Case No. D36/89

Profits tax – disposal of shares in a company – whether an adventure in the nature of trade or disposal of a capital asset.

Panel: T J Gregory (chairman), Foo Tak Ching and Kenneth Ku Shu Kay.

Dates of hearing: 25, 26 and 27 October 1988.
Date of decision: 22 August 1989.

The taxpayer acquired shares in X Limited and sold them at a profit within less than one hundred days of the acquisition. The board resolution authorising the acquisition of the shares was silent as to whether they were acquired for investment or for sale. The purchase price was entirely borrowed and the taxpayer had a nominal issued share capital. It was suggested that the taxpayer was intended to become a public listed company or to become part of the listing of a public company.

Held:

On the evidence and facts before the Board the taxpayer had failed to discharge the onus of proof.

Appeal dismissed.

Cases referred to:

Wing On Cheong Investment Co Ltd v Commissioner of Inland Revenue Inland Revenue Appeal No 1 of [1987]
Simmons v IRC [1980] 1 WLR 1196
Sharkey v Wernher [1956] AC 58
Californian Copper Syndicate (Limited and Reduced) v Harris (Surveyors of Taxes) STC 166
Rutledge v The Commissioner of Inland Revenue 14 TC 490
JP Harrison (Watford) Limited v Griffiths (HM Inspector of Taxes) 40 TC 281
BR 18/76, IRBRD, vol 1, 245
Eames (HM Inspector of Taxes) v Stepnell Properties Ltd 43 TC 678
Simmons (as liquidator of Lionel Simmons Properties Ltd) v Inland Revenue Commissioners [1980] STC 350
D32/85, IRBRD, vol 2, 204
Rees Roturbo etc v Ducker 13 TC 366

Lily Harriet Ram Iswera v Commissioner of Inland Revenue [1965] 1 WLR 663
D8/88, IRBRD, vol 3, 161
Marson (Inspector of Taxes) v Morton and related appeals [1986] STC 463

David Hinchen for the Commissioner of Inland Revenue.
Ronald E Mayne instructed by Richard Bryson & Co for the taxpayer.

Decision:

1. THE NATURE OF THE APPEAL

The Taxpayer appealed to the Board of Review against the profits tax assessment for the year of assessment 1981/82 on the profit derived from the disposal of shares in a company. The question is whether the profit arose from an adventure in the nature of trade, as determined by the Commissioner, or whether it arose from the sale of a capital asset, as the Taxpayer maintains.

2. THE FACTS

2.1 Acquisition of X Limited

2.1.1 By an agreement in writing dated 23 October 1980 ('the X Limited agreement') the then shareholders of a private company (hereinafter 'X Limited') contracted with Mr A to sell to Mr A or, by operation of clause 3 of the X Limited agreement, to such persons or companies as Mr A directed or nominated, the 1,000 shares of $10 each (the 'X Limited shares') which comprised the entirety of the issued share capital of X Limited. The consideration to be paid for the X Limited shares was $18,671,203 of which a deposit of $4,000,000 was paid on the signing of the X Limited agreement. The completion of the sale and purchase of the X Limited shares was expected to be on or before 23 January 1981.

2.1.2 A copy of this agreement is appendix A to the determination of the Commissioner dated 19 March 1986 (the 'determination').

2.2 X Limited

2.2.1 At all material times X Limited was the registered owner of a piece of land in Hong Kong on which a building had previously been erected. The property and the building formerly erected thereon is identified in the third recital of the X Limited agreement.

2.2.2 By an agreement in writing dated 8 September 1979 (the 'joint development agreement') X Limited agreed with three others, who were the owners of property adjacent to the property referred to in paragraph 2.2.1 above, for the joint redevelopment of their respective properties. A copy of the joint development agreement was introduced into evidence during the course of the hearing and was marked exhibit A-3.

2.2.3 X Limited's financial contribution to the cost of the joint redevelopment was limited to $450,000 of which $250,000 was payable on the signing of the joint development agreement and $200,000 on completion of part of the building works, refer clause 4 thereof.

2.3 The Taxpayer

2.3.1 The Taxpayer was incorporated in November 1980 with an authorized capital of $10,000 divided into 100 shares of $100 each.

2.3.2 In January 1981 the directors and shareholders of the Taxpayer were Mr A and Mr B, who was a close business associate of Mr A, who each owned one of the two issued shares of $100 each in the capital of the Taxpayer, and refer paragraph 4.2.1.3 below.

