INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D35/90

Profits tax – sale of property – whether a trade or an adventure in the nature of trade.

Panel: Robert Wei QC (chairman), E J V Hutt and Gillian M G Stirling.

Dates of hearing: 11, 12, 13, 14 and 15 December 1989.
Date of decision: 8 October 1990.

The taxpayer purchased certain property as a long term investment. The property was included as a fixed asset in the taxpayer's balance sheet. The property was redeveloped and sold. The taxpayer was assessed to profits tax on the profits which arose when the property was sold. The taxpayer appealed against this and submitted that the profit was a capital gain. The grounds of appeal were that the taxpayer was merely realising a capital asset and had agreed to dispose of the land prior to any redevelopment and did not participate in earning any development profits.

Held:

After reviewing the facts and submissions in detail the Board concluded that the profits arose from a trade or an adventure in the nature of a trade.

Appeal dismissed.

[Editor's note: The taxpayer has filed an appeal against this decision.]

Cases referred to:

Hudson's Bay Co Ltd v Stevens [1909] 5 TC 424
Taylor v Good [1973] 29 TC 277
Simmons v IRC 53 TC 461
Cunliffe v Goodman [1950] 2 KB 237
Reohorn v Barry Corporation [1956] 1 WLR 845
Fisher v Taylors Furnishing Stores Ltd [1956] 2 WLR 985
Birmingham & District Cattle By-Products Co Ltd v CIR [1919] 12 TC 92
Overseas Textiles Ltd v CIR 3 HKTC 29
D19/85, IRBRD, vol 2, 182
Whitfords Beach Pty Ltd v Federal Commissioner of Taxation 12 ATR 692, 14 ATR 247
Rand v Alberni Land Co Ltd [1920] 7 TC 629

Alabama Coal Co Ltd v Mylam [1926] 11 TC 232
Pilkington v Randall [1966] 42 TC 662
California Copper Syndicate (Ltd and Reduced) v Harris [1904] 5 TC 159

David Milne QC for the Commissioner of Inland Revenue.
John Gardiner QC instructed by Woo Kwan Lee & Lo for the taxpayer.

Decision:

Preliminaries

1. This is an appeal by the Taxpayer against the Commissioner of Inland Revenue's determination dated 13 January 1986, confirming the 1982/83 profits tax assessment raised on it. That assessment (dated 14 June 1984) charges to profits tax the profit realised by the Taxpayer from the sale of a property in A Place formerly known as the B Building ('the property').

2. The question at issue is whether the profits mentioned above arose from a trade or an adventure in the nature of trade or from the sale of a capital asset. The Commissioner determined that the profits had arisen from an adventure in the nature of trade.

3. The grounds of appeal, as contained in the notice of appeal dated 12 February 1986, are as follows:

(1) In disposing of its interest in the land then known as the B Building, the Taxpayer was merely realising the value of an investment asset. The land was not trading stock of the Taxpayer and what was realised was a profit from the sale of a capital asset. There is, therefore, no profit assessable to profits tax.

(2) The Taxpayer agreed to dispose of the whole of its interest in the relevant land prior to any redevelopment thereof and the action it took, in commencing to obtain vacant possession, was merely a means of enhancing the surplus that would be achieved on realisation.

(3) The Taxpayer had no trade of buying and selling land, nor was it a developer. By virtue of the contracts of sale and the development agreement with C Limited ('C Ltd') it merely realised the value of its investment interest in the land in the most efficacious way having regard to the offer which had been made to it and the options open to it.

(4) The Taxpayer did not participate in any development profit regarding the land. This was all taken by C Ltd. Had the Taxpayer truly been a developer it would have developed the land itself and taken all the profit to itself.

(5) In all the premises there is no such assessable profit as has been sought to assess in this case.

(6) If, contrary to the Taxpayer's primary contentions set out above, there was any appropriation to any trading purpose this only occurred, at the earliest, in December 1979, on the first sale. The market value of the Taxpayer's interest in the land at that time was equal to or in excess of the proceeds of sale with the consequence that there can be no assessable profit.

(7) In the further alternative the assessment is excessive in:

(a) proceeding on the basis of a (relevant) 'change of intention' on 23 February 1979, and/or

(b) determining a market value of attributable cost of only $149,600,000.

The Taxpayer will contend that, in any event, the amount to be deducted in respect of the land in computing any alleged assessable profit is substantially in excess of the figure already allowed.

4. At the hearing, the appropriation date argument contained in ground (6) was not pursued. Instead, Mr Gardiner, Counsel for the Taxpayer, contended that it never embarked on the trade of development for sale, and, in the alternative, if it did, that trade commenced, at the earliest, in March 1980 when vacant possession had been obtained and demolition commenced.

5. In the course of the hearing it was agreed between Counsel and accepted by the Board that at this hearing the Board need only concern themselves with the questions whether there was a trade, and, if so, when that trade commenced, and that the matters of valuation raised in the grounds of appeal should, if necessary, be dealt with later.

6. Mr Gardiner produced a statement of agreed facts, and Mr Milne, Counsel for the Commissioner, produced a chronology which was agreed except for one detail. Mr Gardiner also called three witnesses, and they are: Mr D, Mr E and Mr F. Mr Gardiner also put in a written statement of Mr G, a chartered surveyor, whom Mr Milne did not propose to cross-examine at this hearing, but he made it clear that he was not accepting any of the valuation figures contained in that statement and reserved his right to cross-examine on those figures should it become necessary later to do so.

Agreed Facts

7. From the evidence produced, we shall first set out facts which are agreed, admitted or not in dispute in this paragraph and deal with the disputed ones later.

(1) The Taxpayer was incorporated in Hong Kong as a private limited company. At all material times its authorised share capital was $1,000 and its issued share capital $200, being two shares of $100 per share.

(2) In 1976 the Taxpayer purchased the property for $90,000,000 with the aid of a loan from its then holding company, H Limited ('H Ltd'). The property was acquired as a long term investment. This was the Taxpayer's sole business. At all material times the property was included as a fixed asset in the Taxpayer's balance sheet.

(3) In 1978 I Limited ('I Ltd') made an offer to H Ltd for the purchase of the property.

(4) In 1978 J Limited ('J Ltd') was incorporated as a private limited company with an authorised share capital of $10,000 and issued share capital of $2. Its articles of association provide, inter alia, for: (1) the appointment of a managing director or managing directors, (2) chairman of the board of directors to be chairman at general meetings, (3) chairman's second or casting vote on an equality of votes at general meetings and board meetings, (4) on a poll every member to have one vote for each share held by him and (5) questions to be decided by a majority of votes at board meetings.

(5) In late 1798 H Ltd agreed with I Ltd, acting on behalf of itself, K Limited ('K Ltd'), and Mr L, to sell the whole of the issued share capital of the Taxpayer (which was a wholly owned subsidiary of H Ltd) to J Ltd instead of the property at the price of $149,600,000, and received from I Ltd a 20% deposit.

(6) Later, there was a joint press release by K Ltd and I Ltd in the following terms:

> '[I Ltd] and [K Ltd] jointly announced this evening that the two companies had reached agreement to form a new company for the purpose of developing [B Building]. [I Ltd] will have a 25% interest in the new company, [Mr L] 10% and [K Ltd] the remaining 65%.
>
> [B Building] occupies an area of about [the area mentioned] at a prime site in [A Place]. [K Ltd] will be responsible for planning and developing the building into a first class commercial block with approximately [the area mentioned] of gross floor area.'

(7) In 1979 a shareholders' agreement embodied in a document called 'heads of agreement' was entered into between K Ltd, I Ltd and Mr L, of which the material provisions are as follows:

‘ OBJECTS

1. [I Ltd] had on behalf of the parties hereto by a letter dated 5 August 1978 to [H Ltd] … offered to purchase [Lot No AAA] together with the building thereon known as [B Building] (the said property) on the terms and conditions therein contained.

2. The parties hereto have subsequently agreed with the owner of the said property to acquire the entire issued share capital of [the Taxpayer] which is the registered and beneficial owner of the said property instead of the said property on the basis that the said property is valued at $149,600,000.

3. In furtherance of the objects contemplated by these heads of agreement, the parties hereto have agreed to nominate a private limited company, which was incorporated in 1978 under the name of [J Ltd] to acquire the entire issued share capital of [the Taxpayer] on the terms and conditions above mentioned.

4. [J Ltd] presently has an authorised share capital of $10,000 divided into 10,000 shares of $1 each of which two shares of $1 each have been issued and are held in trust for [I Ltd].

5. The parties hereto hereby acknowledge that the deposit of $29,920,000 mentioned in the said letter was contributed by the parties hereto in the percentages hereinafter mentioned.

6. The parties hereto have agreed that [J Ltd] shall be owned by the parties hereto in the following percentages (the said percentages):

(i)	[K Ltd]	65%
(ii)	[I Ltd]	25%
(iii)	[Mr L]	10%
		100%

AGREED

1. Allotment of shares

Each of the parties hereto shall immediately after the execution of these heads of agreement makes unconditional application to [J Ltd] for the allotment at par of the following shares of $1 each in the capital of [J Ltd] payable in full in cash on allotment (that is, [K

Ltd] to apply for 6,500 shares, [I Ltd] 2,498 shares and [Mr L] 1,000 shares).

2. Appointment of directors

The parties hereto shall immediately after the signing of these heads of agreement cause the subscribers of [J Ltd] to appoint the following directors as the first directors of [J Ltd]:

(a) as nominees of [K Ltd];
[Mr M]
[Mr N]

(b) as nominee of [I Ltd];
[Mr D]

3. Replacement and removal of directors

It is the intention of the parties hereto that the board of directors of [J Ltd] shall at all times be composed of three persons, two of whom shall be appointed by [K Ltd], and one of whom shall be appointed by [I Ltd], so long as their respective shareholdings in the capital of [J Ltd] remain in the said percentages. Should any vacancy occur in the board of directors of [J Ltd] with respect to any director appointed by a party hereto, the party which appointed such director who is unable to serve shall have the power and right to fill such vacancy. Each of the parties hereto shall have the right to remove a director nominated by it or him at any time.

