,000, and the sum of $15,720,000 with interest thereon had been paid.

(27) The Second Building Mortgage was released on 3 March 1994.

(28) By two Memoranda of Agreement, both dated 9 June 1994, the Taxpayer sold the 3rd and 5th Floors of Tower W with vacant possession to Company Y at $18,330,000 and $8,866,750 respectively. Company Y was the then tenant of 18th Floor of Tower W. The sale was completed on 24 August 1994.

(29) The Taxpayer filed its profits tax returns for the years of assessment 1993/94 and 1994/95, together with financial statements for the years ended 31 March 1994 and 1995, and tax computations.

(a) The Taxpayer described its nature of business as 'property and share investment', and 'investment in stocks, shares and in real estate' in its profits tax returns for the years of assessment 1993/94 and 1994/95 respectively.

(b) Supporting schedule to the accounts for the year ended 31 March 1994 showed an amount of $45,271,503 as attributable to the development cost of Tower W, which was calculated as follows:

		Total ($)	Amount claimed for RBA ($)
Land cost *		15,779,920	-
Nos. D to F	$162,000		
No. H	$2,617,920		
No. B	$13,000,000		
	$15,779,920		
Capitalised expenditures			
Architect fee		2,206,593	1,195,572
Surveyor fee		48,675	26,373
Site investigation		272,615	147,708
Piling work		587,800	318,481
Demolition work		282,000	-
Construction work		22,854,542	12,383,006
Bank interest		839,514	454,864
Valuation report		18,000	9,753
Engineering fee		789,129	427,564
Payment for surrender of tenancy			
- compensation paid to tenants		336,000	-
- agency fee		497,248	-
- legal fee		3,625	-
- rates paid for vacant units		10,198	-
Utility connection and installation fee		118,460	64,184
Drainage and road repair		38,914	21,084
Legal fee paid for acquisition of land		52,450	-
Legal fee paid for building mortgage loan		54,570	29,567
Stamp duty		481,250	-
		29,491,583	15,078,156
Total		45,271,503	15,078,156

(c) The Taxpayer classified the gains on disposal of 3th, 5th to 19th Floors of Tower W ('**Properties**') as exceptional item in its accounts and did not offer the gains for assessment. In addition, the Taxpayer claimed rebuilding allowance in respect of the Properties. The relevant figures are as follows:

	1993/94 ($)	1994/95 ($)
Adjusted loss	(3,832,172)	(1,104,194)
Gain on disposal of:-		
6th to 19th Floors	14,488,592	
3rd and 5th Floors		23,245,782
Rebuilding allowance	317,635	393,159

(d) The gain on disposal of the Properties were computed as follows:

	6/F to 19/F ($)	3/F and 5/F ($)
Selling price	35,231,172	27,196,750
Less: Capital cost		
45,271,503 [Fact (29)(b)] x (14x36)/1,100 [Fact (24)]	(20,742,580)	
45,271,503 [Fact (29)(b)] x (36+60)/1,100 [Fact (24)]		(3,950,968)
Gain on disposal	14,488,592	23,245,782

(e) The rebuilding allowances for the years of assessment 1993/94 and 1994/95 were calculated as follows:

1993/94	($)
Balance b/f, at cost [i.e. representing the RBA claimed by the Taxpayer prior to 1993/94]	119,437
Additions:	

- Property under development [Fact (29)(b)]	15,078,156
- Office decoration	327,640
- Decoration and renovation	356,532
	15,881,765
2% thereon	317,635

1994/95	($)
Balance b/f, at cost	15,881,765
Additions: Leasehold improvements	3,776,181
	19,657,946
2% thereon	393,159

(f) The Taxpayer did not claim deduction of legal fee of $59,790 incurred for preparing sale and purchase agreement for the disposal of the 6th to 19th Floors in the year of assessment 1993/94.

(30) The Assessor raised enquiries on the Taxpayer in respect of the gain from the disposal of the Properties. Pending reply to her enquiries, the Assessor raised on the Taxpayer the following statements of loss for the years of assessment 1993/94 and 1994/95:

Year of assessment 1993/94	$
Loss per return	3,832,172
Add: Rebuilding allowance underclaimed (119,437 – 119,437 x 2%)	117,048
Adjusted loss	3,949,220

Year of assessment 1994/95	$
Loss per return	1,104,194
Add: Rebuilding allowance underclaimed (Per 1993/94 computation)	117,048
Adjusted loss	1,221,242

(31) In reply to the Assessor's enquiries, Company AR ('**First Representative**') formerly known as Company AS asserted the following:

(a) The original intention in acquiring No. B and No. H was for redevelopment together with Nos. D to F. The re-developed property, Tower W, was originally intended to be held as long-term investment and for generation of rental income. Such intention was evidenced by the following facts:

(i) The accounting classification of the lots from the commencement of development to the completion of Tower W reflected the Taxpayer's long-term investment intention. Upon completion of the re-development, the 'Property under Development' was reclassified as 'Investment Properties' under Fixed Assets in the Taxpayer's audited balance sheet as at 31 March 1994. The same consistent treatment had been adopted in subsequent years.

(ii) The gains from the disposal of the Properties were treated as 'Exceptional Item' and not as trading gains in the Taxpayer's accounts for the years ended 31 March 1994 and 1995.

(iii) The principal activity carried on by the Taxpayer was investment in real estate for rental purpose, not property trading. The investment intention had been clearly described in the financial statements and the profits tax returns for the relevant years.

(b) The selling prices of the Properties were determined and offered to the Taxpayer by the purchasers who initiated the purchase.

(c) The sale proceeds of the Properties were applied to pay the related selling expenses, to repay the bank loans and to finance the Taxpayer's business activities.

(d) The Taxpayer had let out the following properties in Tower W:

Location	Term of lease	Date of first letting	Monthly rental ($)
G/F & M/F	3 years	20 June 1994	532,000
1/F	2 years	1 July 1994	63,700
2/F	2 years	15 July 1994	65,000
20/F	2 years	16 August 1994	32,058
21/F	2 years	10 October 1994	38,880
22/F	2 years	28 December 1994	44,640

The 23rd and 24th Floors were leased to related companies, namely Company Z and Company AA respectively.

(32) The First Representative forwarded to the Assessor copies of, inter alia, the following documents:

(a) Two letters dated 31 October 1986 and 26 November 1986 from Company AB advising that there were offers from buyers for the purchase of Nos. D to H.

(b) The minutes of meeting of the Board of Directors of the Taxpayer held on 20 December 1991. It was resolved that, 'the decision of re-construction of [Tower W] is for rental purpose and for long-term investment'.

(c) The minutes of meeting of the Board of Directors of the Taxpayer held on 15 July 1993. It was resolved that, 'the disposal of the investment properties at 6/F to 19/F of [Tower W, No. F Road I], Hong Kong at the cost of $20,742,580 during the year ended March 31, 1994 be and are hereby approved.'

(d) The minutes of meeting of the Board of Directors of the Taxpayer held on 14 November 1995. It was resolved that, 'the disposal of the investment properties at 3/F and 5/F of [Tower W, No. F Road I], Hong Kong at the cost of $27,196,750 during the year ended March 31, 1995 be and are hereby approved, ratified and confirmed.'

(e) The cost and return estimates dated 1 April 1990 prepared by Company J in respect of the redevelopment project at Nos. D to H.

(f) The revised cost estimates dated 31 January 1991 for both projects at Nos. D to H, and Nos. B to H.

(g) The valuation report dated 16 August 1991 prepared by Company AC in respect of the construction of the XX-storeyed building on Nos. D to H. Company AC was of the opinion that the estimated gross development value of the building assuming it is free of all encumbrances and offered for vacant possession was in the order of $106,000,000.

(h) A letter dated 6 May 1999 from Company Y showing that the sale of 3/F and 5/F of Tower W was initiated by Company Y due to its business expansion.