2.4 Acquisition of X Limited by the Taxpayer

2.4.1 At a meeting of its directors, held in January 1981, it was resolved that the Taxpayer acquired the X Limited shares pursuant to the X Limited agreement. The resolution provided that 988 of the X Limited shares were to be acquired by the Taxpayer and one of the X Limited shares by each Mr A and Mr B, each as trustee for the Taxpayer. These minutes are silent as to the purpose for which the X Limited shares were to be purchased or how the purchase was to be financed. A copy of the minutes of this meeting is appendix B to the determination.

2.4.2 To enable the Taxpayer to meet the purchase price of $18,671,203 for the X Limited shares the Taxpayer borrowed:

2.4.2.1 $12,000,000 from a locally incorporated finance company (the 'finance company') which was secured by a debenture, the borrowing being at an interest rate which was 3% per annum over the prime lending rate from time to time charged by The Hongkong and Shanghai Banking Corporation; and

2.4.2.2 $7,000,000 from Mr A and Mr B.

2.4.2.3 A copy of the debenture is appendix D to the determination.

2.4.2.4 No document to evidence the loan from Mr A and Mr B was produced. However, the audited accounts of the Taxpayer for the period from November 1980 (date of incorporation) to 30 June 1981, a copy being appendix F to the determination, contain a note, note 8, which reads:

> ' An equitable mortgage over the properties of eleventh floor, twelfth floor and eighteenth floor of a building in Hong Kong, owned by third parties have been executed in favour of [the finance company] to secure a loan to the extent of $7,000,000 granted to [the Taxpayer's] directors who in turn granted the loan to [the Taxpayer].'

There was no evidence as to the interest rate, if any, payable on this loan. However, it is noted from these audited accounts that loan interest of $1,996,984 was paid. This, for the period from, and including, 23 January 1981, the X Limited agreement completion date, refer paragraph 2.1.1 above, to, and including, 1 May 1981, the Y Limited agreement date, namely 99 days, or 7 August 1981, the Y Limited allotment date, refer paragraph 2.6.2.2 below, namely 197 days, exceeds the interest payable on the loan from the finance company, assuming the interest rate was a constant 20% per annum, throughout those periods, and refer paragraph 4.2.2.2.7 below.

2.5 Acquisition of X Limited by Y Limited

2.5.1 By an agreement in writing dated 1 May 1981 ('the Y Limited agreement'), a Hong Kong company ('Y Limited') which was incorporated in 1981, contracted to purchase that X Limited shares from the Taxpayer and the issued share capitals of eight other companies from parties who included Mr A and Mr B, selling as shareholders of four of these other companies or as shareholders of the vendor companies of the remaining four companies, and refer paragraph 2.6.2.4 below. Y Limited was purchasing the shares from the various vendors with a view to acquiring a listing on the then Stock Exchanges. A copy of the Y Limited agreement is appendix E to the determination.

2.5.2 Under the terms of the Y Limited agreement:

2.5.2.1 the acquisition of the shares being purchased was with immediate effect, the twelfth recital, although completion was to be 'on or about 30 June 1981', clause 3;

2.5.2.2 Y Limited was to pay the Taxpayer $34,671,153 for the X Limited shares;

2.5.2.3 No vendor contracted to subscribe all or any part of the consideration received for shares in Y Limited.

2.6 The Y Limited prospectus

2.6.1 In August 1981 the Y Limited prospectus was published. This prospectus invited applications for 50,000,000 ordinary shares of $1 each at $1 per share payable in full on application. A copy of the prospectus was introduced in evidence and was marked exhibit A-4.

2.6.2 The Y Limited prospectus provides the following information:

2.6.2.1 That the promoters included Mr A and Mr B, paragraph 9(c) on page 40, and that Mr A was Y Limited's chairman and managing director and Mr B was Y Limited's deputy managing director, page 7;

2.6.2.2 That on incorporation in March 1981 Y Limited had an authorized share capital of $10,000 divided into 10,000 shares of $1 each, that two subscriber shares had been issued fully paid for cash at par, that on 7 August 1981 the authorized share capital was increased to $300,000,000 by the creation of 299,990,000 shares of $1 each and that on the same day 149,999,998 shares were issued fully paid for cash at par, paragraph 1 on page 33.