4. Chairman and managing director

The parties hereto agree that the chairman of the board of directors and the managing director of [J Ltd] shall be nominated by [K Ltd].

…

7. Management

[K Ltd] shall be the project manager of the redevelopment of the property and shall also be the sale agent of the company [J Ltd] for the sale of the units in the new building to be erected thereon. [K Ltd] shall render the aforesaid services free of charges.

…

11. Obligation to vote

(a) Each of the parties hereto agrees that any director(s) nominated by it or him will vote at meetings of directors against any resolution which would, it passed, be in contravention of any of the provisions of these heads of agreement.

(b) Each of the parties hereto agrees that as shareholders it or he will vote or cause its or his nominee to vote against any shareholders' resolution which would, if passed, be in contravention of any of the provisions of these heads of agreement.'

It is agreed that the words 'on behalf of the parties hereto' in paragraph 1 of the objects clauses were wrongly inserted, and that clauses 1, 2 and 4 of the heads of agreement were duly implemented. Mr M was nominated by K Ltd as, and remained at all material times, the chairman and managing director of J Ltd. Mr D signed the heads of agreement on behalf of I Ltd.

(8) In January 1979 J Ltd entered into a formal agreement with H Ltd for the purchase of the whole of the issued share capital of the Taxpayer for the price of $149,600,000, the property being valued at the same figure for the purposes of the agreement.

(9) In February 1979 J Ltd acquired the whole of the issued share capital of the Taxpayer upon completion of the agreement. Mr M, Mr N and Mr D were appointed directors of the Taxpayer in place of those who resigned upon completion. Article 99(a) of the articles of association of the Taxpayer provided that questions arising at any board meeting shall be decided by a majority of votes.

(10) In February 1979 Mr L, as chairman of I Ltd, made the following statement under the heading 'investment in property' in the chairman's report:

> ' [B Building]
>
> In September 1978, your group acquired for $37,400,000 a 25% interest in [B Building], an office building in [A Place]. [K Ltd] has a majority interest in this property. The current intention is that this interest be held as an investment.'

(11) In early March 1979 the Taxpayer obtained a loan of $100,000,000 from a bank repayable in March 1982 against the security of a mortgage of the property.

(12) A week later, as the greater part of the premises in the property were let to tenants under tenancy agreements in the same form, the Taxpayer's solicitors obtained advice from counsel as to the exercise of its rights to terminate the tenancies under a 'break' clause, clause 4(d), which appeared in all those tenancy agreements. In his advice counsel recites the following instructions:

> '4. My advice is sought on the effect of clause 4(d) of the said agreement. This clause also appears in all the tenancy agreements entered into by [H Ltd] on behalf of client (that is, [the Taxpayer]) and reads as follows:
>
> > "If the landlord shall enter into a contract for the sale of the said premises or if the landlord shall resolve to demolish and rebuild the said building (which intention to demolish and rebuild shall be sufficiently evidenced by a copy of a resolution of its directors certified to be true and correct copy by its secretary) then in either of such events the landlord shall be entitled to give six clear calendar months' notice in writing expiring at the end of any calendar month during the tenancy hereby created terminating this agreement and immediately upon the expiration of such notice this agreement and everything herein contained shall cease and be void but without prejudice to the rights and remedies of either party against the other in respect of any antecedent claim or breach of any of the agreement or stipulations herein set out."
>
> 5. Client intends to demolish and rebuild [B Building] as from the end of 1979 and therefore proposes to invoke the said clause 4(d) to terminate all the tenancies which are subject to this clause.'

(13) In mid-March 1979 the new directors of the Taxpayer passed a resolution in the following terms:

> 'It was resolved that the [B Building] standing on [Lot No AAA] be demolished for redevelopment as soon as vacant possession is obtained and that:
>
> (a) [The firm of architects named] be and they are hereby appointed the architects in charge of the proposed redevelopment and that they be instructed to draw up plans for the same.

(b) [The firm of solicitors named] be instructed to take all necessary legal action in particular the service of notices to quit to recover vacant possession of the entire [B Building].'

(14) A few days later, K Ltd wrote to O Limited ('O Ltd'), offering shareholdings in nine land owning companies (eight subsidiaries and one affiliate), including a 10% shareholding in J Ltd to a proposed 50/50 joint venture between K Ltd and O Ltd in development projects the properties for which were to be made available by the two groups.

(15) In March 1979 Mr M as chairman of K Ltd made the following statement in the chairman's report:

> ' The group, together with two other parties, agreed to purchase the entire issued share capital of [the Taxpayer], which owns [B Building] in [A Place]. It is planned to demolish the existing building at the beginning of 1980 and construct a modern commercial and office building on the site. The group will act as project manager and sales agent for this development in which it owns a 65% interest.'

(16) In March 1979 the Taxpayer, through its solicitors, issued standard notices of termination to 'break' clause tenants to vacate by the end of September 1979. The standard notice is in the following form:

> ' We, the undersigned, as solicitors for [the Taxpayer], the landlord of the premises at the above address which you hold of its (sic) as tenant thereof under a tenancy agreement dated [the date mentioned], namely, hereby notify you that the landlord has resolved to demolish and rebuild the said building. A certified copy of the resolution of its directors is enclosed herewith. We would refer you to clause 4(d) of the said agreement.
>
> We accordingly as solicitors for the landlord, hereby give you notice of termination of your tenancy: you must quit and deliver up to your landlord, or to whom it may appoint, [by the end of] September 1979 or at the expiration of the next complete month of your tenancy which will expire next after the end of six months from the service upon you of this notice, vacant possession of the said premises held by you of it as tenant thereof.
>
> Dated this [the date mentioned] day of March 1979.'

The great majority of tenants were 'break' clause tenants. As for tenancies without a 'break' clause, of which there were three or four, negotiations for termination and vacant possession were conducted with the tenants concerned individually. The longest tenancy was to expire in 1982.

(17) In June 1979 a joint venture agreement was signed between K Ltd and P Limited ('P Ltd') (a company owned as to 70% by O Ltd and a subsidiary of O Ltd). K Ltd and P Ltd were to own Q Limited ('Q Ltd') in equal shares and Q Ltd was to acquire the properties offered by the K Group and the O Group (being interests in land and shareholdings in land owning companies, including a 10% shareholding in J Ltd). The agreement starts off by reciting:

> ' The parties hereto are desirous of participating in the development and/or sale of the properties described in the schedule hereto (that is, the properties offered by the two groups as aforesaid).'

It then provides, inter alia, as follows:

> ' 10.1 All the land owned by [Q Ltd] and/or by the subsidiaries of [Q Ltd] shall be developed by erecting thereon new buildings at such time and in such manner as the managing director shall decide: provided that the building plans, specifications and the budgetted costs for each new building shall be subject to the approval of the board of directors.
>
> 10.2 Notwithstanding clause 10.1 hereof, the existing buildings on any land owned by [Q Ltd] or the subsidiary companies of [Q Ltd] may be turned to account otherwise than by the development thereof if the board of directors shall so resolve.
>
> …
>
> 10.5 Each of the parties hereto shall use its best endeavours to procure the board of directors of such of its related companies, of which issued share capitals less then 50% have been sold to [Q Ltd], to have the land and the existing buildings thereon owned by such related companies, or the right to exchange for land held by such related companies, to be developed or otherwise turned to account as the board of directors shall decide.
>
> …
>
> 15. The new buildings or the units therein shall be offered for sale at such time, whether before or after the commencement of the development of the land on which the new buildings are to be erected, and in such manner and upon such terms as the managing director, subject to the approval of the board of directors, shall decide.'

(18) In June 1979 at a board meeting of Q Ltd it was resolved that the properties offered by the two groups as aforesaid, including a 10% shareholding in J Ltd, be purchased.

(19) Between 1979 and 1984, fifteen properties owned respectively by Q Ltd, its subsidiaries and affiliates were sold. It has been accepted that profits from the sales of fourteen out of those fifteen properties arose in the ordinary course of trade, that the properties were stock in trade and were redeveloped for sale, and that there is a liability to profits tax in respect of each of the sale. The only exception is the profits arising from the sale by the Taxpayer (a wholly owned subsidiary of J Ltd) of the property, B Building; the liability to profits tax in respect thereof is in dispute and is in fact the subject matter of this appeal.

(20) In September 1979 K Ltd as the applicant, and Mr R of the firm of architects as the authorised person and the registered structural engineer, made an application to the Building Authority for the approval of building plans for the property.

(20A) In September 1979 K Ltd appointed a firm of surveyors to carry out quantity surveying services in relation to the development project at the property.

(21) In November 1979 the Taxpayer's solicitors received from a purchasing group an offer together with a deposit of $5,000,000 for the purchase of all the eighteen floors of office accommodation (fifth to twelveth and fourteenth to twenty-third floors) in the new building to be constructed on the sits of the property at the price of $2,700 per square foot of gross floor area.

(22) In mid-November 1979 approval of the building plans was granted to K Ltd.

(23) In mid-November 1979 the Taxpayer through its solicitors obtained advice from counsel. One of the questions counsel advised on was as follows:

> 'For tax reasons client may wish to enter into an agreement for the sale of the existing [B Building] and the land on which it stands to another limited company having the same shareholders. Again, will this prejudice the effect of the said notice to quit?'

Counsel's advice was as follows:

> '4. Further I am of the view that although on a strict interpretation it is possible to argue that all (that) is required to fulfil the second limb is the <u>requisite resolution</u> without the necessity to prove a continuing intention to carry out the resolution there is a substantial risk that the contrary argument will prevail. This means that once a notice to terminate is given in reliance on the

second limb it will be unsafe for the landlord to sell the premises to another without carrying out or taking steps to carry out the rebuilding project.'

(24) In mid-December 1979 consent was granted by the Building Authority to Mr R to the commencement of the demolition of the B Building.