(33) The Assessor did not accept that the Properties were the Taxpayer's capital assets and considered that the profits on disposal of the Properties should be chargeable to profits tax and that the rebuilding allowance in respect of the Properties should not be allowed. On diver dates, the Assessor raised on the Taxpayer the following profits tax assessments for the year of assessment 1993/94 and 1994/95:

(a) Year of assessment 1993/94

	$	$
Loss per return [The Assessor accepts that the loss per return should in fact be $3,832,172 per Fact (40)(a)]		(3,082,172)
Add		
Gain on disposal of redeveloped property [Fact (29)(d)]	14,488,592	
Rebuilding allowance as per Taxpayer's claim [Fact (29](e)]	317,635	14,806,227
		11,724,055
Less		
Rebuilding allowance (re: unsold properties in Tower W (*)	137,074	
Rebuilding allowance per 1992/93	119,437	256,511
Assessable profits		11,467,544
Less: Loss brought forward and set-off		1,450,864
Net assessable profits		10,016,680
Tax payable thereon		1,752,919

Note (*): the RBA for the remaining properties at Tower W:

Qualifying expenditure ranking for RBA [Fact (29)(b)] x [Development cost of Tower W [Fact (29)(b)] - Development cost in respect of 3/F, 5/F to 19/F [Fact (29)(d)]] / [Total capital cost [Fact (29)(b)]]

$15,078,156 x $[45,271,503 – (20,742,580 + 3,950,968)] / 45,271,503 x 2%
= $137,074

(b) Year of assessment 1994/95

	$	$

Loss per return [Fact (29)(c)]		(1,104,194)
Add		
Gain on disposal of redeveloped property [Fact (29)(d)]	23,245,782	
Rebuilding allowance over-claimed		
$393,159 [Fact (29)(e)] - {256,511 [Fact (33](a)] + 3,776,181 [Fact (29)(e)] x 2%}	61,124	23,306,906
Assessable profits		22,202,712
Tax payable thereon		3,663,447

(34) The First Representative objected against the above assessments on the ground that the gain on disposal of the Properties was capital in nature. It provided the following information in relation to the development of Tower W:

(a) Nos. D to F had been inherited and owned by the Taxpayer for over 60 years whereas No. H was purchased from an unrelated party on 31 May 1986. It was the intention of the Taxpayer to acquire No. B and merge with the other three pieces of land and develop the site into a commercial building for long-term rental purposes and not to trade for profits.

(b) At that time, old buildings were erected on No. B from which rental income was derived. Continuous efforts were made to acquire the land so as to achieve unity in ownership for the site for the long-term investment project. However, there were obstacles in doing so as the owner rejected to sell the land. Realising that the owner was not willing to co-operate, the Taxpayer resolved to commence construction of a commercial building on Nos. D to H. Construction plan and financing arrangement were made with Company J and Bank K respectively. Valuation report and cost & return estimates were performed to see whether it was feasible to develop Nos. D to H for long-term rental purposes.

(c) Before development, some of the properties were leased out for rental income. After the expiry of the tenancy agreements, demolition work was carried out in the site which was followed by foundation work. However, the progress of the foundation work had been delayed and lasted for over a year due to sudden

intervention by the infrastructure construction. Construction finally commenced in 1991.

(d) After years of negotiation, the Taxpayer was finally able to acquire No. B. The construction work at Nos. D to H was then suspended on 3 August 1992 and the 2 to 3-storeyed building which had already been constructed was ordered to be demolished.

(35) In support of the Taxpayer's long-term investment intention in respect of Tower W, the First Representative contended, inter alia, the following:

(a) No advertisement had ever been placed for the sale of the Properties. The Taxpayer was only approached by Company T shortly after Tower W was constructed. Company T made an attractive offer, while the Taxpayer was planning to solicit potential tenants. It was the Taxpayer's understanding that Company T subsequently changed its shareholders and sold the properties to Company S. The properties were only then offered to public. The Taxpayer had no relation with either Company T or Company S. The advertisement made, if any, might probably be the effort of Company T or Company S.

(b) In June 1994, the new owner of 18/F, Company Y approached the Taxpayer to purchase more floors for its business expansion. The initiation for the purchase came from Company Y. The Taxpayer had never any intention to sell Tower W which was built for earning rental income and own use. On both occasions of sale, the offers were unsolicited. Like the sale of 3/F and 5/F, Company Y persuaded the Taxpayer to sell at least 2 floors to them. Clearly, Company Y preferred to buy 2 consecutive floors. However, the Taxpayer was unwilling to sell 4/F as this was the only floor in the whole building with a canopy and therefore was highly valued for long-term purpose for earning rental income.

(c) The Taxpayer had requested Company J to carry out a cost and return estimate in 1990 just before the commencement of the redevelopment. In that model, two courses of action were identified and examined to see which served the long-term investment policy. It was clearly demonstrated that renting out the properties provided a good internal rate of return and reasonable paid back period. Therefore, the model itself demonstrated the yield potential of holding the properties for long-term which was consistent with long-term intention. The model re-affirmed the commercial rationale which justified the

Taxpayer's intention to develop and hold the properties for rental income after their completion.

(d) The Taxpayer had received many attractive offers from potential buyers directly and also through real estate agents and surveyors while development of Tower W was still in progress. However, the Taxpayer rejected all these offers for reason that the properties at Tower W were not re-developed for sale.

(e) The Taxpayer appointed Company AD on 14 November 1992 as its executive leasing agent for a period of 6 months for leasing out G/F to 3/F of Tower W.

(f) The demolition of the old buildings at the lots for redevelopment was just a natural course of action that any long-term investor would take to increase the return from the investment. The Taxpayer had never changed its intention of holding the properties for long-term purposes. If the Taxpayer had intended to trade for profits, instead of holding the lots for redevelopment, it could sell the lots and realize a windfall gain. However, the Taxpayer's choice to redevelop the lots only manifested its unchanged intention.

(g) As a matter of fact, the property market started to bloom in 1992 and property prices were soaring crazily throughout 1993 to 1994. The ownership of 6/F to 19/F changed several times after they were sold to Company T. If the Taxpayer intended to trade the redeveloped properties for a fast gain, it could have easily sold the remaining floors to reap a handsome profit.

(h) The development in Tower W was only partly financed by secured bank loan and construction bank loan. The rest of funding came from retained earnings and property redevelopment reserve. They were all long-term sources of finance. This demonstrated the Taxpayer's ability to hold the investment for long-term investment purposes.

(i) The Taxpayer never had any intention to trade the property units in Tower W which were developed for long-term rental purpose. The disposal of the Properties resulted from fortuitous offers at good prices. The blooming property market starting from late 1992 had distorted the demand for rental commercial properties. As the property prices rose sharply in those days, people were only willing to purchase property for their own use instead of leasing as buying property had the added value of asset appreciation in times of property blooming period. Therefore, to

the Taxpayer's unexpectedness, there was hardly any demand for rental commercial properties when Tower W was near completion. The property market at that time had been tilted unhealthily to one of mainly buying and selling. As a result, it had become unexpectedly difficult to lease out the property units. The failure of Company AD and Company AE to successfully lease the units out were clear evidence of the change of property market demand at that time.

(j) The Taxpayer had no history of property dealing.

(36) The Taxpayer's changed its tax representative to Company AT ('**Second Representatives**') who put forth the following information and documents in support of the Taxpayer's long-term intention towards the redevelopment of Nos. B to H:

(a) Copies of minutes of directors' meeting:

(i) Dated 7 December 1978. The Taxpayer rejected the offer from an independent third party to purchase Nos. D to F. The Taxpayer would only consider to redevelop the site.

(ii) Dated 12 November 1980. It was resolved that due to the poor condition of the property at Nos. D to F, the property should be redeveloped and the redevelopment could be undertaken in co-operation with the owners of the adjacent properties. The Taxpayer would set aside $3,000,000 from its retained earnings to 'property redevelopment reserve'.

(iii) Dated 23 August 1985. It was resolved that Nos. D to F should be redeveloped. In addition, the management considered that the acquisition of Nos. B and H could benefit the redevelopment of Nos. D to F.

(iv) Dated 22 December 1986. The Taxpayer had appointed Company J to carry out a research in respect of the redevelopment project at Nos. D to H. It was resolved that the Taxpayer would borrow from bank for the necessary funds to finance the development cost. It was recorded that the Taxpayer rejected the offer from an independent third party to purchase Nos. D to H as it was not in line with the redevelopment plan of the Taxpayer.

(b) The disposal of the 4/F to 20/F in August 1992 was a result of receiving a very attractive unsolicited offer from Company T. Company T is a well-known property dealer. Company T offered

to purchase 4/F to 20/F of Tower W, representing 626 equal undivided 1,100th shares of Tower W, at a consideration of $54,000,000. According to the cost estimation prepared by Company V as of May 1992, the estimated total construction cost for the redevelopment was $30,000,000. Based on the estimation, the relevant portion of the construction cost attributable to the 4/F to 20/F would be $17,000,000 (i.e. $30,000,000 x 626/1,100). Comparing the purchase price offered by Company T and the attributable construction cost and taking into account other relevant expenses for the redevelopment, the management of the Taxpayer considered that the unsolicited offer from Company T was certainly a very attractive offer which was too good to resist. The offer from Company T was accepted and the Taxpayer entered into the 1992 Agreement with Company T for the sale of 4/F to 20/F in August 1992.

(c) Despite that part of the redeveloped properties was disposed of upon receipt of an unsolicited offer from Company T, the Taxpayer retained the naming right of the building and the building was named as 'Tower W'. If the Taxpayer's intention towards the redevelopment had been short-term and the building had been redeveloped for sale, the Taxpayer would not have retained the naming right of the building.

(d) The Taxpayer retained the top floors of 23/F to 25/F of Tower W as its headquarters. The locating of the headquarters at the long-inherited family property indicated that the intention towards the redevelopment was long-term. In addition, the Taxpayer retained the management right of Tower W.