2.6.2.3 That the cost to Y Limited of purchasing the issued share capital of the various companies purchased from the vendors pursuant to the Y Limited agreement and for the purchase of loans due from these companies totalled $149,550,000, refer paragraph 3 on page 34.

2.6.2.4 That Mr A and Mr B, respectively, were beneficial owners of shares in four of the companies purchased by Y Limited pursuant to the Y Limited agreement and shareholders in the five remaining vendor companies, paragraph 5 on pages 36 and 37.

2.6.2.5 Following the allotment of the shares offered to the public Mr A and Mr B would hold an attributable 21.26% and 21.12%, respectively, of Y Limited's issued share capital, refer paragraph 5(a) on page 36.

2.6.2.6 That at 30 June 1981 X Limited's interest in the building under construction was $37,700,000 and that when completed, estimated in December 1982, it would be worth $42,319,000.

2.7 Tax returns of the Taxpayer

2.7.1 For the period ended 30 June 1981:

2.7.1.1 On 7 December 1982, obviously incorrectly stated to be 1983 in paragraph 1(9) of the determination, the Taxpayer submitted its profits tax return for the year of assessment 1981/82 accompanied by a tax computation and its audited

accounts for the period from November 1980 (its date of incorporation) to 30 June 1981. A copy of these documents is appendix F to the determination.

2.7.1.2 The profit and loss account included a net profit of $15,715,326 derived from the sale of the X Limited shares. This profit was shown as an extraordinary item and was not offered for assessment.

2.7.1.3 Annexed to the tax computation is a document entitled 'schedule showing profit on disposal of unquoted share investment'. This provides the following information:

'Cost of investment –

Consideration	$18,671,203
Stamp duty	56,024
Legal fee	48,600
Commission and brokerage	180,000
	$18,955,827
Sale proceeds	34,671,153
Profit on sale of unquoted share investment	$15,715,326,

2.7.2 For the period ended 30 June 1982

2.7.2.1 The profits tax return of the Taxpayer for the year of assessment 1982/83, together with a tax computation and audited accounts for the year ended 30 June 1982, as filed by the Taxpayer, were produced by the Revenue and admitted as an exhibit and marked exhibit R-3.

2.7.2.2 This exhibit discloses that in the year ended 30 June 1982 the Taxpayer received dividend income of $1,740, made a profit on disposal of quoted investments of $4,926.50 and paid a dividend of $8,000,000.

2.7.2.3 A schedule entitled 'statement showing movement of share investments' attached to the tax computation shows that in the year 6,826,000 shares were purchased at a consideration of $6,826,000 and during the year 6,768,000 shares were sold for $6,772,926.50, resulting in the profit of $4,926.50. 58,000 of the shares, costing $58,000, were owned as at 30 June 1982 the market value of those shares being $71,340.

2.8 Correspondence

2.8.1 By letter dated 11 April 1983, a copy whereof was produced by the Revenue and admitted as an exhibit and marked exhibit R-4, the assessor requested information as to the acquisition and disposal of the X Limited shares which was provided in a letter from the Taxpayer's authorized representative dated 12 December 1983, exhibit R-5.

2.8.2 Subsequent correspondence between the Revenue and the Taxpayer's representatives as to the liability, or otherwise, of this profit to tax was exchanged and, ultimately, on 25 September 1985 the assessor raised the following 1981/82 profits tax assessment on the Taxpayer:

'Basis period: November 1980 (date of incorporation) to 30 June 1981

Profits per account	$13,610,074
Add: Preliminary expenses written off	3,263
Assessable profits	$13,613,337
Tax payable thereon	$ 2,246,200,

2.8.3 By letter dated 28 September 1985 the Taxpayer, through its authorized representative, lodged an objection against the assessment in the following terms, extracted from paragraph 1(14) of the determination:

> 'The profit on disposal of shares in [X Limited] of $15,715,326 are capital gains which are not assessable. As pointed out in our letter dated 18 June 1985, the underlying objective of the purchase and sale of shares in [X Limited] was to enable the shareholders of [the Taxpayer] to transfer the property development projects owned by their privately controlled companies to [Y Limited], a public company to be controlled by the same shareholders. [The Taxpayer] has no motive at all to deal with the shares and hence the profit arising for the transfer of such shares should not be assessable.'