(25) In December 1979 a development agreement was entered into between the Taxpayer (called the owner) and C Ltd (called the developer) for the development of the property for the sum of $90,000,000. C Ltd was ultimately in the same beneficial ownership and had the same directors as J Ltd. The agreement provided, inter alia, as follows:

'1(4) "Development" shall mean the demolition of existing buildings on and the erection and completion within the development area of the buildings erections and structures and of all works in accordance with the approved plans and when appropriate the sites of such demolition and erections.

…

3. The developer hereby agrees to perform and observe the following stipulations:

(1) Forthwith to confirm to [the firm of architects named] their appointment as the developer's architect …

(2) To enter upon the owner's land by licence only and remain thereon for a period expiring on or upon the completion of the development (that is, the demolition of existing buildings on and the erection and completion within the development area of the buildings erections and structures and of all works in accordance with the approved plans) …

(3) As soon as practicable (upon the owner giving to the developer vacant possession of the owner's land) to commence and to proceed to cover in and complete the development at its own cost and expense and to the reasonable satisfaction of the owner without delay in a workmanlike manner with the best materials obtainable of their several kinds …

…

(11) To pay from the date hereof all compensation payable to the tenants of the existing buildings on the owner's land in obtaining vacant possession thereof and to reimburse on or before [the end of] December 1979 all such compensation already paid by the owner to date including all legal costs in connection therewith.

(12) To reimburse on or before [the end of] December 1979 all sales commission paid by the owner to date in connection with the sale of the units.

(13) (a) At all times during the carrying out of the development to insure and keep insured the same … against loss or damage by fire …

…

(c) The developer shall be liable for and shall indemnify the owner … and shall insure against any liability loss claim or proceeding in respect of any injury or damage whatsoever to any person or to any property real or personal in so far as such injury or damage arises out of or in the course of or by reason of the negligent execution of the development.

…

6. It is hereby mutually agreed that until the developer has executed and performed the provisions of this agreement … the owner shall possess the following rights and powers:

(1) Liberty and power in case the development shall not be completed within a period of two years from the developer's taking possession of the owner's land … or if the developer shall not proceed with the development with proper diligence or if the developer shall enter into liquidation whether compulsory or voluntary … to re-enter upon and take possession of the owner's land and at the option of the owner to remain thereon and appoint another developer to complete the development …

…

8. Within twenty-eight days of the substantial completion of the development of the development area to the reasonable satisfaction of the owner and of the developer's architect … the owner shall pay to the developer a sum of Hong Kong dollars ninety million ($90,000,000).

…'

(26) In December 1979 the Taxpayer entered into sale and purchase agreements to sell the eighteen floors of the office tower (that is, the fifth to twelveth and the fourteenth to twenty-third floors inclusive) of the new building at the price of $2,600 per square foot with a 30% down payment. In each of the agreements it was recited, inter alia, as follows:

'(2) The vendor will be developing the land by the erection thereon (of) a building (hereinafter called the new building) …

(3) The vendor has caused plans to be prepared by [the firm of architects named] … for the construction of the new building which plans have been approved by the Building Authority …'

It was agreed between the parties, inter alia, as follows:

'3. (a) The vendor shall comply with the requirements of the Building Authority and of the Public Works Department relating to the new building and shall have the new building completed and fit for use and occupation in all respects in accordance with the said plans on or before [the date mentioned] June 1982 (hereinafter called the completion date) or such extended date as is hereinafter referred to (whichever shall be the later) … If the new building is not completed by the completion date or such extended date as is hereinafter referred to (whichever shall be the later), the vendor shall pay to the purchaser liquidated damages calculated at the rate of 3% above the best lending rate per annum quoted by the bank from time to time from the completion date or such extended date (whichever shall be the later) on all sums which have been paid hereunder until the new building shall be completed as aforesaid … PROVIDED that where delay in the completion of the new building or any part thereof is or has been caused before or after the signing of this agreement by any of the following causes namely [here follows a list of

causes beyond the control of the vendor] the architects shall certify the length of time for which the work has been delayed and the completion date of the new building shall be extended by the time so extended and no liquidated damages shall become payable until such extended date.

(b) Subject to sub-clause (a) of this clause, the purchaser shall be entitled at any time after the expiration of twelve calendar months from the completion date or such extended date as aforesaid (whichever shall be the later) in the event that the occupation permit for the new building has not then been issued to serve notice in writing on the vendor to rescind this agreement and on the vendor repaying to the purchaser all amounts paid by the purchaser hereunder (excluding legal costs and expenses) together with interest thereon at the rate of 3% above the best lending rate per annum quoted by the bank from time to time from the date of payment to the date of repayment this agreement shall be rescinded and of no further effect …

5. The sale and purchase shall be completed at the offices of [the firm of solicitors named], the vendor's solicitors, within fourteen days of receipt by the purchaser of notice of issuance of an occupation permit in respect of the new building. On completion:

(a) The purchaser shall pay the balance of the purchase price to the vendor together with any arrears of interest thereon;

(b) Subject to the aforesaid payments, the vendor and all other necessary parties (if any) shall execute a proper assignment of the said undivided shares of and in the land and the new building together with the exclusive right to hold use occupy and enjoy the premises in favour of the purchaser … and the purchaser … shall subject to compliance with clause 15 hereof (which relates to payments of deposits in respect of the management of the new building) be given vacant possession of the premises.

…

7. Notwithstanding anything hereinbefore contained:

(i) The vendor hereby reserves the right to alter the plans whenever the vendor considers necessary. If as a result of such alteration the gross floor area of the premises

according to such amended plans shall differ from the gross floor area thereof according to the present plans the purchase price shall be increased or reduced proportionately.

(ii) The vendor hereby expressly reserves the right to adjust the number of undivided shares of and in the land and the new building PROVIDED that such adjustment shall not affect the purchaser's right to hold use occupy and enjoy the premises.'

(27) On 21 December 1979 C Ltd paid a sales commission of $5,113,692 to a Mr S in respect of the sale of the fifth to twelveth and fourteenth to twenty-third floors of the new building in accordance with an oral agreement between Mr S and Mr M.

(28) In January 1980 K Ltd announced to the press that the whole of the proposed new building had been presold.

(29) In January 1980 the development agreement with C Ltd was amended to increase the sum to be paid to C Ltd from $90,000,000 to $120,000,000.

(30) In February 1980 vacant possession was obtained of B Building and demolition commenced.

(31) In August 1980 K Ltd appointed associated consulting engineers to perform specified duties in connection with the installation of building services in the new building.

(32) In March 1981 the Taxpayer as employer and T Limited ('T Ltd') as main contractor entered into an agreement for the construction of the super-structure of the new building at the price of $74,000,000.

(33) In May 1981 K Ltd as project manager confirmed by letter the appointment of the firm of architects as the architect for the design and supervision of the redevelopment of the property at a fee to be calculated as specified. The letter was written on the letterhead of the Taxpayer.

(34) In March 1982 the Building Authority issued an occupation permit for the new building.

Testimony

8. Mr D's evidence may be summarised as follows:

(a) In chief Mr D is the chairman and managing director of I Ltd. Mr L was his late father. At all material times Mr D was a full time executive director of I Ltd and most of its subsidiary and associated companies. B Building stood on a prime site in A Place and was a good buy at the price of $149,600,000 (that is, $17,000 per square foot). Having reached an agreement in principle with H Ltd for the purchase of the property, I Ltd approached Mr M with a view to K Ltd becoming a co-investor in the project. The size of I Ltd's balance sheet at that time was approximately $270,000,000 and an acquisition of an investment for $150,000,000 was quite substantial in comparison, although it was within I Ltd's ability to finance the project on its own, if need be. K Ltd had 'in house' development expertise and resources and considerable financial strength. Mr L's family ('the Ls') also felt that the building was good for redevelopment. They explained the project to Mr M. Mr M felt that K Ltd's preference would be to sell the site as soon as it was sure that vacant possession could be obtained or to sell the redeveloped building. On the other hand, the Ls' intention, as was explained to Mr M, was to redevelop the property as an investment. Although the discussions were inconclusive the Ls and Mr M did agree that the price was very good and that they should buy the Taxpayer first. It was agreed that K Ltd would take 65% of the equity, with I Ltd taking 25% and Mr L 10%. In February 1979 the sale was completed by H Ltd selling to J Ltd the entire issued share capital consisting of two shares of $100 each in the Taxpayer. J Ltd was owned as to 65% by K Ltd, 25% by I Ltd and 10% by Mr L, as agreed. Mr M, Mr N and Mr D were appointed new directors of the Taxpayer. Mr D has not seen Mr N for some time, and he understands that Mr N has emigrated to Canada. In March 1979 they agreed that the best course would be for the site to be redeveloped. It certainly did not give a particularly good investment return in its then state. Many of the leases had a 'break' clause whereby the tenancy could be terminated on redevelopment or sale. They therefore passed the board resolution on 16 March 1979 so as to enforce the 'break' clause. However, they knew that there were some difficulties with obtaining vacant possession and they had always proceeded on the basis that the position might have to be considered afresh in the light of such difficulties. The termination of tenancies was dealt with by the Taxpayer's solicitors and Mr N of K Ltd. From the middle of 1978 and throughout 1979 the property market had been booming. In October/November 1979 they were told by K Ltd that the Taxpayer had received an offer from a group of overseas interests to purchase the whole of the office tower of the proposed building. They were told that K Ltd considered the offer very attractive and that it should be accepted. At that time the Taxpayer had not yet obtained every tenant's agreement to vacate B Building. They were quite confident that it would be able to do so and were so advised by K Ltd. They were a little concerned about this but Mr N of K Ltd assured them that there were not any insurmountable difficulties. They considered that the offer was simply too attractive to refuse. Formal agreements were entered into in

December 1979 for the sale of the floors in the office tower. Reverting to his earlier statement that B Building was a good buy at the price of $149,600,000, the old B Building on a fully let basis would yield about $7,000,000, that is, less than 5% of the price, while on a redeveloped basis the yield would be $20,000,000 per year or about 8% of the total cost of $230,000,000.