(e) The Second Building Mortgage was entered with Bank K after the Taxpayer received the unsolicited offer from Company T for purchasing some properties at Tower W. Given the arrangement of term loan with Bank K took place subsequent to the execution of the 1992 Agreement with Company T in August 1992, the management of the Taxpayer had taken this into account in agreeing the repayment term of the loan with Bank K. The sale proceeds arising from the disposal of the properties as a result of the unsolicited offer from Company T could serve as a source of funds for repaying the term loan. The management of the Taxpayer considered it beneficial to repay the term loan as soon as practicable to minimize the interest expenses to be incurred. This course of action was wholly justifiable from a commercial point of view.

(f) Before the issuance of the occupation permit on XX-XX-1993, Company AD had already been appointed by the Taxpayer as its leasing agent to lease G/F to 3/F of Tower W. The appointment of leasing agent for certain floors in the first instance was consistent with the long-term rental purpose of the Taxpayer towards the property units at Tower W. The 3/F of Tower W was offered for lease before the occupation permit was issued in XX-1993. This served as concrete evidence of the Taxpayer's long-term investment intention towards the 3/F and 5/F which were disposed subsequently as a result of the unsolicited offer from Company Y in June 1994 whilst those floors were looking for tenancies.

(g) The valuation report [Fact (32)(g)] had been prepared for the purposes of satisfying the Taxpayer's banker in order to obtain long-term finance. A valuation prepared on the basis that the property was for sale was a pre-requisite when applying for debt-funding from banks, as banks would need to know how much they could realize from the collateral to cover their exposure by selling the collateral in the open market if the borrower was in default in repaying the bank loans. In this regard, the Second Representative provided a letter from Bank K dated 19 January 2005 advising Bank K's standard requirement to obtain a valuation report on the potential sales value of the mortgaged property for their lending decision regardless of whether their clients intend to keep the property as long-term investment or otherwise.

(h) Even if the Taxpayer had not sold the relevant floors of Tower W, the Taxpayer could have easily obtained the necessary funding from its banker to finance the redevelopment and the long-term holding of all properties in Tower W. To this end, they submitted 2 computations showing hypothesized scenarios comparing the rental income generated from Tower W and the associated mortgage outlays. These hypothesized scenarios had been prepared based on the assumption that the Taxpayer had held onto the floors and rented them out to derive rental income. The two analyses indicated that the amounts of monthly rental income after allowing the related repair and maintenance cost would exceed the amounts of monthly loan repayments. Furthermore, the acquisition of No. B actually improved the Taxpayer's rental return.

(37) The Commissioner of Rating and Valuation valued Nos. D to F as at 31 May 1986 as follows:

		Valuation
(a)	On vacant possession	$7,300,000
(b)	On vacant possession contemplating a redevelopment of a commercial building at Nos. D to H	$8,600,000

(38) In response to the Assessor's draft statement of facts, the Second Representative sent further submissions and, inter alia, the following documents:

(a) An affirmation from Mr U.

(b) The minutes of meeting of the Board of Directors of the Taxpayer held on 8 May 1981. It was recorded that as the owner of No. H was not prepared to sell the property, the joint redevelopment at Nos. D to F could not be put through. The Taxpayer would appoint an architect to prepare a building plan in respect of Nos. D to F for the Board's approval.

(c) The minutes of meeting of the Board of Directors of the Taxpayer held on 30 December 1982. It was recorded that the owner of No. H was willing to sell the property. Mr U was authorized to negotiate the selling price with the owner of No. H. He would also discuss with the architect concerning the feasibility to carry out the redevelopment.

(d) The minutes of meeting of the Board of Directors of the Taxpayer held on 18 December 1985. It was recorded that the Taxpayer would continue to plan to acquire Nos. H and B. The Board resolved that no dividend was payable for the year due to the purchase of Nos. B and H and the redevelopment.

(39) The Assessor maintains the view that the Taxpayer should be chargeable to profits tax in respect of profits derived from the disposal of the Properties. On the other hand, the Assessor is of the view that the market value of Nos. D to F as at 31 May 1986 (when the Taxpayer purchased No. H) on a vacant possession basis [i.e. $7,300,000 per Fact (37)(a)] should be used to compute the taxable profit, instead of the historical cost of $159,500 [Fact (2)].

(40) The Assessor now considers that the 1993/94 and 1994/95 profits tax assessments should be revised as follows:

(a) Year of assessment 1993/94

	$	$

Loss per return [Fact (29)(c)]		(3,832,172)
Add		
Gain on disposal of redeveloped property [Note 1]	11,173,152	
Rebuilding allowance as per Taxpayer's claim [Fact (29)(c)]	317,635	11,490,787
		7,658,615
Less		
Rebuilding allowance [Fact (33) Note]	137,074	
Rebuilding allowance per 1992/93 [Fact (29)(e)]	119,437	
Legal fee for disposal of 6/F to 19/F [Fact (29)(f)]	59,790	316,301
Assessable profits		7,342,314
Less: Loss brought forward and set-off		1,450,864
Net assessable profits		5,891,450
Tax payable thereon		1,031,003

(b) Year of assessment 1994/95

	$	$
Loss per return [Fact (29)(c)]		(1,104,194)
Add		
Gain on disposal of redeveloped property [Note 1]	22,614,270	
Rebuilding allowance per Taxpayer's claim [Fact (29)(c)]	393,159	23,007,429
		21,903,235
Less		
Rebuilding allowance $137,074 + 119,437 + {3,776,181 [Fact (29)(e)] x 2%}		(332,035)
Assessable profits		21,571,200
Tax payable thereon		3,559,248

Note 1: Gain on disposal of the Properties

	6/F to 19/F	3/F and 5/F
	$	$
Selling price [Fact (29)(d)]	35,231,172	27,196,750
Less: capital cost		
52,507,583 x (14x36) / 1,100 [Fact (24)]	(24,058,020)	
52,507,583 x (36+60) / 1,100 [Fact (24)]		(4,582,480)
Gain on disposal	11,173,152	22,614,270

Capital cost	$
Land cost	
- Nos. D to F [Fact (37)(a)]	7,300,000
- No. H [Fact (3)]	2,716,000
- No. B [Fact (10)]	13,000,000
	23,016,000
Other capitalized expenditure [Fact (29)(b)]	29,491,583
Total	52,507,583

The issues

4. Section 14(1) of the Inland Revenue Ordinance (Chapter 112) ('IRO') provides as follows:

> *'Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from a sale of capital assets) as ascertained in accordance with this Part.'*

5. Therefore, the key issue for us to consider is whether the various floors of Tower W which were ultimately sold to Company T and Company Y were the Taxpayer's capital assets or were they considered to be trading.

6. There can be no issue that the Taxpayer did indeed carry on activities in an organized fashion and was able to utilize its assets to generate profits. Therefore, the Taxpayer needs to rely on the exception set out in section 14(1), that is, that the profits arose from the sale of capital assets.

7. Section 68(4) of the IRO provides that:

> *'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

8. Therefore, we need to consider:

(a) Whether the Taxpayer has discharged its onus of proving that each of the assessments appealed against is incorrect because the various floors of Tower W sold during the relevant years of assessment were capital assets; and

(b) If the Taxpayer fails in the first ground of appeal, whether the Taxpayer has discharged its onus of proving that each of the assessments in question is excessive because the market value adopted by the Deputy Commissioner for the cost of sale was below the fair and proper market value for tax purposes.

9. Therefore, we accept that the crucial issue for us to consider is whether the assessment is excessive or incorrect. We also accept that the Deputy Commissioner is not bound by any of the reasons or grounds that are set out in the Determination. We do not need to have considered whether the analysis in the Determination is incorrect. We refer to All Best Wishes Ltd v CIR [1992] 3 HKTC 750 (at 772) per Mortimer J:

> *'It must be remembered that the burden of disturbing the assessment, rests upon the taxpayer.'*

The law

10. Under section 14(1) of the IRO, profits tax is chargeable on profits arising in or derived from Hong Kong for such trade, profession or business, excluding profits arising from a sale of capital assets. The definition of trade is very wide and includes 'every adventure and concern in the nature of trade' (section 2 of the IRO). We rely on the relevant statement of principle as set out in All Best Wishes Ltd V CIR [1992] 3 HKTC 750 (at 771) per Mortimer J:

> *'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. All 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.'*

11. We also refer to Lord Wilberforce in Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196 at 1199A-D:

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

12. We are of the view that the correct approach is that the intention has to be ascertained objectively by reference to whole of the surrounding circumstances including things said and things done not only at the time but also beforehand and afterwards. Again, we rely on Marson v Morton [1986] 1 WLR 1343 as to the fact that we need to have regard to all facts and circumstances of each particular case and the interaction of the factors that are present in any given case. We also rely on the Real Estates Investment v CIR [2007] 1 HKLRD 198 (CA) where Andrew Cheung J in the Court of Appeal stated as follows:

> *'The question then becomes: which approach should one adopt in deciding whether the transaction was a sale of a capital asset and not a trading activity? It is clear from a reading of the judgment of Simmons that although Lord Wilberforce focused on the question of the taxpayer's intention at the time of the acquisition of the property, this issue cannot be dealt with in isolation and has to be considered by examining all the circumstances of the case. As often said the state of a man's mind is as much as a question of fact as the state of his digestion. One needs to consider all the circumstances in order to ascertain a person's intention. Once this point is clear then there really is no conflict between the approach in Simmons and the badges of trade approach. Both approaches will lead to the same destiny, namely, the answer to the question of*

> *whether profits arise from the sale of a trading stock or a capital asset. This is because both involve a consideration of the circumstances of the case. The badges of trade are convenient categorization of the relevant factors when one considers the circumstances of the case. The intention to trade or to hold the property as an investment is one of the circumstances to be considered in deciding whether the property that is eventually disposed of is a capital property. At the same time if after considering all the circumstances one can conclude on the nature of the intention then this will help to answer the question posed in the enquiry.'*

13. We also take onboard the comments made by the Board in D58/06, (2006-07) IRBRD, vol 21, 1071:

> *'The authorities clearly show that the issue for us to decide is whether the Taxpayer has established to our satisfaction that the Taxpayer did not have such an intention to trade but rather had the intention to hold the property as a long term assessment. The Taxpayer must satisfy us that the Subject Properties were capital assets and that their* **only intention** *was to retain them for a long term investment and for rent. Therefore, it is incumbent upon us to review the evidence as a whole, look at all circumstances and factors that resulted in the sale of the Subject Properties and to come to a conclusion whether or not the intention of the Taxpayer was to hold the property for a long term investment as a capital asset and was not participating in an adventure in the nature of trade.'*

14. We also take the view and accept that the Taxpayer's stated intention in itself cannot be decisive (All Best Wishes).

15. Again, we emphasize that our task in the light of all the authorities put before us by both parties is to consider the evidence that was called and produced before us and in turn, decide whether or not the Taxpayer did have the intention to hold the investment for a long term purpose.

16. We also have had the opportunity to consider the following authorities:

(a) Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 per Holmes JA;

(b) Crawford Realty Ltd v Commissioner of Inland Revenue (1991) 3 HKTC 674 per Barnett J;

(c) Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue [2001] 1 HKLRD 489 per Tong J;

(d) Commissioners of Inland Revenue v Reinhold (1953) 34 TC 389;

(e) Bowden Investments Pty Ltd v Federal Commissioner of Taxation (1987) 19 ATR 17 per Fox, Northrop and Burchett JJ;

(f) D67/88, IRBRD, vol 4, 95;

(g) D21/02, IRBRD, vol 17, 500;

(h) D14/08, (2008-09) IRBRD, vol 23, 244.

17. We believe these cases are clear in that a property originally acquired as a capital asset can indeed change its characteristic. The authorities are clear. We need to look at the facts and the circumstances that led to the change and come to our conclusions. We therefore need to carefully consider the evidence and see exactly what did indeed take place with regard to the development of the various lots in the case before us.

The evidence

18. The Taxpayer called two witnesses, Mr U and Mr AF.

A. Mr U

19. Mr U is a majority shareholder and a director of the Taxpayer. He has been a practicing barrister in Hong Kong. He was called to the Bar in London in 19XX and in Hong Kong in 19XX.

20. Mr U signed his first witness statement on 30 September 2008 and this statement was adopted as his evidence in chief.

21. The Taxpayer was a private company incorporated in Hong Kong in 1931. He advised us that he was the head of the family and he was the Chairman and Permanent Director of the Taxpayer and confirmed that most of its business decisions were made by him. It can be seen from the agreed facts and confirmed by Mr U that Nos. D and F were acquired on 1 April 1931 and subsequently on 21 March 1986, the Taxpayer purchased No. H with completion taking place on 31 May 1986. He confirmed in his evidence that in 1986 when they acquired No. H, there were four directors of the Taxpayer including himself, his mother, his elder son (Mr AF) and his younger son (Mr AG).

22. He told us that before Tower W was constructed, it was a x-storey building on Nos. D and F. He advised us that since the condition of the old buildings was progressively declining, the Taxpayer's position was that it wished to acquire adjoining lots and in turn, combine and merged these into one large lot and this would allow for redevelopment of the land and in turn, the construction of a commercial building for what he indicated would be long-term rental purposes. Hence, the reason for the acquisition of No. H.

23. The Taxpayer also sought to acquire No. B. Again, as he said, it was to form a larger site and part of an intended redevelopment plan. However, he indicated to us that

despite their continued efforts to acquire No. B, the existing owner was not content to sell and various obstacles were put up to prevent such an acquisition.

24. He indicated to us that the Taxpayer decided to commence construction of a commercial building on Nos. D, F and H only. He drew to our attention the fact that various construction plans and financial arrangements were put in place, the Taxpayer's civil engineers, Company J, and their bankers, Bank K were appointed to assist. He drew to our attention the various reports, costs and return estimates which he said were prepared to see whether it was feasible to develop the property for long-term rental purposes.

25. There were various consents obtained from the Building Authority with regard to the commencement of the demolition work at the site of Nos. D to H in June 1987. However, there were various difficulties with regard to the ongoing infrastructure construction work in respect of an intended piling and other issues that were needed to be dealt with. Therefore, it took some time and it was not until March 1991 that substantive construction work could be carried out on the Nos. D to H site.

26. The Taxpayer had not entirely given us its plan to acquire No. B to form part of the combined site. He referred to the various costs estimates prepared by various surveyors between 1989 and 1991 in respect of an overall redevelopment plan.

27. The property market in Hong Kong was exceptionally active in the early 1990s until late 1997.

28. He indicated to us that while the development was still in progress, he had received numerous attractive offers to buy the whole of the building under construction from the Taxpayer. He recalled receiving these offers on an almost daily basis from various real estate agents, surveyors, etc. who came up to his chambers attempting to lure him into selling.

29. He emphasized to us that all along, he continued to reject these proposals.

30. He then explained to us the circumstance that led to the sale to Company T. He advised us that Company T was one of many parties which approached the Taxpayer to purchase the whole of the redeveloped building.

31. He advised us that he could not actually recollect when Company T made its first approach but he was clear that it was some time towards the end of 1991 when the construction of the site of Nos. D to H was already underway. He recollected that Company T came back with a revised offer to buy only part of the redeveloped building (he advised us that at that time, No. B was not acquired).

32. He indicated to us that the reason for the sale was that the price offer was in his words 'irresistible' and they offered in excess of $54,000,000 for the 4th to 20th floors of the building.

33. During the course of his evidence, he indicated to us that it would have taken a 'super human effort' to resist such an offer. He told us that it was he himself who decided to proceed with the decision to sell without consulting any of the other directors.

34. During cross-examination, he agreed, having been taken to the relevant documentation that the first time he was approached by Company T was roughly about a month before 10 August 1992. He indicated that at first he refused to sell. He then advised that Company T came back with a revised offer of $54,000,000. His evidence was unequivocal, that this happened in July and August 1992. He was specifically asked during cross-examination as to whether there was any binding agreement signed before 10 August 1992. He categorically confirmed there was none at all. However, during the cross-examination when he first gave evidence before us, his attention was drawn to a Memorandum and Sub-sale Agreement dated 23 March 1992. That Memorandum and Sub-sale Agreement clearly referred to a Memorandum of Agreement dated 15 August 1991 ('MOA') which was stated to be between the Taxpayer and Company T where it was agreed that they would sell to the latter the very same floors and the naming right being the subject matter of the Sale and Purchase Agreement dated 10 August 1992 between the same parties. During his evidence, he indicated to us that no such sale actually happened.

35. After Mr U and his son, Mr AF, had finished giving evidence, we raised our concerns as to the status of the conveyancing file of Company AH. We were informed that file had been lost and could not be located. Mr Chua Guan-hock, SC requested that an adjournment be allowed to enable further enquiries to be made as to whether or not the file was indeed lost and to see whether it could be recovered.

36. We agreed to allow a short adjournment to enable enquiries to be made.

37. The hearing was then adjourned until 14 April 2009. Before that date, we were provided with supplemental statements both of Mr U and Mr AF. The conveyancing file was found. We were provided with a copy of the file and the documents.

38. When the hearing was reconvened on 14 April 2009, Mr Chua Guan-hock, SC made an application to recall both Mr U and Mr AF. Mr Stewart Wong on behalf of the IRD did not raise any objections and in turn, Mr U gave further evidence in respect of this matter.

39. It is clear however from his supplemental witness statement which again stood as his evidence in chief, Mr U was now able to provide some further evidence as to the circumstances that led to the sale to Company T.