2.9 The determination of the Commissioner

In the determination the Commissioner rejected the submissions by the Taxpayer's authorized representative and confirmed the profits tax assessment for the year of assessment 1981/82 showing assessable profits of $13,613,337 with tax payable thereon of $2,246,200.

2.10 The notice of appeal

On 18 April 1986 the Taxpayer gave notice of appeal against the determination, the grounds being:

> ' 1. The profits derived from the acquisition and disposal of the shares in [X Limited] were not of a revenue nature. [The Taxpayer] had no intention to deal with such shares. At the time of acquisition of the shares in [X Limited], the only asset of [X Limited] was a joint development project which took time to complete. [X Limited] would be entitled to several floors of the new building on completion. By holding the shares in [X Limited], [the Taxpayer] would have benefits in the long run. Hence, the intention of acquiring the shares in [X Limited] was for long term investment purpose.
>
> 2. The funds for the purchase of the shares borrowed from [the finance company] were only on short term basis. The shareholders of [the Taxpayer], [Mr A] and [Mr B], could have repaid such loans out of their own funds and provided long term financial assistance to [the Taxpayer] for the holding of shares in [X Limited].
>
> 3. The only reason why the shares in [X Limited] were sold was that the shareholders of [the Taxpayer] took steps to transfer their privately controlled companies to [Y Limited], a public company on 1 May 1981. The intention of the resale was not for profit-making. The consideration for the shares was based upon the valuation of the project and the cash received was wholly used by [the Taxpayer] and [the Taxpayer's] shareholders to subscribe for shares in [Y Limited].'

3. DOCUMENTATION

The Board had before it copies of the documents set out below:

3.1 Papers submitted before the hearing:

3.1.1 The determination dated 19 March 1986;

3.1.2 The X Limited agreement, appendix A to the determination;

3.1.3 The report and accounts of X Limited for the period from 10 September 1980 to 30 June 1981, appendix B to the determination;

3.1.4 The minutes of the meeting of the directors of the Taxpayer held on 12 January 1981, appendix C to the determination;

3.1.5 The debenture dated 22 January 1981 issued to the finance company to secure $12,000,000, appendix D to the determination;

3.1.6 The Y Limited agreement, appendix E to the determination;

3.1.7 The audited accounts of the Taxpayer for the period from November 1980 (date of incorporation) to 30 June 1981 together with its tax computation, appendix F to the determination.

3.2 During the evidence of Mr A, refer paragraph 4.2 below, the following documents were produced and admitted in evidence:

3.2.1 An affirmation by Mr A, marked exhibit A-l;

3.2.2 A copy of the occupation permit for the building erected in fulfillment of the joint development agreement, which was marked exhibit A-2;

3.2.3 A copy of the joint development agreement, refer paragraph 2.2.2 above, which was marked exhibit A-3;

3.2.4 A copy of the Y Limited prospectus, dated 17 August 1981, which was marked exhibit A-4.

3.3 The Revenue submitted the following exhibits:

3.3.1 A copy of page 51 of the Hong Kong monthly digest of statistics for November 1981 as to interest rates between 1 January 1975 and 7 October 1981, which was marked exhibit R-1;

3.3.2 A copy of extracts from memorandum and articles of association of the Taxpayer which was marked exhibit R-2;

3.3.3 A copy of the profits tax return for the year of assessment 1982/83 together with the Taxpayer's audited accounts for the year ended 30 June 1982 together with a tax computation as filed by the Taxpayer, which was marked exhibit R-3;

3.3.4 A copy of a letter dated 11 April 1983 from the assessor to the Taxpayer's representatives which was marked exhibit R-4;

3.3.5 A copy of the reply dated 12 December 1983 from the Taxpayer's representatives to the assessor which was marked exhibit R-5.

4. THE HEARING OF THE APPEAL

4.1 The opening submission of the Taxpayer's Counsel

4.1.1 The joint development agreement:

The attention of the Board was drawn to recitals 4 and 5 and clauses 1, 8 and 9 of this agreement and it was submitted that these provisions established that the property owned by X Limited was not readily marketable. Attention was also drawn to clauses 13 and 15, the former prohibiting assignment, mortgaging or charging by the parties to the agreement of their respective properties, and the latter restricting agreements for sale of the parts of the building to be assigned on completion of the redevelopment to the parties to the redevelopment for their exclusive use and occupation to sales to which the land office had given prior consent and subject to any restrictions imposed as a condition of such consent. It was submitted that these various restrictions would be unacceptable to any person other than one seeking a long term investment.