(b) In cross-examination At the price of $149,600,000, even if they had to wait until 1982 for the longest tenancy to expire and for the last tenant to move out, that would still have represented a good investment. He did not believe that there were any written projections or feasibility study for the new building as a long term investment. Mr M's preference was to sell. At the meeting between Mr L, Mr M and himself, that was argued. Had Mr M insisted that this investment should be for resale, the Ls would have offered this opportunity to someone else. As for the heads of agreement in January 1979, clause 7 of which reads:

> '7. Management
>
> [K Ltd] shall be the project manager of the redevelopment of the property and shall also be the sale agent of the company [J Ltd] for the sale of the units in the new building to be erected thereon. [K Ltd] shall render the aforesaid services free of charge.'

that clause was put in to say that if and when the property was to be disposed of, K Ltd would render its services to the joint venture free of charge. It was suggested to him that I Ltd or Mr L could not even vote against clause 7 because clause 11 imposed an obligation on the parties to vote against any resolution which, if passed, would contravene any provisions of the heads of agreement, and his answer was that he did not think that with the relationship between Mr M and Mr L, they would ever have come to that stage. It was suggested to him that having entered into the heads of agreement, there was nothing the Ls could do to enforce their intention to hold the property as a long term investment, and that intention was pure hope, and his answer was that with the relationship between Mr M and Mr L, which were both a business relationship and a personal relationship, he was very sure that they would not end up in any insurmountable disagreement. He was then referred to Mr M's statement in the chairman's report of K Ltd in March 1979 which reads as follows:

> 'The group, together with two other parties, agreed to purchase the entire issued share capital of [the Taxpayer], which owns the [B Building] in [A Place]. It is planned to demolish the existing building at the beginning of 1980 and construct a modern commercial and office building on the site. The group will act as project manager and sales agent for this development in which it owns a 65% interest.'

It was put to him that it was very clear that K Ltd's intention was that the development should be sold. To that his reply was that he did not want to comment on another company's annual report or chairman's statement. It was pointed out to him that in the heads of agreement (see para 7(7) above) there was no mention of letting the proposed new building or any part of it, and his answer was that there were a lot of alternatives, that even with disagreement he did not think that Mr M would just enforce his voting rights and that at the end of the day, between two good friends doing business together there would be other ways of resolving problem. On the other hand, he was not saying that the parties should not take the heads of agreement too seriously; that was a genuine agreement. K Ltd was a well known developer for sale. K Ltd did not necessarily have good letting agencies. I Ltd still holds its share in J Ltd; the shareholding is a fixed asset. When he first became a director of C Ltd, it was a shelf company with no assets or employees. The Taxpayer entered into the development agreement in December 1979 with C Ltd after obtaining advice from counsel. He signed the agreement on behalf of C Ltd. C Ltd did not enter into any contract, nor did it do anything physically. It was put to him that once K Ltd was brought in some time before 23 August 1978 declaring to the Ls that its intention was for resale, the Ls never had a chance of fulfilling their hope of achieving a long term investment. His answer was that at the meeting between Mr M, Mr L and himself, it was clearly understood that there was agreement on certain things, that is, demolition and redevelopment and that there were certain things they did not agree on, namely, sale on K Ltd's part and letting for rental income on Ls' part. One can say that there was agreement on disagreement.

9. The next witness was Mr E, whose evidence may be summarised as follows:

(a) <u>In chief</u> Mr E is a deputy managing director of K Ltd and executive director of two other companies and their subsidiary or associated companies. He joined K Ltd in September 1979 and his job was to perform accounting functions for the group as a whole and management functions for joint venture companies (that is, companies in which both K Ltd and outside parties had interests), such as J Ltd and the Taxpayer. He was briefed on the detailed position in relation to J Ltd/the Taxpayer joint venture by Mr N. The first issue that came to his attention was the difference in opinion in relation to the business direction. K Ltd preferred to develop and sell the building, while I Ltd and the Ls preferred to hold the property as an investment. However, there was never any disagreement in relation to the redevelopment of the property. It was the view of K Ltd that since time was still required to vacate the lessees of the building and to finalise a detailed development plan, and in view of a rising property market, there was no urgency to resolve this difference in opinion immediately. Therefore, the Taxpayer was still a going concern collecting rent and dealing with lessees about vacating their premises, and, as far as he was concerned, no decision had been made by the Taxpayer at that time that the property was to be redeveloped for sale. In the ordinary course of events had a definite agreement

been reached by the parties that the whole of the building should be redeveloped for sale, the Taxpayer would have followed the practice of selling the land once vacant possession had been obtained to an associated development company at full market value. That would have realised the full value of the Taxpayer's investment asset and the associated developer would have subsequently made any development profit. That he believes is common practice in Hong Kong and has been done in the K Group. In October/November 1979, he was told that an offer had been made to purchase the office tower of the proposed new building. At this stage, other than an intention that the site should be developed, his understanding was still that no firm decision had been taken as to whether the Taxpayer itself was to undertake the development and that no agreement had been reached with I Ltd as to the ultimate purpose of any redevelopment. He certainly had no firm instructions on this. It was classified as a fixed asset in the accounts, and as no decision had been made it was not necessary to change that classification. Clearly any such decision would have to be discussed by the shareholder of J Ltd and to be resolved by the board of the Taxpayer. They were concerned with obtaining vacant possession and had been proceeding on the basis that a decision concerning the future of the proposed new building and its ownership was to be considered once it became clear that they could obtain vacant possession. He was told of the offer by Mr N and plainly an offer of $2,700 per square foot together with a 30% down payment was very attractive. He was told that he should explore all the options open and consider the tax implications if any. If it were decided that such an offer should be accepted then the simplest course would have been to follow the procedure mentioned above of selling the land at full value to another group company which would sell to the offeror and carry out the development. They were concerned, however, that this might invalidate the notices to quit which had been served. Therefore they sought advice from counsel. Counsel advised that there was a substantial risk of invalidating the notices to quit if, at that stage, they were to sell the land to a related company. In the light of that advice they came to the conclusion that the risk was too substantial and decided not to pursue that course. He was told by Mr N that in the light of the attractiveness of the offer, I Ltd and the Ls and changed their minds and agreed with K Ltd that the redeveloped property should be disposed of. As a result they instructed their solicitors to draft the sale agreements and the development agreement which were then executed in December 1979 (para 7(25) and (26) above). The purpose of the development agreement was that all development obligations and all development profit should be undertaken and received by the developer C Ltd, a company in the same beneficial ownership as J Ltd. The Taxpayer therefore made no profit from the development as such.

(b) In cross-examination He became a director of K Ltd in December 1986 and a director of the Taxpayer in 1987. He is not a director of C Ltd. Mr N retired in 1985 and emigrated to Canada. Mr N has not come back. He has not come across anything on the files about rentals of the new building. The principal

business of Q Ltd was that of developer for sale. He was asked whether K Ltd ever had any intention of developing the property for rental, and his answer was that K Ltd always preferred to sell. The purpose of the development agreement was that C Ltd was to be the developer, just to draw the distinction that the Taxpayer was not the developer. He agreed with the suggestion that C Ltd would be responsible for the completion of the new building to the Taxpayer, but not to the purchasers. As to what C Ltd did in the course of the development, he stated that it did all these things: to co-ordinate, to pay the construction costs, to liaise with various parties, including the architect. In performing those functions, C Ltd made use of K Ltd's employees, but it did not enter into any written contract with anyone. It was pointed out to him that the Taxpayer entered into the building contract with the main contractor for the construction of the new building, and it was asked of him how could it be said that C Ltd was the developer. His answer was that C Ltd took all the financial risk and was responsible for putting up the finance. The reason for increasing the price payable to C Ltd under the development agreement from $90,000,000 to $120,000,000 was that there was a change in the method of construction. C Ltd was responsible to the Taxpayer for any fault in the construction of the project.

(c) In re-examination, further cross-examination and further re-examination K Ltd is famous for joint-venturing with other people. They never do business by forcing other people; they do business by discussion and persuasion. If they threw their weight about, nobody would joint-venture with them. As chairman of each company, Mr M represented K Ltd and Mr L represented I Ltd with Mr D, son of Mr L, assisting his father.

10. The third witness Mr F's evidence may be summarised as follows:

(a) In chief He is a partner of a firm of certified public accountants. He has been in charge of the audit engagements of both the Taxpayer and J Ltd since 1979 and that of K Ltd since 1976. In early 1979, when the entire issued share capital of the Taxpayer was acquired by J Ltd, the sole business of the Taxpayer was the holding of the property for rental. The property had been included as a fixed asset in the Taxpayer's balance sheets from its acquisition in 1976 until its disposal in 1982. Even during the redevelopment stage, there was no transfer of the property to trading stock. It is plain from the tenth schedule (part I paragraph 4 sub-paragraph 2) of the Companies Ordinance and generally accepted accounting practices that fixed and current assets must be properly and separately identified. In the directors' reports of the Taxpayer annexed to its audited accounts, the principal activity of the Taxpayer was stated as property investment throughout the four years from 1979 to 1982. They were not aware of any events or matters that caused them to believe that the Taxpayer had commenced or engaged in property trading activity that would have led to the reclassification of the property as trading stock under current assets. They

confirmed this from their discussions with the management. Although the board of the Taxpayer had resolved in March 1979 that the existing building on the property should be demolished for redevelopment as soon as vacant possession had been obtained, this did not establish any relevant change of intention and there was no evidence that the Taxpayer was going to redevelop the property for sale itself. The sale agreements entered into in December 1979 were agreements to sell fixed assets and as such, the assets continued to be treated as fixed assets in the balance sheets of the Taxpayer until the agreements were completed in 1982. In his view, this classification was proper since they were fixed assets in a process of realisation. The directors of the Taxpayer had chosen to play a passive role in that the redevelopment of the property was given to C Ltd under a development agreement entered into between the two parties in December 1979. The gain on disposal of the property was dealt with in the Taxpayer's profit and loss account for the year ended 31 December 1982 as an extraordinary item. This treatment was considered as appropriate by them because it arose from a disposal of a fixed asset and was non-recurrent in nature. The Taxpayer became a dormant company after the disposal of the property. In the group accounts of K Ltd, the property was included in the relevant consolidated balance sheets as a fixed asset and the gain on disposal was included in the consolidated profit and loss account for 1982 as an extraordinary item.