40. He indicated to us that once he had the opportunity to review the recently discovered conveyancing file:

> 'Some of my long-lost memory in the development of [Tower W] was jogged after reading through various documents in the conveyancing file of some 18 years ago'.

41. He advised us in his evidence before us, he was confused when he claimed that there was no MOA.

42. Having had sight of the conveyancing file, he must have confused the negotiations that led to the signing of the formal agreement with Company T in August 1992 with negotiations that took place earlier on in August 1991 (a year earlier).

43. He now recollected that in about June 1991, one or two months before the MOA was signed, a lady representing Company T approached him with an unsolicited offer to buy firstly the whole of Tower W and later with an alternative offer to buy part of the building under construction.

44. He stated that he directed her to the Taxpayer's solicitors, Company AH. He advised us that this lady kept on coming to his chambers with various offers and he did not really want to be hassled or bothered at his chambers.

45. He could not recall exactly the precise terms of the various offers. However, from reconstructing the documents, he took the view that it was quite likely that the offer which attracted his interest was when she offered $2,600 per square foot to buy the 4th to 22nd floors of the building under construction.

46. He now indicated to us that Company T's offer at $2,600 per square foot was a '*very good offer*'. However, when cross-examined, he accepted and agreed that this was '*a fair price*'.

47. Under cross-examination he now recollected that he had told his mother about the agreement to sell part of the building. His mother told him that there was no need for him to tell his two sons about the sale and that the reason why his sons should not be told was because his mother knew all along they did not want to sell any part of the building which was under redevelopment.

48. Previously, when he first gave evidence, he advised us that the reason for not telling his sons was due to the fact that they were not in Hong Kong at that particular time and that they were not told because they would object or be unhappy about it. However, it now seems that the reason given is because his mother told him that he should not tell his sons. In his supplemental witness statement, he stated that the reason for not telling his sons about the discussions with Company T was because he did not want to cause any conflict between his mother and his sons.

49. It is important to give careful consideration to what Mr U said at the first time when he gave evidence as to what happened in July and August 1992. The following was put to him by Mr Stewart Wong:

> '….. the effect of your evidence was that you were first approached by [Company T], the purchaser, about four weeks or a month or so before 10 August 1992 for the whole building, you said no, and then they came back

> about two weeks later and this time you say some floors only. You pretend that you are not interested, you said 'I did not show any interest'. Then you went back and you did some calculations, you talk to the architects and solicitors, and then you decided to sell. Then you instructed [Company AH] to draft a formal sale and purchase agreement. Then you told [Company T] for the first time, on 10 August 1992, that you would sell and then you signed the formal agreement on the spot.'
>
> He agreed with this.

50. It is also clear from his evidence that the $600,000 deposit was paid in August 1991 under the MOA and there was a receipt dated 17 August 1991 from Company AH. When Mr U gave evidence to us in the first round, his explanation as to the nature and circumstances of the payment was now totally different. Mr U tried to explain this to us by way of mixing up dates or his poor memory.

51. Mr U originally said that he instructed Company AH to prepare a formal sale and purchase agreement in August 1992 after he decided to sell and that this was the first binding document. However, this was not the case since there was the MOA dated 15 August 1991. It was clear however that the MOA was not drafted by Company AH and Company AH did not open their file until 17 August 1991.

52. Mr U, when he first gave evidence, he indicated to us that the reason for selling was due to the fact that the offer was too good to resist because the sale price of approximately $54,000,000 was more than three times the estimated construction costs ($17,000,000). When specifically asked in cross-examination whether this calculation with those figures was carried out by him, he answered yes. In cross-examination, Mr U also agreed that he could not have done and in fact did not do the calculation in 1991. The calculation was devised by Mr U after the sale and, in turn, he attempted to present this as the actual calculation carried out before in an attempt to justify the sale.

53. We have no difficulties in accepting that this calculation indeed was 'made up' for the Board's consumption as suggested by Mr Stewart Wong.

54. It is also clear that Mr U did accept that the calculation was also based on Company V's estimate not long before he made his first statement dated 30 September 2008.

55. In our view, the facts and circumstances of the sale, that were supposed to have happened in July and August 1992 cannot be taken and put into context and as Mr Stewart Wong suggested by 'transplanting' these to July and August 1991. We accept that this was not a question of just misplacing the time of the events. It was also not a question of poor memory because in his first round of evidence, he gave a very positive case of what took place with a full sequence of events which he clearly set out and had no difficulties in recalling matters. He relied very heavily on his witness statement which dated 30 September 2008.

56. We have given very careful consideration to the second round of evidence given by Mr U. He stated that Company T made an unsolicited offer based on $2,600 per square foot. Again, he asserted that his mother 'pressured' him to sell and that he did not tell his sons because he did not want to cause a family dispute.

57. We need to consider as to whether the $2,600 per square foot put forward by Mr U was indeed correct. Again, there was no direct evidence of the market value of the property in July and August 1991. The valuation report prepared by Company J showed the value at between $3,000 and $3,500 per square foot. During the course of cross-examination, Mr U and indeed, Mr AF when he gave evidence, both accepted that the real property market was steadily on the rise from April 1990 to July 1991. Therefore, taking all matters into account, it is quite clear that the offer of $2,600 per square foot could only be considered to be close to 80% of the market value.

58. It is clearly Mr U's evidence when cross-examined that he agreed to sell certain floors at a price that was clearly lower than the market value. This was so even when the naming rights had not been included and the flat roofs at the 4th and 22nd floors were also not included in the calculation.

59. We accept that such a course of conduct does not illustrate nor support an intention that they did not want to sell.

60. In the course of his evidence before us during the second round, Mr U indicated that the real reason why he sold was because of the fact that his mother (the matriarch of the family) wanted to sell. Mr U however agreed that no matter how much his mother would wish to sell, he would not sell if the price was not fair or proper. Of course, one needs to have regard to the market value of the property at the relevant time. During the first round of his evidence, Mr U confirmed that he talked to his architects and solicitors about the offer. However, during the second round, he indicated to us that he was now talking to the bank. During the course of his evidence before us during the second round, he was now able to give very detailed evidence of his conversation with the bank. When he first gave evidence before us, he made no mention of any discussions with the bank.

61. During his first round of evidence before us, he made very clear that he expressly said that he did not ask his mother about the intended sale. He indicated to us that between 1991 and 1992, his mother was very sick and was always in hospital. He stated to us that she never approved the sale and the sale was never mentioned to her. However, during the second round of his evidence, his evidence dramatically changes. His position is that not only that she approved the sale and that she was the key person who really wanted to sell. He told us that his mother was pressuring him to sell. However, it is quite clear that he did not mention the word 'pressure' in his supplemental witness statement. When asked why he did not mention it, he indicated that he did not believe that these family issues needed to be aired. He was of the view that the IRD and the Board would only be interested in facts.

62. Mr U's evidence that he decided to sell in July and August 1991 without consulting his sons because his mother told him not to do so needs to be looked at carefully. At that time, Mr AF was in charge of the redevelopment project. Mr U indicated to us that the reason why he did not tell his sons was because he did not want to have a confrontation or cause family difficulties. However, having regard to the ongoing redevelopment project, the sale would have come out into the open. The suggestion that he did not tell his sons because his mother told him not to, in our view, is not believable and we reject this part of his evidence.

63. We also repeat what we have previously said. It is clear that when he first gave evidence, the reason for not telling his sons was that they were not in Hong Kong. He did not mention that the reason for not telling them was to avoid a family conflict. When Mr U gave evidence, he did not say that he failed to recollect his mother's role during the first time round but simply did not give evidence because he felt this was something he did not want to have aired before the Board or the IRD.

64. We reject this explanation. Mr U also indicated to us the reason why he had to come clean and to tell his sons as to the sale to Company T was due to the fact that they were closing in on the deal to buy No. B. However, when he first gave evidence and having regard to his first witness statement, he indicated that this was not prompted by the acquisition of No. B.

65. According to Mr AF, his father just told him of the sale and it was Mr AF who then raised the question of the status of No. B. Hence, it is clear from the first version that No. B was not in Mr U's mind when he told Mr AF.

66. Mr U also gave evidence regarding the naming rights of the building. He said that he overlooked this in the formal sale and purchase agreement. However, the naming right was expressly mentioned in the MOA dated 15 August 1991. This is a five-page document which is clearly and easily readable. We have no difficulties in accepting that Mr U would have known about this. Indeed, in cross-examination, he agreed that he did read the MOA before signing it, and he saw the naming rights that had been sold. Hence, it is quite clear that the naming right was not as he alleged slipped in without him noticing.

67. In considering Mr U's evidence with regard to the intention to sell the property to Company T, we were also able to look at the relevant communications and correspondence in the conveyancing file. There was a letter dated 17 December 1991 from Company AI, the solicitors for Company T which offered to buy the whole of Nos. D to H.