4.1.2 The determination:

4.1.2.1 The Board's attention was drawn to paragraph 1(6) of the determination which was read in conjunction with the minutes of the meeting of the directors of the Taxpayer held in January 1981, appendix C to the determination.

4.1.2.2 The Board was then taken through the remaining sub-paragraphs of paragraph 1, sub-paragraphs 7 to 14, and the quotation from the letter dated 28 September 1985 from the Taxpayer's representative, which appears in paragraph 1(14) of the determination, refer paragraph 2.8.3 above. Counsel made two comments with respect to these sub-paragraphs of the determination:

4.1.2.2.1 After reading sub-paragraph 1(8): on the documents the $34,671,153 received from Y Limited exceeded the $18,671,203 paid for the X Limited shares and it was the difference which the Commissioner says was the trading profit of the Taxpayer; and

4.1.2.2.2 After reading sub-paragraph l.14: the case for the Taxpayer was that the shares were purchased as part of the portfolio which was being put together for Y Limited.

4.1.2.3 Paragraph 2 and the whole of paragraph 3 of the determination were then addressed. Counsel commented on the first three sub-paragraphs of paragraph 3 as follows:

4.1.2.3.1 After reading sub-paragraph 3(1): this paragraph went to the root of the appeal: the property in which X Limited was interested was not marketable; Counsel

then repeated the substance of his submission recorded in paragraph 4.1.1 above;

4.1.2.3.2 After reading sub-paragraph 3(2): the Commissioner accepted in the second sentence that the X Limited shares were not marketable. As to the third sentence: it was not the position that the Taxpayer was a vehicle; reference should be made to the letter from the Taxpayer's authorized representative dated 28 September 1985 and the paragraph quoted in sub-paragraph 1(14) of the determination (refer paragraph 2.8.3 above); and

4.1.2.3.3 After reading sub-paragraph 3(3): Counsel queried what the word 'marketable', as used in this sub-paragraph, meant. Counsel said that the Commissioner had linked the asset with the shares and identified the asset as the factor in determining marketability. Counsel reiterated that neither the interest in the redevelopment nor the X Limited shares were readily marketable.

4.1.3 The prospectus:

The Board was then referred to the various parts of the Y Limited prospectus and, particularly, to the section entitled 'Business', commencing at page 9, in which Y Limited stated that whilst its intention was to sell some of the properties it had acquired, others were to be retained for long term investment including the property owned by X Limited, and refer the paragraph numbered (viii) commencing on page 11.

4.1.4 The intentions of the Taxpayer:

It was submitted that there could be no doubt as to the intentions of Mr A and Mr B: from the time that Mr A commenced to negotiate for the purchase of X Limited to the publication of the Y Limited prospectus the intention had been to retain the property owned by X Limited as a long term investment.

4.2 Evidence

Mr A was called to give evidence. The effect of those parts of his evidence which the Board considers relevant to the matters in issue may be summarised as follows:

4.2.1 Evidence-in-chief:

4.2.1.1 That he had been connected with the Taxpayer in 1980 and 1981 and continued connected with the Taxpayer at the date of the hearing of the appeal.

4.2.1.2 Counsel then formally produced the affirmation made on 24 October 1988 and after the witness had confirmed that it had been interpreted and explained to

him the affirmation was admitted as an exhibit and marked 'exhibit A-1', the occupation permit, exhibit CSK-1 thereto, was marked 'exhibit A-2', a copy of the joint development agreement, refer paragraph 2.2.2 above, exhibit CSK-2 thereto, was marked 'exhibit A-3' and the copy of the Y Limited prospectus, exhibit CSK-3 thereto, was marked 'exhibit A-4'.

4.2.1.3 Paragraph 8 of the affirmation was incorrect. The Taxpayer was not wholly owned by Mr A although it was under his control. It was jointly owned by Mr B and himself. Subject thereto the content of his affirmation was confirmed.

4.2.1.4 He came to Hong Kong in 1962 when he started working for others trading in teakwood materials but, subsequently, he got into the construction industry and by the last quarter of 1980 owned several construction sites through companies he controlled.