(b) In cross-examination His firm audits all the subsidiaries and most of the associated companies of K Ltd, including C Ltd and Q Ltd. At the time when he formed his view, he was aware of all the sale and purchase agreements, minutes, joint venture agreements, the development agreement and so on. He saw all the documents that are referred to in the statement of agreed facts at the time of the audit, if they were available. Asked whether he saw, for example, the advice from counsel in March 1979 on the 'break' clause, he stated that he had never seen the advice or the subsequent letter written in November 1979 by the firm of solicitors to counsel (para 7(12) and (23) above), both being included as annexures to the statement of agreed facts. In the year ended 31 December 1982, dividend was paid to the amount of $264,000,000, leaving $41,000,000 to be carried forward as unappropriated profits, and the balance sheet as at 31 December 1982 shows total net assets at $41,000,000 which has been lent interest free to K Ltd which acts as treasurer of the group in respect of money not in use. The profit from the sale of the property was not brought into the Taxpayer's profit and loss account until 1982, although the contracts for sale were entered into in 1979/80. That is because the Taxpayer did not realise a profit until the sales were completed and the money was received, and the sales were completed when the building was completed. He audited the accounts of C Ltd as well. Its audited accounts for the year ended 31 December 1979 stated that the company was active in property development, and that was a true description of C Ltd's activities, because C Ltd entered into the development agreement with the Taxpayer, and he thought it had performed the

duties under that agreement, such as looking for tenders from contractors and so on. He thought that C Ltd did that through the employees of the K Group. As for entering into contracts with contractors, he thought probably sometimes contractors like to enter into contracts with the landowners themselves. C Ltd paid tax on its part of the development profits.

The Three Questions

11. The property was acquired by the Taxpayer as a long term investment (para 7(2) above). Its case is that in preselling the redevelopment is was merely realizing the value of an investment asset as a landowner, and not trading for profit as a developer for sale. Here the basic question of fact is:

(1) Who was the developer – C Ltd or the Taxpayer? If the Taxpayer was the developer, then the following two questions of fact arise:

(2) When, if at all, did the Taxpayer form a definite intention to develop the property for sale?

(3) When, if at all, did the Taxpayer commence the trade of development for sale?

‘Developer’

12. The first question concerns C Ltd’s role and performance in the development of the property and arises from the Taxpayer’s contention that C Ltd was the developer of the property and made all the profit from the development and therefore that the Taxpayer, in preselling the new building, merely realized the value of the property as its investment. By clause 3(3) of the development agreement (para 7(25) above), C Ltd undertook, for a price of $90,000,000 (clause 8) which was later increased to $120,000,000 (para 7(29) above), to commence and complete the development at its own cost and to the reasonable satisfaction of the Taxpayer, the owner. ‘Development’ consisted of the demolition of B Building and the construction of the new building and all related works in accordance with the approved plans. C Ltd did not do any construction work either by itself or by any contractor it might have employed. There was no contractual relationship between C Ltd and the main contractor, T Ltd, which was employed by the Taxpayer (para 7(32) above) and therefore was answerable to the Taxpayer for its performance. There is no evidence of any arrangement whereby T Ltd was made answerable also to C Ltd for its work. C Ltd paid the construction costs, and it was therefore contended by Mr E (para 9(b) above) that it took all the financial risk. However, we think that the risk was more apparent than real. C Ltd and J Ltd were ultimately in the same beneficial ownership. C Ltd was relived of a loss in January 1980 (para 7(29) above) when the contract sum was increased from $90,000,000 to $120,000,000 to cover an increase in costs due to a change in the method of construction. Further relief against losses could no doubt be given, if necessary, and we do not think that C Ltd was in any real sense put on the line over the development. That apart, C Ltd sought

tenders from contractors, co-ordinated and liaised, and all that was done through the employees of K Ltd the project manager (see Mr E and Mr F in cross-examination in paras 9(b) and 10(b) above). There is no evidence that C Ltd did anything else. That, in our view, falls far short of what a developer would be expected to do and what C Ltd had undertaken to do under the development agreement. In so far as Mr E and Mr F stated expressly or by implication that C Ltd undertook all development obligations and made all development profit, we do not accept such evidence. As far as development profit is concerned, there is no evidence that the contract sum of $120,000,000 is what an arms length developer would have accepted. We think that the true position is that the Taxpayer developed the property by employing others to do the work for it, such as the firm of architects, T Ltd the main contractor, K Ltd the project manager who rendered its services free of charge and C Ltd the 'developer' who did some minor work and also paid the construction costs. Even if C Ltd had performed all the development obligations under the development agreement, the Taxpayer would still have been the developer, because the Taxpayer would have developed the property by C Ltd who was employed to bring about the redevelopment for the Taxpayer and hand over the redevelopment to the Taxpayer, so that the Taxpayer could in turn perform its obligations under the sale and purchase agreements by delivering vacant possession of the new building and completing the sales. It would simply have been a case of an owner employing someone else to bring about the development for him. The owner is just as much a developer as if he had developed himself.

Intention to Trade

13. On the second question the most important witness is Mr D who was present when Mr M and Mr L discussed their views and intentions regarding the future of the property. He puts it this way:

> 'After having arrived at an agreement in principle for the purchase of [the Taxpayer], but prior to conclusion of a formal agreement, we approached [Mr M] with a view to [K Ltd] becoming the co-investor in the project. [K Ltd] had "in-house" development expertise and resources and considerable financial strength. We also felt that the project was good for redevelopment. We explained the project to [Mr M] as well as our intention and the prospects of redeveloping the property as an investment. [Mr M] felt that [K Ltd's] preference would be to sell the site as soon as it was sure that vacant possession could be obtained or to sell the redeveloped building. Although these discussions were inconclusive we did agree that the price was very good and that we should buy [the Taxpayer] first.'

According to the agreed chronology, the agreement to buy the Taxpayer pending a decision on the future of the property would have taken place on or before 24 August 1978 when I Ltd, acing for itself, K Ltd and Mr L, agreed with H Ltd that J Ltd should purchase the entire issued share capital of the Taxpayer and paid a 20% deposit amounting to $29,920,000 (see para 7(5) above). In September 1978 I Ltd and K Ltd jointly announced their agreement to form a new company for the purpose of developing the property and their respective

shareholdings of 25% and 65% in the new company, with Mr L holding the remaining 10%. The new company was J Ltd. Pursuant to the heads of agreement in January 1979 (see para 7(7) above), the three joint venture parties became shareholders of J Ltd in the percentages of 65% for K Ltd, 25% for I Ltd and 10% for Mr L, and Mr M and Mr N as nominees of K Ltd and Mr D as nominee of I Ltd were appointed directors of J Ltd (clauses 1 and 2). Mr M was nominated and remained at all material times the chairman and managing director (clause 4). Clause 3 provides for the board to be always composed of two nominees of K Ltd and one nominee of I Ltd, so long as their respective shareholdings shall remain in the same percentages. It has been mentioned in para 7(18) above that in June 1979 K Ltd sold a 10% shareholding in J Ltd to Q Ltd which was owned by K Ltd and P Ltd in equal shares. However, that did not affect the composition of the board of J Ltd, which at all material times was constituted by Mr M, Mr N and Mr D. Under clause 11, the directors and shareholders were under an obligation to vote against any resolution which, if passed, would contravene any of the provisions of the heads of agreement. Thus under the heads of agreement K Ltd obtained control of J Ltd at both shareholders and directors levels.

14. For present purposes the most important clause is clause 7 which is in the following terms:

> ‘7. Management
>
> [K Ltd] shall be the project manager of the redevelopment of the property and shall also be the sole agent of the company [J Ltd] for the sale of the units in the new building to be erected thereon. [K Ltd] shall render the aforesaid services free of charge.’

The expression ‘the company’ in that clause refers to J Ltd. In our view by clause 7 the joint venture parties made a policy decision fixing the business direction of the property, that is, that it was to be developed for sale, and they agreed that J Ltd should be their vehicle for carrying out that decision and that K Ltd should be the project manager and the agent of J Ltd in the sale of the units in the new building. In fact J Ltd did not carry out their decision, nor did K Ltd become the sole agent of J Ltd in the sale of the units of the new building, because J Ltd purchased the shares of the Taxpayer and not the property which was owned by the Taxpayer. However, that did not change the fact that the three joint venture parties had made their decision to develop the property for sale, and that decision was in the shape of a contract binding on all of them. Mr D stated that clause 7 was put in to say that if and when the property was to be disposed of, K Ltd would render its services free of charge. The words ‘if and when’ are of course not there and Mr D did not go so far as to say that clause 7 failed to express the intention of the parties. In fact he clarified his position by stating that he was not suggesting that the parties should not take the heads of agreement too seriously and by stressing that the heads of agreement was a genuine agreement. The other two witnesses, Mr E and Mr F, did not deal with the heads of agreement at all. In the circumstances, we feel that the proper approach is to construe clause 7 as it stands, as has been done. On the same day, J Ltd entered into a formal agreement with H Ltd for the purchase of the entire issued share capital of the Taxpayer (para 7(8) above). That

agreement was completed in February 1979 (para 7(9) above) when Mr M, Mr N and Mr D were appointed directors of the Taxpayer in place of the previous board. Although there was no direct evidence of this, we are able to infer from the circumstances that, as in the case of J Ltd, Mr M and Mr N represented K Ltd while Mr D represented I Ltd.

15. In February 1979, Mr L, as chairman of I Ltd, made a statement under the heading 'investment in property' in the chairman's report as follows (para 7(10) above):

> ' [B Building]
>
> In September 1978, your group acquired for $37,400,000 a 25% interest in [B Building], an office building in [A Place]. [K Ltd] has a majority interest in this property. The current intention is that this interest be held as an investment.'