68. Although the letter dated 17 December 1991 was entitled 'Nos. D-AK Road I', there can be no doubt that the reference to No. AK must have been a typographical error. The purchase price stated in the letter dated 17 December, 1991 was $104,000,000. On 18 December 1991, Company AH responded to Company AI that their offer was not acceptable but the Taxpayer was prepared to sell the above site, that is, Nos. D-H for $100,000,000 but with advanced payment terms. In the course of his evidence, Mr U stated

that the counter-offer was just a joke by him and his solicitor, Mr AJ. However, there can be no doubt that there was a clear willingness to counter-offer.

69. We find the suggestion that this counter-offer was a joke incredible and not believable. We accept the submissions of Mr Stewart Wong that there was no reason why it should be in the absence of evidence from the Taxpayer as to the market value of the site at that time to be 'so laughable' that it would never be accepted.

70. Mr U gave evidence regarding the sale of the property to Company Y. The sale to Company Y of the 3rd and 5th floors took place on 9 June 1994. In cross-examination, Mr U indicated that he had nothing to do with the sale, however, Mr AF, when he gave evidence and when he was also cross-examined, said that he had nothing to do with negotiations and the sale. However, in their respective witness statements, again they indicated that the offer was one that was too good to reject. Hence, it is clear that neither Mr U nor Mr AF had given any satisfactory or coherent evidence as to the reason for sale of these particular floors.

B. Mr AF

71. Mr AF was also called to give evidence before us on behalf of the Taxpayer. He gave evidence on two occasions. His first evidence was in respect of his first witness statement dated 30 September 2008. He subsequently was recalled to give further evidence based on his supplemental witness statement dated 9 April 2009. As previously stated above, the reason for this was due to the fact that the conveyancing file in respect of the sale to Company T was subsequently located.

72. Mr AF is a director of the Taxpayer. He has a Bachelor of Science Degree from University AL. He is a businessman. He indicated to us that he played an active role since 1989 when he returned from the United States to Hong Kong to help out in the full-time operations of the Taxpayer.

73. Again, he drew our attention to the history and background in respect of this matter and the way in which Nos. D and F needed to be redeveloped and in particular, drew our attention to the acquisition of No. H and the subsequent acquisition of No. B. He asserted in his evidence that the decision of reconstruction of Tower W was for rental purpose and for a long-term investment. He set out the difficulties that the Taxpayer faced in obtaining No. B and in particular, their attempt to merge No. B with Nos. D, F and H to form a larger combined site for their redevelopment plans.

74. The Taxpayer resolved to commence reconstruction of a commercial building on Nos. D, F and H in the first place and proceeded with making the necessary financial arrangements through its civil engineers, bankers, etc.

75. He referred to the various costs and return estimates prepared by Company J.

76. This was done in an effort to satisfy the Taxpayer's bankers in order to obtain a long-term financing.

77. He told us that the Taxpayer had not entirely given up its plans to acquire No. B and of the various efforts and attempts done to acquire this particular property. He also drew to our attention to the fact that the state of property market in early 1990s until late 1997. He also gave evidence as to the intended sale to Company T. Neither he nor any of the other directors of the Taxpayer was aware of the final offer that was made by Company T to his father. He was not aware that his father had signed the sale and purchase agreement with Company T for the sale of the 4th to 20th Floors. He was away on a business trip and was overseas and when he discovered that his father had signed the agreement with Company T, this came as a total shock to him and the whole family. He referred to the relevant board minutes which in his view indicated that the Taxpayer did not intend to sell any part of the property but intended to retain the same for long-term investment purposes to generate rental income after the redevelopment was completed.

78. He recollected that he and his brother, Mr AG, strongly objected to the naming rights of the building being given to Company T which he understood was due to his father's inadvertence.

79. However, he did accept that the offer to Company T was 'indeed very irresistible'. He emphasized that the Taxpayer never approached Company T. It was Company T which actively approached his father in dealing with what he called an unsolicited and very attractive offer to acquire the 4th to 20th Floors for over $54,000,000. He also stated that the Taxpayer only managed to acquire No. B at $30,000,000 after it sold the 4th to 20th Floors of the building under construction to Company T. Again, he emphasized to us that both formal sale and purchase agreements with Company T and the No. B owner was dated 10 August 1992 respectively, this was a pure coincidence.

80. Mr AF told us that as the Taxpayer already constructed a two to three-storey structure to Nos. D to H. Following the successful acquisition of No. B, the construction plan was revised from the XX-storey building to a XX-storey building as a result of the enlargement of the site. He drew to our attention that the Taxpayer then re-negotiated with Company T in relation to the sale of the units in the new XX-storey building. He indicated that they reached an agreement that Company T would buy the 6th to 19th Floors of the new building instead of the 4th to 20th Floors and it was also agreed to cancel naming right to the new building.

81. The purchase price was thereby reduced to in excess of $35,000,000 rather than in excess of $54,000,000. The sub-sale from Company T to Company S was also re-negotiated.

82. He emphasized that the only reason why the Taxpayer decided to sell the units to Company T was because of their unsolicited offer was at a price which was too attractive to be rejected.

83. In his evidence to us with regard to the sale to Company Y, he again indicated to us that the initiation for the purchase came from Company Y, there was an agreement that it would be sold to them in a sum in excess of $27,000,000 due to their unsolicited offer. Again, he confirmed that this was too good to be rejected but again in cross-examination he confirmed that this was something which his father dealt with.

84. When he was recalled to give evidence, Mr AF again indicated to us he did his very best to locate the conveyancing file. He made some further enquiries with Mr AN, the senior legal clerk of Company AH originally in 2007 who advised that the file could not be located. However, he was able to contact Mr AN and in turn his current solicitor then made a written request to Company AH for the file to be retrieved. This as we know proved to be successful.

85. In his evidence, Mr AF indicated that he had never seen the MOA until the conveyancing file was retrieved from Company AH. He did not know that his father had signed the MOA on behalf of the Taxpayer without even calling a board meeting.

86. He emphasized that had he known about this, he would have strongly objected. Again, he emphasized that he had no knowledge of any of the conveyancing matters and dealings between his father and Company AH with regard to the disposal of the relevant Floors to Company T. He could not recall specifically that his father told him as to the sale of the building to Company T. However, he believed that it may have been close to the time when they were able to strike a deal to purchase No. B. He emphasized that he was very surprised and upset when his father broke the news to him. He emphasized at short notice, he had spent a lot of time working matters out with the architects as to how best to utilize No. B and to have this incorporated into the intended redevelopment.

87. Mr AF emphasized that he was not in charge of any of the financials of the Taxpayer. However, he indicated that a feasibility study was completed by Company J. However, on cross-examination, he accepted that that document did not match up expected rental with expected payments to the bank to see if it was feasible to hold the building long-term without selling any of the parts.

88. In cross-examination, Mr AF indicated that he did not deal with the bank and could not assist any further with regard to applications made to the bank for financing.

89. Mr AF emphasized that his father was in charge of all financial aspects of the Taxpayer. However, when Mr U was asked about a specific loan application, he said that he knew nothing about it and in turn, indicated that Mr AF dealt with this.

90. Mr AF also insisted that they would have enough money to pay the bank in respect of any financing that would be obtained. When asked whether or not any reports had been commissioned, he confirmed that this was a Company J report. However, when it was pointed out to him that this had no analysis with regard to any intended bank payments, he stated that this did not matter because the bank knew about this in any event.

91. In cross-examination, it was put to Mr AF that the Taxpayer did not have substantial funds to finance the acquisition of No. B and to complete the re-development which was estimated at $30,000,000. Again, Mr AF agreed with this. The relevant balance sheets of the relevant years were put to Mr AF and in particular, the low cash position and the net current liabilities for each year were put to him. It was also put to him that the property redevelopment reserve of $6,000,000 was not in liquid assets which Mr AF did not dispute in his cross-examination.

92. However, Mr AF did state that the Taxpayer owned the Road P and Road AP properties which in turn generated rental income. In re-examination, the profits and loss accounts as to the rental income received was put to him, however, as Mr Stewart Wong quite rightly pointed out, it was not helpful to look at gross income but one should look at net profits after tax to consider the financial viability of the Taxpayer.

93. The net profit after taxation for the year ended 1989/90 was only $188,543 whereas the figures for subsequent years showed a net profit after taxation of $181,021 for 1990/91 and a net loss after taxation of $59,669 for 1991/92 and a net profit after taxation of $127,245 for 1992/93. In 1993/94, during which the redevelopment was completed and the assignment of the Floors sold to Company T was made with full payment of the price, there was a net operating loss to the Taxpayer of $5,337,051.

94. Mr AF also stated that, he, his father and his grandmother could put in their own money if the need arose. However, according to Mr U his mother preferred to sell so as to obtain cash and it would be inconceivable that she would want to put in any of her own money to support a long-term holding of the property. In any event, she passed away shortly after completion of the redevelopment.