4.2.1.5 The areas in the new building to be acquired by X Limited were attractive to him as they included the exclusive ownership of ground floor premises in the central district.

4.2.1.6 He negotiated the purchase of X Limited and he had to be the buyer as he was a person with whom the then shareholders of X Limited would deal. The owners of X Limited knew he was going to hold the X Limited shares as a long term investment and this was why they were willing to sell to him. At the same time, the other parties to the redevelopment would not have any objection. He identified the X Limited agreement and his signature on page 8.

4.2.1.7 The Taxpayer was formed with the intention that it might go public. He had previously received advice from financial advisers that if a company like the Taxpayer was formed to go public it would be better: the advice he had received was that a new company would be easier with respect to audited accounts.

4.2.1.8 The sale of the X Limited shares was not a sale: it was an internal transfer so that Y Limited would become bigger and stronger. The shares were transferred from the Taxpayer to Y Limited because the Taxpayer could not go public just with a sole asset. The company to go public would have injected into it assets of ten plus building sites.

4.2.1.9 The accounting records of Y Limited and the Taxpayer show cash as paid by Y Limited for the X Limited shares. What actually happened took place on the advice of the financial advisers. Back to back cheques were issued to be negotiated through the banks so that they could be posted in the relevant accounts but the purchase price was actually satisfied by means of shares. At the conclusion of these cheque transactions the Taxpayer held Y Limited shares, not cash. The Y Limited shares were then pledged with the finance

company, to secure the debenture, and he did not receive any cash, as profit, from the transaction.

4.2.1.10 When considering going public he relied on other people's skills and advice.

4.2.1.11 The X Limited shares were not acquired for trading: the only purpose was to conveniently put assets together for going public.

4.2.2 Cross-examination:

4.2.2.1 The initial thrust of the cross-examination was directed to the identification of the time at which the witness had decided to float a public company. Mr A made an unsatisfactory impression on the Board during this phase of his cross-examination. To many straight forward questions he gave evasive or patently incorrect answers. For example:

4.2.2.1.1 When asked when he first decided to float a public company his answer was at the beginning of May in 1981.

4.2.2.1.2 When asked if he had had no thoughts about going public prior to May 1981 his answer was that before May he had been contemplating a plan to float a public company by getting assets together in a company.

4.2.2.1.3 When asked whether he had that plan prior to incorporating the Taxpayer his answer was that it was difficult for him to say what he had in mind at the time of incorporation of the Taxpayer. He said he had received the advice of merchant bankers and their advice was implemented.

The Board notes that the Y Limited agreement was signed on 1 May 1981 and, accordingly, his answer to the question in paragraph 4.2.2.1.1 cannot be true. Further, his answers to the questions in paragraph 4.2.2.1.2 and 4.2.2.1.3 contradict his evidence-in-chief, refer paragraph 4.2.1.7 above.

4.2.2.2 Under further questioning the witness sought to avoid giving direct answers. For example:

4.2.2.2.1 When asked whether when the Taxpayer was incorporated it was his intention to incorporate a company which would become a public company his reply was that the Taxpayer was not big enough.

4.2.2.2.2 When asked to confirm that by November 1980 he had the firm intention to float a public company his answer was:

> ' Not quite so. My intention was to get all my assets into one company.'

When asked to clarify this answer his reply was that when his assets had been grouped together they could be classified into trading and investment assets and he could then secure loans and retain premises in Central for rental. When pressed whether this was with a view to floating a public company his answer was in the affirmative as, as he explained, the public company would be able to collect rentals to repay interest to financial institutions.

4.2.2.2.3 Under further questioning, particularly whether the purpose of the Taxpayer was to acquire one or more assets for sale to a public company, the witness replied in the negative and stated that it was formed to be submitted to the Commissioner of Securities and for its assets to be transferred to another company which would become a bigger and better company and go public. He added that both of these companies were under his control.

4.2.2.2.4 Eventually the witness was forced to acknowledge that his intention to assemble sufficient properties in one vehicle to justify a floatation had been conceived in the autumn of 1980.

4.2.2.2.5 Mr A sought to distinguish the transaction in which the Taxpayer sold the shares of X Limited to Y Limited by describing it as a transfer as opposed to a sale.