Does that statement show that I Ltd was opposed to the view that the property should be developed for sale? This turns on he meaning of the words 'this interest' in the statement. Mr Milne submitted that those words referred to I Ltd's 25% shareholding in J Ltd because the joint venture parties purchased shares in J Ltd and not the property. As Mr D stated in cross-examination, I Ltd has held and still holds its shares in J Ltd. On the other hand, Mr Gardiner submitted that the words referred to I Ltd's interest in the property. We think that Mr Gardiner must be right. The statement, which appears under the heading 'investment in property', first refers to I Ltd's '25% interest in [B Building]', and then to K Ltd's 'majority interest in this property'. It is plain that Mr L, and I Ltd through him, did not draw the legalistic distinction between the shares of a company and the underlying property, but was merely looking at the commercial reality. We think that the words 'this interest' should be interpreted in the light of that approach and that by those words Mr L was referring to I Ltd's interest in the property, despite the fact that in law I Ltd only had a 25% interest as a shareholder. It seems to us that if parts of the new building equivalent to 25% of the total market value had been sold to I Ltd at the market value, and the remaining 75% to the public, then I Ltd would have had an opportunity to hold its 25% interest in the property (which did not exist in law) as a long term investment, while the joint venture parties' agreement to redevelop for sale would have been implemented. The property market was booming from the middle of 1978 and throughout 1979. Conceivably, I Ltd's liability to pay the purchase price could have been set off or largely set off against the dividend payable on the total net profit made by the vehicle company out of the sales. In our view, neither I Ltd nor Mr L was opposed to the view that the property should be redeveloped for sale. Indeed, it is difficult to see how they could properly have taken such a stand, having signed the heads of agreement and thereby committing themselves to the course of redevelopment for sale. What they were saying by that statement in the chairman's report was that I Ltd should somehow be allowed to keep its 25% interest in the property as a long term investment.

16. In his advice dated 14 March 1979, counsel recites the instructions from the Taxpayer's solicitors as follows:

> '5. Client intends to demolish and rebuild [B Building] as from the end of 1979 and therefore proposes to invoke the said clause 4(d) to terminate all the tenancies which are subject to this clause.'

That shows that prior to 14 March 1979 the joint venture parties and the directors of the Taxpayer had decided that the Taxpayer, instead of J Ltd, should conduct the demolition and redevelopment of B Building. And, more importantly, the compelling inference is that they must also have decided that the Taxpayer should sell the redevelopment, because sale was the purpose laid down in clause 7 of the heads of agreement. From 23 February 1979 to 14 March 1979 was a mere matter of nineteen days. There being no evidence of any intermediate date on which they made those decisions, we find that they made those decisions on 23 February 1979 and then, on the same day, instructed the Taxpayer's solicitors to seek advice from counsel as to the exercise of its rights to terminate the tenancies under the 'break' clause. We find those decisions to be unanimous, or alternatively the decisions of K Ltd the majority joint venture party and Mr M and Mr N, the two directors representing K Ltd's interests.

17. By a resolution in March 1979 (para 7(13) above), the directors of the Taxpayer resolved, inter alia, that the property 'be demolished for redevelopment as soon as vacant possession is obtained'. Mr Gardiner's submission is that the resolution is merely evidence of an intention that the property should be redeveloped, and not that it should be redeveloped for sale, nor that it should be redeveloped by the Taxpayer. Mr Milne submitted that the intention of the directors was that the property should redevelop for sale, and he relied on the following documents as well as surrounding circumstances for support:

(a) By clause 7 of the heads of agreement in January 1979, the joint venture parties agreed and decided to have the property redeveloped for sale.

(b) In his advice dated 14 March 1979 on the effect of the 'break' clause (see para 7(12) above), counsel recited his instruction as follows:

> 'Client intends to demolish and rebuild [B Building] as from the end of 1979 and therefore proposes to invoke the said clause 4(d) to terminate all the tenancies which are subject to this clause.'

(c) By the board resolution in mid-March 1979 it was also resolved that the firm of architects be appointed as architects in charge of the proposed redevelopment and that they be instructed to draw up plans for the same, and that the firm of solicitors be instructed to take all necessary action, in particular, the service of notices to quit to recover possession (para 7(13) above).

(d) In March 1979 the Taxpayer through its solicitors served notices to quit on tenants (para 7(16) above). The standard notice contained the following words:

> '… hereby notify you that the landlord has resolved to demolish and rebuild the said building. A certified copy of the resolution of its directors (that is, the afore-mentioned resolution in March 1979) is enclosed herewith.'

(e) As the notices to quit were going out, K Ltd published its chairman's report in late March 1979 (para 7(15) above) which contains the following statement by Mr M:

> 'The group, together with two other parties, agreed to purchase the entire issued share capital of [the Taxpayer], which owns [B Building] in [A Place]. It is planned to demolish the existing building at the beginning of 1980 and construct a modern commercial and office building on the site. The group will act as project manager and sales agent for this development in which it owns a 65% interest.'

We agree with Mr Milne. First of all, we would agree with Mr Gardiner's general proposition that the primary evidence of a company's intentions is the resolutions of its board of directors. However, that does not preclude the consideration of any other evidence of intention, and, in a case where a company does not generally run its business through board minutes, nor do its directors usually record their decisions in board resolutions, the need to look beyond a board resolution may well become greater. The Taxpayer is one such case. The question whether its business was managed through board resolutions was raised, but, apart from the annual general meeting minutes formally approving the audited accounts for the years ending 31 December 1979 to 1983 and reappointing the directors and auditors, the only board resolution that was produced was the one in mid-March 1979. For example, there is no evidence of any board resolution to approve or authorise any of the following transactions:

(i) obtaining a loan of $100,000,000 in March 1979 (para 7(11) above);

(ii) entering into the development agreement in December 1979 (para 7(25) above);

(iii) entering into the sale and purchase agreements in December 1979 (para 7(26) above);

(iv) increasing the lump sum payable to C Ltd from $90,000,000 to $120,000,000 (para 7(29) above); and

(v) entering into a building contract with T Ltd in March 1981 (para 7(32) above).

On the other hand, while the resolution in March 1979 is silent on the question whether the redevelopment should be for sale or for rental, the documents mentioned in (a) to (e) above throw light on it. First of all, the chairman's statement in (e) above, we think, reflects the

joint venture parties' agreement implied in clause 7 of the heads of agreement that the property should be developed for sale. In our view, in passing the resolution in March 1979, the directors of the Taxpayer, namely Mr M and Mr N representing K Ltd and Mr D representing I Ltd, must have intended that the property should demolish, redevelop and sell after redevelopment. The intention to demolish and redevelop is to be inferred from the documents in (b), (c) and (d) above, while the intention to sell is to be inferred from the documents in (a) and (e). The directors cannot have intended that the property should just redevelop without deciding whether to sell the redevelopment or to hold it as a long term investment, because the heads of agreement had left them no choice but to sell. There was some suggestion that the board resolution made no reference to the purpose of the redevelopment because the joint venture parties had agreed to defer their decision on the issue. With respect, we do not agree. We think the true view is that it was not the tradition of the Taxpayer to record directors' decisions in board resolutions, and that the board resolution in March 1979 was passed not for the purpose of recording the directors' decisions as such, but only for the purpose of recording their decision to demolish and redevelop so that the Taxpayer's intention to demolish and rebuild might be stated in the notices to quit as required by clause 4(d) of the tenancy agreements.

18. For these reasons, we find that the directors were unanimous in deciding that the Taxpayer should sell the redevelopment, or alternatively that Mr M and Mr N the majority directors representing K Ltd so decided.

19. Mr Milne also relied on the fact that Q Ltd's principal business was that of a developer for sale (para 7(19) and para 9(b) above) as evidence to show that the Taxpayer's business was the same, on the ground that otherwise it would have been out of character for Q Ltd to take a 10% interest in J Ltd, the sole owner of the Taxpayer. The point is of some marginal relevance, but we have not relied on it in considering the nature of the Taxpayer's business.

20. Mr D's evidence was to the effect that K Ltd and I Ltd could not agree as to the ultimate purpose of the redevelopment and that on that question there was an 'agreement on disagreement' between them. In our view, any disagreement that may have existed before January 1979 disappeared on that day when the heads of agreement was signed. Alternatively, by reason of the control K Ltd had over the Taxpayer at board meetings as well as at general meetings, any opposition on the part of I Ltd would have been ineffectual. K Ltd's mind was made up, as can be seen from the chairman's report published in late March 1979. It was Mr D's belief that in view of the good relationship between the two families, K Ltd would never force the issue by exercising its voting rights. Such belief, in our view, was based on mere hope. Good relationship may well have existed between Mr M and Mr L, but at the same time one also sees the determination of Mr M and K Ltd to develop for sale.

21. Mr E stated that he joined K Ltd in September 1979 and that at that time, as far as he was concerned, no decision had been made by the Taxpayer that the property was to be redeveloped for sale. In our view, either he was insufficiently briefed as to what had taken

place before his time, particularly during the period January to March 1979, or he failed to appreciate the significance of the documents mentioned in para 17(a) to (e) above. In fact there is no evidence that he studied any of those documents. As for Mr F the auditor, his evidence is that they (that is, he and his staff) were not aware of any events or matters that caused them to believe that the Taxpayer had commenced or engaged in property trading activity that would have led to the reclassification of the property as trading stock under current assets. They confirmed this from their discussions with the management. Although the board of the Taxpayer had resolved in March 1979 that the existing building on the property should be demolished for redevelopment as soon as vacant possession had been obtained, this, he said, did not establish any relevant change of intention and there was no evidence that the Taxpayer was going to redevelop the property for sale itself. With respect, we are unable to accept that view of the affairs of the Taxpayer. Apparently they were only looking at the board resolution, or they must have missed the points mentioned in para 17(a) to (e) above.

22. For these reasons, we find that the Taxpayer formed a definite intention to demolish and redevelop the property for sale in February 1979, and that answers the second question. Had it not been for counsel's advice dated 14 March 1979, we would have found that the Taxpayer formed such an intention in mid-March 1979. We also find the directing mind of the Taxpayer in Mr M and Mr N, the majority directors representing the majority joint venture party K Ltd, and, in the final analysis, in Mr M the chairman of K Ltd. On the whole, Mr D the third director did not take an active part in the management, and was content to leave the business direction of the property to the judgment of his colleagues Mr M and Mr N. Although in the early stages (that is, until the October/November offer caused I Ltd and Mr L to change their minds) they had a preference for holding a 25% or perhaps 35% interest in the redevelopment as a long term investment, they did not oppose the decision of K Ltd to develop for sale, as indeed they could not.