95. No evidence was put before us as to the personal financial abilities of Mr AF or of any other members of the AQ family. As at 31 March 1994, Mr U owed the Taxpayer $16,356,807 and Mr AF was indebted in the sum of $8,118,763.

96. During the course of his evidence, Mr AF tried to show that there was sufficient rental income that would cover bank payments. However, on a closer analysis, it is quite clear that based on the redevelopment of Nos. D to H, there would be an annual income of $659,167 on a conservative basis. This is only slightly more than the payments of $635,940, however, this is subject to all Floors being rented out for the whole year.

97. During the course of his evidence, Mr AF was unable to tell us actually whether or not there was actual rent received or paid for the top three Floors of the building and whether this was accounted for. In our view there was insufficient evidence to show that the Taxpayer had the financial ability to service the bank loans whilst holding the entire redeveloped building for a long-term position.

98. Mr AF also gave evidence as to the relevant board meetings that took place. The Taxpayer produced minutes of eight board meetings. Other than the last dated 20 December 1991, not one of them recorded the purpose of the redevelopment.

99. Those minutes talked about the potential redevelopment, acquisition of adjoining properties and financing. The board minute dated 20 December 1991 was produced by Mr AF. This was a typed-up minute and he told us that the reason for this minute was due to the fact that the estate agents were making daily offers to his father, he wanted to let his brother, Mr AG, know what was happening and in turn, there was a need to formalize the Taxpayer's position.

100. However, it was put to him that there was no reason to call a board meeting and to record this in a minute. He could simply tell his brother that this was happening.

101. On cross-examination, Mr AF accepted that Mr AG would have known by the time of this meeting of the purpose of the redevelopment as this would have been mentioned over various dinners by casual conversation since he came back to Hong Kong. If this was correct, then we agree with Mr Stewart Wong's submission that there is no reason to have this repeated at a board meeting. In any event, we are of the view that the explanation for this meeting is not credible. It is unbelievable that the Taxpayer had to produce a formal board minutes to stop the estate agents from making the alleged daily offers. Having looked carefully at this minute and having regard to the various events that transpired, we are of the view that this meeting did not take place whether at the time as alleged or at all. Indeed, one has to have regard to the counter-offer by the Taxpayer through Company AH to sell the whole of the building on 18 December 1991 just two days before the so-called meeting. The intention stated in the minutes was contradicted by the making of such counter-offer but according to Mr AF the making of this counter-offer was not the reason for supposedly calling and having the meeting on 20 December 1991.

102. Further, if an agreement had been reached in August 1991 to sell to Company T, would one hold the board meeting on 20 December 1991 for the sole purpose of discussing redevelopment as long-term investment? Indeed, during cross-examination, Mr AF was asked whether or not he would still have held this meeting if there was such agreement and he said no. Again, Mr AF confirmed that the fact of a previous sale is logically incompatible with the holding of such a meeting. We accept the submissions of Mr Stewart Wong that there was no logical reason to hold this meeting.

103. Mr AF was also cross-examined over the fact that he did not know of the sale at the time. However, as we have previously concluded, it seems to us to be incredible that his father, Mr U, had not told him earlier and did not mention the sale to his sons at this meeting if indeed, it was held on that day. It would seem to us to be incredible that there would be a board meeting held which stated that they hold the property for long-term investment when some months beforehand the property had been sold by way of a MOA and in turn, there were extensive dealings, communications and correspondence through the solicitors with regard to offers and counter-offers.

104. Mr AF was also cross-examined as to a minute which referred to the name 'Tower W'. In his evidence, he stated that he had started using the name at least at the construction site shortly after he came back to Hong Kong in 1989. It is unlikely that this

name would not have been used by others including his father, Mr U, and the Taxpayer's solicitor, Mr AJ.

105. However, if one looks at the various minutes, there is not a single document produced and dated before 1993 that bears the name 'Tower W'.

106. In the relevant conveyancing files that were subsequently disclosed, between two documents both dated 9 August 1993, there was a document with three versions for the name of the building in English and three in Chinese. We accept this suggests that as at 9 August 1993, the Taxpayer had still not finalized but was considering a suitable name for the building. This, in our view, clearly contradicts the evidence given by Mr AF as to when the name was chosen. To be fair to Mr AF, he did not dispute this when asked but said he could not recall the exact position. Indeed, when it was put to Mr AF that the English name 'Tower W' was still being considered as a possibility only on 9 August 1993, he did not deny this. He simply stated that he did not know. Again, this accords with our view that the minute dated 20 December 1991 which states '….. *resolved that the decision of re-construction of [Tower W] is for rental purpose and for long-term investment*', does not reflect what actually took place. The words 'Tower W' were never utilized at that time and therefore, this supports our finding that clearly no meeting took place on 20 December 1991 and this document could only have been created after 9 August 1993.

107. In any event, with regard to the minutes, we accept the submissions of Mr Stewart Wong that these are really self-serving statements of the Taxpayer and are of little assistance to us.

Our analysis

108. There are 3 properties involved in this case. Based on the agreed facts, there can be no doubt that in 1931 when the Taxpayer acquired Nos. D and F it was intended as a long-term investment and the Taxpayer had been holding this property as capital asset for a number of years. Equally clear is that when the Taxpayer acquired No. B in 1992, the Taxpayer could not have intended to hold the property long-term since this property was all along intended to be incorporated into the building under construction a large part of which had already been sold to Company T. Obviously, at least by the time when the Taxpayer acquired No. B, the intention of holding Nos. D and F as a capital asset must have changed to that of holding a trading stock. The remaining question is whether such change of intention in fact took place earlier when the Taxpayer acquired No. H in 1986 and this question must be answered in the light of the evidence adduced by the Taxpayer.

109. As can be seen from the above, we are of the view that the evidence of Mr U is unsatisfactory, full of inconsistencies and indeed, incredible. We cannot rely on his evidence. We come to the conclusion that much of his evidence was made up and indeed, was untrue. Indeed, if one looks very carefully at the first version of the evidence that he gave before, it was diametrically opposed to the evidence he gave second time round.

110. We have no hesitation in accepting that what he was trying to do was to put to us a story that he had hoped that the Board would buy. Hence, we accept the submissions of Mr Stewart Wong that we cannot safely rely upon his evidence.

111. Mr U was a barrister and in our view, he clearly knew what he was doing when he gave evidence before us. Indeed, as we have previously pointed out, he accepted that part of his evidence was indeed made up. We conclude that his evidence was unreliable. He was not able to give us any clear and acceptable evidence as to the reasons and circumstances that led to the sale to Company T.

112. We also have no hesitation in rejecting the submissions of Mr Chua Guan-hock, SC who indicated that there were two alternative explanations for any inconsistencies in the evidence of Mr U. Firstly, a very long lapse of time of 18 years; and secondly, his advanced age of 80 years. He signed detailed witness statements. He knew exactly what he was doing when he gave evidence. He was evasive. Although he is 80 years of age, he was fully aware of his obligations when giving evidence before us.

113. On a careful analysis of the evidence, it clearly shows that Mr U was prepared to mislead the Board. Indeed, if he was telling the truth, there was no good reason why he would not have told the Board in detail when he first gave evidence as to his mother's position and his reason for selling. His excuse that he did not wish to air family matters before the Board and the IRD has no credibility and does not make sense. The attempt to put before the Board a board minute that did not exist in an attempt to show there was an intention to hold the property for the long-term was improper.

114. We also refer in particular to the letter from Company AH dated 18 December 1991. Solicitors in our view do not write 'joke' letters. In our view, this letter was written on instructions and clearly sets out the intention of the Taxpayer, that is, they were prepared to sell.

115. As stated above, it is quite clear in our view that it was also incredible that the father did not tell his sons as to what was happening. It was incredible for him not to have told his sons as to the various discussions that were taking place and the various communications and correspondence from the Taxpayer's solicitors and in particular, the letter dated 18 December 1991. As again we have previously pointed out, if a board meeting was held on 20 December 1991, it would again have been incredible for Mr U, who was a barrister, not to have mentioned to his sons exactly what was going on with regard to the intended communications and correspondence with Company T's solicitors.

116. We also have regard to the fact that when this case first came before us, the main thrust of the Taxpayer's evidence through both Mr U and Mr AF was that the reason for the sale was due to the fact that it was an irresistible offer that could not be refused under any circumstances. Clearly, this was not the true reason for the sale. The evidence given by Mr U on the second occasion was dramatically opposed to what he said to us when he first gave evidence. Indeed, on cross-examination, Mr U conceded that the price was not so

irresistible that it could not be refused. This illustrates that he was prepared to say anything to us in an attempt to get us to believe what he was saying was the truth.