4.2.2.2.6 Mr A confirmed that what he described as a transfer took place at the then market price.

4.2.2.2.7 Mr A agreed that at the time the Taxpayer issued the debenture to the finance company the best lending rate quoted by The Hongkong and Shanghai Banking Corporation was 17%, whereby the interest payable to the finance company under the debenture was 20%. He also agreed that the development would not be completed for some two years whereby, at that interest rate, the interest during the redevelopment would total $4,800,000. When questioned about interest on the loans of $7,000,000 from the directors Mr A replied that these were interest free.

4.2.2.2.8 Mr A confirmed that the Taxpayer had no ability to pay interest on the loans during the redevelopment period.

4.2.2.2.9 Mr A was questioned as to projected annual rentals from the property owned by X Limited he said $4,000,000 and that the $2,750,000 projected in the Y Limited prospectus was conservative. He anticipated letting the ground floor to a bank at an annual rental of $3,000,000.

4.2.3 Re-examination

Under the relevant part of his re-examination, Mr A agreed that he had first met with financial advisers to discuss going public in 1980.

4.3 Evidence from the Revenue

4.3.1 The Revenue submitted the documents described in paragraph 3.3 above which were admitted as exhibits and marked and therein stated.

4.3.2 The Board's attention was drawn to:

4.3.2.1 the page in exhibit R-3, numbered 7 in the bundle, entitled 'statement showing movement of share investments' which discloses a profit of $4,926.50 in respect of disposal of shares;

4.3.2.2 paragraph 1(c) in exhibit R-5, at page 18 of the bundle, showing what was paid for the X Limited shares and what was received when they were sold;

4.3.2.3 appendix F to the determination, being the profit and loss account of the Taxpayer in 1981 which showed loan interest of $1,996,984.

4.4 The concluding submission of Counsel for the Taxpayer

4.4.1 Counsel stated that the case for the Taxpayer was capable of being summarised in one question:

> ' Does the Board believe Mr A when he says that the shares in X Limited were purchased and obtained to facilitate putting the property in the portfolio of the company to go public?'

4.4.2 Counsel then referred to the decision of Godfrey J in Wing On Cheong Investment Co Ltd v Commissioner of Inland Revenue, IR Appeal No 1 of 1987. Having read the learned Judge's statement at page 2 of the report as to what profits made from sales of traffic were and were not taxable, Counsel stated that this paragraph contemplated three positions:

4.4.2.1 The asset acquired for investment and so retained.

4.4.2.2 The asset acquired for trading with the intention of making a profit.

4.4.2.3 The asset acquired for investment and subsequently traded to earn a profit.

4.4.3 Counsel submitted that the Taxpayer fell within the first of these situations. Although the appeal was concerned with the sale of the Taxpayer's shareholding in X Limited to Y Limited, the shares were linked so closely with the X Limited investment that the Board should not look at the transfer as a

transfer of shares in isolation. The Board should look at what the shares represented, namely an interest in a development project. The development of the property was subject to the joint development agreement which did not permit free transfer of the X Limited interest in the joint development. In other words the X Limited interest in the joint development was not marketable. As the property was not freely marketable it followed that the shares were not freely marketable in the sense that any buyer would be looking to the property, X Limited's sole asset, as opposed to X Limited. On the evidence the redevelopment was the only asset of X Limited. Further at the time Y Limited issued its prospectus it was expressly stated that the intention of Y Limited was that the property owned by its subsidiary X Limited was to be retained for rental income.

With all due respect to Counsel, the Board was not impressed with this submission. Owning an interest in a development being jointly undertaken by several owners through a company is one way to overcome the difficulty which the individual might encounter if he wished to dispose of his interest during the period of redevelopment. The reality was that the shares in X Limited were no less marketable after their acquisition by the Taxpayer than they had been prior thereto. Further, the provisions of clause 15 of the joint development agreement constitute a positive commitment on the part of each party thereto to cooperate with the others to obtain the necessary consent to enable sales to be made.

4.4.4 Counsel stated that Mr A's evidence was that:

4.4.4.1 he purchased X Limited because the properties the subject matter of the joint development agreement were in a prime location in Central, and that he intended to hold the parts of the new building which would belong to X Limited for rental income;

4.4.4.2 the passing of the shares in X Limited by the Taxpayer to Y Limited was a manoeuvre advised by the merchant bankers so that the Commissioner of Securities would be satisfied with the proposal for Y Limited to go public;

4.4.4.3 he treated X Limited as his own company whereby its property was his property and that the various transactions did no more than move the property from the left to the right pocket. He had no intention to trade in the X Limited shares or its interest in the property.