Commencement of Trade

23. As for the third question, we are of the view that the Taxpayer commenced its trade of development for sale on 23 February 1979. On that day the joint venture parties acquired the Taxpayer, and decided that the Taxpayer should redevelop the property for sale. On the same day the Taxpayer instructed its solicitors to seek advice from counsel as to the exercise of its rights under the 'break' clause to terminate the tenancies. Had that step not been taken, we would have found the date of commencement to be 16 March 1979 when the Taxpayer appointed the architect to draw up plans and instructed solicitors to take steps to recover possession. What followed was a whole series of activities and operations carried out in the course of the trade ending with the completion of the sale and purchase agreements. Such activities and operations included: serving notices to quit, applying to the Building Authority for approval of the building plans, engaging quantity surveyors, receiving a deposit of $5,000,000 from the purchasers of the eighteen office floors, obtaining the approval of the building plans, obtaining consent to the commencement of demolition, entering into a development agreement with C Ltd, entering into sale and purchase agreements with purchasers, paying a sales commission through C Ltd, obtaining

vacant possession, commencing and completing demolition, engaging consulting engineers, entering into a building contract with T Ltd, completing the construction work, applying for the issue of and obtaining the occupation permit, delivering vacant possession to and receiving balance of purchase money from the purchasers and completing the sale and purchase agreements. All these activities and operations were part and parcel of the trade of development for sale.

Cases

24. A landowner who sells his land is not trading but merely realizing the value of his investment, and this is so even if he lays out part of his estate with roads and sewers for sale in building lots, because that is merely taking steps to enhance the value of the property in the eyes of a developer who might wish to buy for development (Hudson's Bay Co Ltd v Stevens 5 TC 424; Taylor v Good 29 TC 277). On the other hand, if the landowner embarks on a trade in which he uses the property for the purposes of his trade, he then becomes liable to pay tax on the profits from that trade (Hudson's Bay v Stevens). In the present case, the only possible trade the Taxpayer could have engaged in is that of development for sale. That much is common ground. The Taxpayer's case is that it did not engage in any such trade because C Ltd undertook all the development obligations and made all the development profit. As we have found that the Taxpayer was the developer (see para 12 above), this part of the case fails.

25. Simmons v IRC 53 TC 461 is a leading case on the formation of an intention to hold an investment. The relevant dicta there are, we believe, equally applicable to the formation of an intention to trade, such as an intention to redevelop for sale. While no definition is attempted, the case does throw light on the quality of such an intention. At first instance, Goulding J described it as 'a definite intention, going beyond a mere contingent hope' (at page 484). In the House of Lords, Lord Wilberforce was of the opinion that such an intention could be formed even though 'the final decision might have to wait on events', or 'frustration' was 'foreseen as a possibility' (at page 494). At page 495 his lordship criticized the Court of Appeal for basing 'their decision largely upon a passage from the judgment of Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237, which was concerned with the making by a landlord of a provisional – as contrasted with a conditional – decision. This they sought to apply to a very different situation, for there is no basis, either in fact or in finding, for holding Mr Simmons's intention to be provisional in the sense of that word in the judgment'. The passage was quoted in Orr LJ's judgment at page 489, of which the relevant part reads:

> 'The Commissioners were not referred to the well known passage in the judgment of Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237, at page 253, where he gave the following explanation of the meaning of the word "intention":
>
> > "X cannot, with any due regard to the English language, be said to 'intend' a result which is wholly beyond the control of his will. He

> cannot 'intend' that it shall be a fine day tomorrow: at most he can hope or desire or pray that it will. Nor, short of this, can X be said to 'intend' a particular result if its occurrence, though it may be not wholly uninfluenced by X's will, is dependent on so many other influences, accidents and cross-currents of circumstance that, not merely is it quite likely not to be achieved at all, but, if it is achieved, X's volition will have been no more than a minor agency collaborating with, or not thwarted by, the factors which predominantly determine its occurrence. If there is a sufficiently formidable succession of fences to be surmounted before the result at which X aims can be achieved, it may well be unmeaning to say that X 'intended' that result."

That passage was directed to section 18(1) of the Landlord and Tenant Act 1927 but in our judgment is equally apt to the present context where the question for the Commissioners was whether they were satisfied that Mr Simmons and his associates had formed, in the case of each of the properties, an intention, as distinct from a mere hope, that it should be retained as an investment.'

Cunliffe v Goodman was an action brought by the plaintiff landlord for damages for breaches of the undertakings for repair contained in the tenancy agreement. The defence was that the defendant was relieved from liability under section 18(1) of the Landlord and Tenant Act 1947 on the ground that at the time of the termination of the tenancy the landlord's intention was to pull down the premises. Asquith LJ said at page 254:

'This leads me to the second point bearing on the existence in this case of "intention" as opposed to mere contemplation. Not merely is the term "intention" unsatisfied if the person professing it has too many hurdles to overcome, or too little control of events: it is equally inappropriate if at the material date that person is in effect not deciding to proceed but feeling his way and reserving his decision until he shall be in possession of financial data sufficient to enable him to determine whether the project will be commercially worth while.

A purpose so qualified and suspended does not in my view amount to an "intention" or "decision" within the principle. It is mere contemplation until the materials necessary to a decision on the commercial merits are available and have resulted in such a decision. In the present case it seems to me that … she never reached, in respect of the first scheme, a stage at which she could decide on its commercial merits; nor, in respect of the second scheme, the stage of actually deciding that scheme was commercially eligible – unless indeed she must be taken not merely to have repudiated her architect's authority but to have decided that it was commercially ineligible. In the case of neither scheme did she form a settled intention to proceed. Neither project moved out of the

> zone of contemplation – out of the sphere of the tentative, the provisional and the exploratory – into the valley of decision.'

Those words were said in the context where Lady Cunliffe the landlord never in fact decided to proceed with her redevelopment scheme but was reserving her decision until the financial data which she required to enable her to make a decision were made available. In the meantime she never reached more than a provisional decision. That Lord Wilberforce contrasted with a conditional decision. In the Simmons case, Mr Simmons in fact decided to create and retain investments and acquired and developed sites with a view to creating permanent investments, relying on short and long term loans for the various stages, but the final decision whether to retain might have to wait on events, such as the position of lettings and so on. Mr Simmons's decision was a definite one, going beyond the tentative, the provisional and the exploratory, although it may be said that it was conditional on not being frustrated by events, such as less favourable economic climate, the problems created by the Rent Act 1965 and the Finance Act 1965, restrictions on credit and office buildings, the property market tending to decline, long time finance becoming less easy to obtain, etc. Those events led to the decision in principle taken on 27 October 1966 to liquidate the group and to dispose of the properties, that is, nine years after the first company, Polewin, was formed in May 1957 to acquire and develop properties. In the present case it may be said that the Taxpayer's decision to redevelop for sale was conditional on not being frustrated by having insurmountable problems with vacating the tenants not subject to a 'break' clause, of whom there were three or four. But there was nothing provisional about the decision. The Taxpayer clearly decided to develop for sale and took definite steps to implement that decision from 23 February 1979. Nor is there any evidence of any real difficulty with any of the tenants. In fact the Taxpayer and K Ltd predicated the date of obtaining vacant possession with virtual precision (see para 7(12), (15) and (30)). Mr Gardiner cited Reohorn v Barry Corporation [1956] 1 WLR 845 for the proposition that intention connotes the present means and ability to carry it into effect. That case turned on the construction of the word 'intend' in section 30(1)(f) of the Landlord and Tenant Act 1954, under which the Barry Corporation the landlord resisted an application by the tenant for a new lease on the ground that on the termination of the current tenancy they intended to carry out substantial work of construction on the holding and could not reasonably do so without obtaining possession. At page 849 Denning LJ quoted himself in Fisher v Taylors Furnishing Stores Ltd [1956] 2 WLR 985 at 988 as follows:

> 'It must be remembered that if the landlord, having got possession, honestly changes his mind and does not do any work of reconstruction, the tenant has no remedy.'

It is clear that the Court of Appeal was influenced by the consideration that there should be safeguards against the tenant being turned out on this ground too lightly, and therefore that they imported into the word 'intend' the concept of having the present means and ability to carry the intention into effect. That construction was required by a particular statutory context and is not in our view apt to the present case. For these reasons we decline to follow Cunliffe v Goodman or Reohorn v Barry Corporation.

26. As we take the view that the Taxpayer, and not C Ltd, was the developer, the third question is simply when the Taxpayer commenced the trade of development for sale. The question was raised no doubt because of its association with the question – at what date should the property be valued? The Taxpayer's argument is that it commenced the trade of development for sale when it commenced development in a physical sense with the required intention, and that at the very earliest that would have been late February 1980 when vacant possession was obtained and demolition commenced (see para 7(30) above). In other words, the trade of development for sale is equated with the actual work of demolition and rebuilding for sale and does not include the necessary steps leading to demolition. Both sides referred to paragraph 18 of the Departmental Interpretation and Practice Notes, No 1, Part B, issued by the Inland Revenue Department in July 1976 (para 18 of the Departmental Notes), which reads:

> ' Date of Commencement
>
> 18. Where a person first enters into a property development (development for profit by sale) project, he is regarded as having commenced business for the purposes of section 18C of the Inland Revenue Ordinance when he takes the first clear step towards that end. This may be the date of acquisition of the site, or if the land has been held for some time, when some definite move is made towards development.'