117. The Taxpayer sold the relevant floors and the naming rights to Company T at a time when redevelopment had not even begun. If the Taxpayer intended to keep the whole of the property and the redeveloped building for the long-term with no intention to sell, there must be a reason which the Taxpayer must prove for it to agree to sell. There was no acceptable or credible evidence for us to find there was any particular reason for the Taxpayer to do so. Clearly, coupled with the absence of any evidence of any change of intention in the re-development plan of the Taxpayer, the only inference that can be drawn was that the sale was made pursuant to an intention to sell at least part of the building which had been held since 31 May 1986 when the Taxpayer completed the purchase of No. H.

118. As can be seen from our analysis of the evidence, it is quite clear in our findings that when the purchase of No. H was completed on 31 May 1986 pursuant to the resolution made on 23 August 1985, the Taxpayer had clearly decided to and did take steps to embark on an adventure in the nature of trade, that is, to redevelop the properties at Nos. D – H and as we have previously said, with the addition of No. B if possible. We have clearly in our analysis come to the conclusion that the Taxpayer did not have the intention at any time to hold the entire building for long term investment after completion of the redevelopment. Instead, the intention was to sell at least substantial parts of the completed building after redevelopment was completed and the sales to Company T and Company Y in our view were made pursuant to that intention.

119. We also have had the opportunity to consider very carefully the submission put forward to us by the Taxpayer and in particular, with regard to the consideration of the relevant badges of trade. Mr Chua Guan-Hock, SC in his written submissions and before us drew our attention to various authorities which deal with various aspects of circumstances applicable to those cases in considering whether a transaction was in the nature of trading or a sale of capital asset. In particular, we have considered:

(a) Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196 [HL];

(b) Real Estate Investment v CIR [2007] 1 HKLRD 198;

(c) Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (Appellate Division);

(d) Wing On Cheong Investment Co Ltd v CIR (1987) 3 HKTC 1;

(e) Waylee Investment Ltd v CIR [1991] 1 HKLR 237 [PC];

(f) Chinachem Investment Co Ltd v CIR (1987) 2 HKTC 261 (CA);

(g) Kirkham v Williams [1991] 1 WLR 863 [CA];

(h) All Best Wishes v CIR [1992] 3 HKTC 750;

(i) Hudson's Bay Co v Stevens (1909) 5 TC 424 (CA);

(j) CIR v Reinhold (1953) 34 TC 389;

(k) CIR v Quitsubdue Ltd [1999] 2 HKLRD 481;

(l) Real Estate Investment (NT) Ltd v CIR (2007-08) IRBRD, vol 22, 913 [CFA];

(m) D74/91, IRBRD, vol 7, 16;

(n) CIR v Secan Ltd & Anor (2000) 3 HKCFAR 411 [CFA];

(o) Jones v Leeming [1930] AC 415;

(p) Commissioner of Taxes v British Australian Wool Realization Association [1931] AC 224 [PC];

(q) CH Rand v The Alberni Land Company Limited (1920) 7 TC 629;

(r) Lee Yee Shing v CIR [2008] 3 HKLRD 51 (CFA);

(s) Crawford Realty v CIR (1991) 3 HKTC 674.

120. However, it is quite clear that each of these cases was decided on their own particular factual nexus and as can be seen, the intention in each case always depends upon the specific facts and circumstances relating to each case. One of the circumstances relied on by the Taxpayer is the asserted fact that the Taxpayer intended to and did hold the properties for an indefinite period of time and that the properties were in fact held over many years. This is not true so far as the properties in Nos. H and B are concerned. As to the other circumstances relied on such as the alleged protracted negotiations over many years to acquire Nos. H and B and the absence of sales agents ever appointed by the Taxpayer, firstly, given our view on the credibility of the witnesses called on behalf of the Taxpayer, we have reservation in accepting the evidence in support of such assertions. Secondly, even assuming that there were protracted negotiations, this must have arisen from the fact that the Taxpayer was the owner of the adjoining site and therefore the Taxpayer would not simply opt for the acquisition of some other properties in lieu of Nos. H and B. On the facts of this case, the alleged protracted negotiations would not be an indication that the redevelopment was not intended for sale. Thirdly, again assuming that in fact sales agents were never appointed and the offer from Company T was unsolicited and instead several leasing agents were appointed, it is noteworthy that the appointment of leasing agents came after the sale to Company T. If one considers the absence of the appointment of sales agents to be a circumstance pointing to an intention to hold the properties long-term, presumably one

should also accept that the absence of the appointment of leasing agents right from the beginning must be taken as a circumstances negating such intention.

121. In any event, in the end of the day, the crucial issue for us to consider is the intention of the Taxpayer as ascertained from all the facts and circumstances of this case including a considered view of all matters before us. Again, one salient and important factor that we need to consider is the clear fact shown in the conveyancing files that on or about 15 August 1991 before any of the redevelopment work had even commenced and before the problems with the infrastructure were solved, the Taxpayer had agreed to sell nineteen floors (of course they purchased back two floors later on) and a flat roof (out of a total of XX floors and two flat roofs) to Company T. It is also clear from the evidence that shortly after completion of the redevelopment, that is, on 9 June 1994, the Taxpayer again sold two more floors to Company Y. As stated in the decision of the Board of Review in D11/80, IRBRD, vol 1, 374:

> *'When an owner of land exploits it by the development and construction of a multi-storey building and in the course of construction or shortly thereafter he sells units in the building, the inference that would be drawn is that the building was not erected for retention as an investment but for the purpose of resale. If the owner's case is that he intended to retain the property as a long term investment but supervening events outside his control forced him to dispose of the property, then before such a claim can succeed he must satisfy the Board that it was his intention to keep it as an investment or capital asset.'*

122. We also accept that we are bound to look carefully at the badges of trade and in particular we refer to Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51. In particular, we refer to the judgment of McHugh NPJ at paragraph 60 which states as follows:

> *'60. What then are the "badges of trade" that indicate an intention to trade or, perhaps more correctly, the carrying on of a trade? An examination of the many cases on the subject indicates that, for most cases, they are whether the taxpayer:*
>
> 1. *has frequently engaged in similar transactions?*
> 2. *has held the asset or commodity for a lengthy period?*
> 3. *has acquired an asset or commodity that is normally the subject of trading rather than investment?*
> 4. *has bought large quantities or numbers of the commodity or asset?*
> 5. *has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?*
> 6. *has sought to add re-sale value to the asset by additions or repair?*

7. has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?
8. has conceded an actual intention to resell at a profit when the asset or commodity was acquired?
9. has purchased the asset or commodity for personal use or pleasure or for income?'

123. Dealing with each of the specific badges, we accept most of the submissions of Mr Stewart Wong when he dealt with each of the badges:

(1) Even a single, one-off transaction can be an adventure in the nature of trade let alone on the facts of the present case, the sale to Company T was followed by a similar transaction in the sale to Company Y soon after the redevelopment was completed.

(2) Of course, we accept that the Taxpayer held Nos. D and F for a long period of time but of course as clearly pointed out, Nos. H and B were newly acquired. Indeed, a substantial part of the redevelopment was already sold to Company T even before No. B was acquired.

(3) It is quite clear that the nature of the subject matter is real property which was going to be developed into a commercial tower. This is normally the subject of trade in Hong Kong. Indeed, at paragraph 63 in Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51, McHugh NPJ followed and accepted the views of the Board of Review in D111/97, IRBRD, vol 13, 20:

'Does the intention of the taxpayer at the time of acquisition of shares determine whether it is trading? If the property purchased was landed property, the well-established principle is that it does: see Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196.'

(4) It is clear here that the Taxpayer was going to redevelop the property into a building with far more space than for its own use and indeed, Mr AF confirmed that the Taxpayer did not need to hold the whole of the building as its headquarters.

(5) No. As above noted, the various reasons given by the Taxpayer for the sales to Company T and Company Y despite their avowed intention to hold the properties long-term must be rejected.

(6) Again, we accept that the Taxpayer did develop the properties into a new building in substitution instead of just adding re-sale value to the properties.

(7) In a booming property market, the time, money or effort to be expended in selling properties by a trader would not be that much different from a non-trader.

(8) Despite the absence of any concession by the Taxpayer, it is unarguable that when No. B was acquired, it was intended to be included in the re-sale to Company T.

(9) Yes but only in respect of a very few floors that were not sold which do not form part of the subject-matter of this appeal.

124. In respect of the second ground of appeal, no evidence was adduced before us as to the fair and proper market value for tax purposes. Nor did the Taxpayer adduce any evidence to show why the cost of sales was incorrectly ascertained or in turn, valued on an incorrect basis.

Conclusions

125. We have carefully reviewed and considered the evidence, authorities and submissions of the Taxpayer and those of the Deputy Commissioner. As can be seen from our analysis, we have no hesitation in dismissing the appeal and upholding the assessments in the Determination.

126. Having regard to the evidence given on behalf of the Taxpayer and the way in which the Taxpayer conducted itself in this appeal, we have no hesitation in awarding costs in the sum of $5,000 against the Taxpayer.