Mr Gardiner also cited Birmingham & District Cattle By-Products Co Ltd v CIR [1919] 12 TC 92, where it was held that the taxpayer company commenced to carry on its trade or business of sausage skin manufacturers on 6 October 1913 when it began to take the raw materials and to turn out its product. Rowlatt J related the facts as follows:

> '… Now apparently the company was incorporated on 20 June to carry on the business of making some use of the by-products of the butcher's trade. It arose out of a combination of a number of butchers who entered into a contract with the trustee of the company to be formed that they would supply, and the company to be formed would take, these by-products. There was a combination among those butchers for that purpose. Now the company took over those agreements, and having taken over those agreements the directors, at the expense of the company, as was very proper, went about and looked at places of business of a similar character in various parts of the country. That was an admirable thing to do preparatory to commencing business, but it certainly was not commencing business. If you go and look at other businesses to see how you will conduct your business when you set it up, you are preparing to commence business, but you are not commencing business.
>
> Then they entered into a contract for the erection of works, which works were duly erected in July 1913. That again is preparatory. The company were occupying themselves with activities within their powers, of course; they were

> living their life; but they had not yet begun to conduct their trade or business. Then they purchased machinery and plant for carrying on the business. That was getting ready. Then they entered into agreements for the purchase of products. Those are the agreements which I have already referred to which formed the substratum of the company, but no materials came in nor were any sausage skins made from 20 June. They waited, and I suppose in October, the date they refer to in their minutes, having looked round, and having got their machinery and plant, and having also employed their foreman, and having got their works erected and generally got everything ready, then they began to take the raw materials and to turn out their product.'

A subsidiary question as to whether there were any presales before actual manufacture commenced was raised in the course of the argument. Rowlatt J did not mention any presales in his judgment, while the headnote states, inter alia, that between 20 June 1913 and 6 October 1913, the directors entered into agreements relating to the purchase of products to be used in the business and to the sale of finished products. There is a similar statement in the case stated. Mr Milne submitted that there were no presales; otherwise they would have been mentioned in the judgment. We have no knowledge of the exact contents of any agreements for sale, and, in view of the fact that there was no reference to actual presales in the judgment, we do not feel justified in drawing from the headnote or the case stated an inference that there were presales. The court was able to draw a clear line separating the preparatory acts aimed at forming the substratum of the company and consisting mainly of incurring capital expenditure on the erection of works and the installation of plant and machinery from the receipt of raw materials which marked the commencement of the business or trade of manufacturing sausage skins for sale. However, we fail to see how that case can be of assistance to the present context where there was no preparatory stage of substratum formation or capital outlay, and the property, the 'raw materials' so to speak, was in the Taxpayer's ownership at all material times. On 23 February 1979, the new shareholders and directors decided that the Taxpayer should develop the property for sale and instructed solicitors to consult counsel as to the exercise of its rights under the 'break' clause to terminate the tenancies; from that day onwards steps were taken and expenses incurred which were necessary to the commencement of physical development; and before the end of February 1980, when demolition began, all the units in the new building had been presold and part of the proceeds of sale received. The question is whether in these circumstances the date of commencement of demolition should be taken as the date of commencement of the trade or business of development for sale. Mr Milne cited Overseas Textiles Ltd v CIR 3 HKTC 29 and D19/85, and Whitfords Beach Pty Ltd v FCT 12 ATR 692 and 14 ATR 247. In the Overseas Textiles case, the taxpayer company owned the land as a capital asset. All the shares in the company were sold to new owners who were well known property developers. On 28 May 1976 the directors passed a resolution to cease business as a textile factory on 3 June 1976 and to instruct the architect to submit plans for redevelopment as soon as possible. The resolution also stated that it would be beneficial to utilize the land more advantageously by erecting a flatted factory thereon for rental, but it was found that the company had no real intention to rebuild for rental purposes and that the company commenced its property trading business on 28 May 1976 notwithstanding: (1)

that demolition commenced on 12 December 1976, (2) that the first sales apparently took place in March 1977 and (3) that a major sales promotion campaign began in May 1977, and even assuming that before 14 April 1977 when the memorandum of association was amended, the company had not had any power to redevelop land. The High Court took the view that 'it (14 April 1977) would simply be the earliest date upon which property dealing could properly commence', while in actual fact it commenced on 28 May 1976. Before we deal with the Whitfords Beach cases, we think that it is apposite to refer to Taylor v Good [1973] 29 TC 277, where Russell LJ, after referring to Hudson's Bay Co v Stevens [1909] 5 TC 424, Rand v Alberni Land Co Ltd [1920] 7 TC 629, Alabama Coal Co Ltd v Mylam [1926] 11 TC 232 and Pilkington v Randall [1966] 42 TC 662, said at 296:

> 'All these cases, it seems to me, point strongly against the theory of law that a man who owns or buys without present intention to sell land is engaged in trade if he subsequently, not being a developer, merely takes steps to enhance the value of the property in the eyes of a developer who might wish to buy for development.'

By that dictum Russell LJ was not laying down a proposition of law that as long as he is not a developer in the sense of a builder, a person is not trading when he sells his investment property, no matter what steps he may take to enhance its value. That can be seen at 297 where he had this to say:

> 'For the Crown it was further argued that all these cases were matters of degree, and therefore even if the purchase in this case be equated, for example, to an inheritance by the taxpayer, it should be left to the Commissioners to determine whether subsequent events amounted to an adventure in the nature of trade. Hereunder reference was made to the passages in the Pilkington case, both at first instance and in this Court, as suggesting or showing that even in such a case the activities of the landowner on or in connection with the land and its improvement and enhancement in value might of themselves be of such a quality or degree as could properly be regarded as constituting a relevant adventure. Let me assume this to be so. Nevertheless, I cannot think that the activities of the taxpayer in this case subsequent to the purchase, which I have already summarised, could be so regarded by any reasonable body of Commissioners versed in the relevant law.' (Emphasis supplied)

The facts in the Whitfords Beach case are briefly these. The taxpayer company (Whitfords) purchased the subject land in about 1954. It was agreed that the acquisition was not for the purpose of profit-making by sale. On 20 December 1967 the shares in Whitfords were sold to three companies – 50% to A Co, 25% to B Co and 25% to C Co. At the time of the acquisition of the shares in 1967 the land could not be sub-divided without a change in zoning. Under a contract of the date of the acquisition of the land B Co and C Co entered into contracts with Whitfords whereby the sub-division and the sale of the land was to be undertaken by those two companies. In October 1969 the zoning of the land was varied. On 26 March 1970 an application for sub-divisional approval was lodged with the town

planning authorities in respect of part of the land. This was eventually approved and sale of the land after sub-division commenced in July 1971 in individual lots. All work in association with the change in zoning, development and sale was undertaken by persons other than Whitfords, and at no time was Whitfords engaged in a business of development of property as all land was sold vacant. It was agreed that the acquisition of the shares by the three new shareholders in 1967 was for the purpose of sub-dividing the land and selling it in individual lots. The Commissioner treated the profits made as assessable income, taking as the basis of cost the price paid for the shares at the time of the acquisition in 1967. It was agreed that the profits were either assessable income under section 25(1) or section 26(a) of the Income Tax Assessment Act 1936-1975. The High Court by a majority of three to one held that the proceeds of sale were assessable income under section 25(1) which reads as follows:

> '25(1) The assessable income of a taxpayer shall include –
>
> (a) where the taxpayer is a resident –
>
> the gross income derived directly or indirectly from all sources whether in or out of Australia; and
>
> (b) where the taxpayer is a non-resident –
>
> the gross income derived directly or indirectly from all sources in Australia,
>
> which is not exempt income.'

The question – whether the proceeds of sale, the gross income, were assessable income under section 25(1) – was decided by applying the test for profit laid down by Clerk LJ in California Copper Syndicate (Ltd and Reduced) v Harris [1904] 5 TC 159 at 166, where he said:

> ' It is quite a well settled principle in dealing with questions of assessment of income tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of schedule D of the Income Tax Act of 1842 assessable to income tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose,

> and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for income tax.
>
> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being – Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?'

As a result of applying that test, they were able to find that the sales were made by Whitfords in the course of carrying on or carrying out a business of development (without building), sub-division and sale of land and that the resulting profits were gain made in an operation of business in carrying out a scheme for profit-making. Thus their Honours used a well known United Kingdom test for profit in determining the taxability under section 25(1) of the profits made by Whitfords. It does not seem to us that the difference in structure between the Australian and the United Kingdom legislation affects the aptness of the Whitfords cases to the present context. The High Court remitted the case to the Federal Court to determine the date at which the land should be valued; the value thus determined was to be deducted from the proceeds of sale in calculating the taxable profits. The Federal Court held that the relevant date for purposes of ascertaining the value of the land was 20 December 1967. The taxpayer's activities in the period between December 1967 and June 1969, although preliminary to sub-division and development, were nevertheless an integral part of the business. At least some of those activities, related to roads and services, were of relevance to the development of the whole land. From June 1969 on the evidence showed that the entire project progressed stage by stage with operations overlapping. The conclusion must be that the taxpayer was carrying on a business of developing, sub-dividing and selling the land, and that business commenced as soon as the intention to take steps for that purpose in elation to the entire land was formed and activities directed to that end began. That summarises the decision of the Federal Court. In other words, the date of commencement of the business was the same as the date of valuation, namely, 20 December 1967, and this notwithstanding that the land could not be sub-divided before the legal impediment to sub-division was removed in October 1969 and that the actual work of sub-division did not begin until even later. In making our finding as to the date of commencement of business (see para 23 above), we followed the approach adopted in the Overseas Textiles and Whitfords Beach cases and had regard to the suggestion of 'some definite move towards development' in paragraph 18 of the Departmental Notes, even though it is only a practice and has no binding force. In our view, the date when the Taxpayer commenced its business or trade of development for sale is not the date when demolition work began, but the date on which it took the first definite step to implement its intention to develop the property for sale, and that date we have found to be 23 February 1979 (see para 23 above).

Conclusion

27. Our conclusion is that the profits made by the Taxpayer from the sales of the premises of the redeveloped property arose from the trade of a developer for sale or from an

adventure in the nature of that trade, and are therefore assessable to profits tax. The case is hereby remitted to the Commissioner for matters of valuation to be agreed with the Taxpayer, if possible. Failing such agreement, the parties shall have liberty to apply for the case to be restored for hearing before the Board.