4.4.5 Counsel then referred to the speech of the Lord Wilberforce in Simmons v IRC [1980] 1 WLR 1196 at pages 1198 and 1199, particularly:

> ' Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset.

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

He suggested that the Board would have no difficulty in accepting Mr A's evidence that his intention to retain the parts of the new building which X Limited would obtain pursuant to the joint development agreement never changed: the purchase was for the rental income and the purchase of the X Limited shares by the Taxpayer was to facilitate a subsequent floatation. Mr A's evidence was that the rental income for the property would be used to pay off other loans and on that basis the primary intention continued all along: it was an investment. The actual sale of X Limited by the Taxpayer to Y Limited was nothing more than a step in the ultimate objective which was to have a company with sufficient assets to justify it going public.

4.4.6 Counsel referred to the timetable as follows:

4.4.6.1 The joint development agreement was dated 8 September 1979;

4.4.6.2 The X Limited agreement was dated 23 October 1980 and provided that completion would be on or before 23 January 1981;

4.4.6.3 The Taxpayer, was incorporated in November 1980, and was nominated by Mr A as the purchaser of the X Limited shares.

Counsel submitted that this timetable was consistent with Mr A's evidence: he wanted to go public but he did not know the vehicle. There was no evidence before the Board that the acquisition was for trading purposes.

4.4.7 Counsel concluded by saying that paragraph 3(1) of the determination, which he quoted to the Board in full, was an over-simplification of the position. The Commissioner misunderstood what was said in the Taxpayer's representative's letter of 18 June 1985 which is quoted in paragraph 1(11)(3) of the determination. He submitted that the Commissioner had taken an incorrect approach and should have recognised that in all the circumstances it was never the intention to trade in the shares or the property of X Limited.

4.5 The submission of the Revenue

Counsel for the Revenue made the following submissions:

4.5.1 The issue is whether or not the Taxpayer was trading in shares. The Board was not concerned with the land but with the shares of X Limited. The underlying asset of X Limited should be ignored.

4.5.2 The Board was concerned with the intention and action of the Taxpayer. This was to the exclusion of the intentions of Y Limited and the intentions of Mr A. What did the Taxpayer intend to do and what did the Taxpayer actually do?

4.5.3 Having read section 14 of the Ordinance Counsel pointed out that this section differs from the comparable provision in United Kingdom legislation in that it also referred to a 'business'.

4.5.4 Counsel then proceeded to refer to the following authorities:

4.5.4.1 Californian Copper Syndicate (Limited and Reduced) v Harris (Surveyor of Taxes) STC page 166 and the second sentence in the first paragraph which reads:

> ' 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 a 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.'

Counsel referred to Mr A's evidence to the effect that the Taxpayer was formed to get assets to be transferred to the company which went public.

Counsel submitted that the Taxpayer had no intention to hold the shares in X Limited: its intention was to sell these shares to the public company. It was to be noted that no income would accrue to X Limited from its underlying asset

for two years and, thereafter, it would be some time, say six months, before it could pay a dividend.

Counsel then referred to the second sentence in the fifth paragraph, which commences on page 166, in which it is said:

> ' Although that was a sale, the price to be paid in shares, I feel compelled to hold that this company was in its inception a company endeavouring to make profit by a trade or business, and that the profitable sale of its property was not truly a substitution of one form of investment for another.'

4.5.4.2 Rutledge v The Commissioners of Inland Revenue 14 TC 490.

Counsel submitted that when an isolated transaction was under consideration assistance was obtained from a passage at page 496 reading:

> ' But the question here is not whether the taxpayer's isolated speculation in toilet paper was a trade, but whether it was "an adventure ... in the nature of trade"; and in the opinion referred to I said that, in my opinion, "the profits of an isolated venture ... may be taxable under schedule D provided the venture is 'in the nature of trade'". I see no reason to alter that opinion.'

Counsel submitted that the relevant legislation applicable to the Rutledge case was the same as Hong Kong legislation: one distinguishes the sale of an object d'art which an individual has purchased and then sold. The shares of X Limited were purchased for resale at the market price which, hopefully, would result in a profit. It was irrelevant whether the Taxpayer intended to make a profit. If the intention was to resell, whether the question of profit had been considered or not, if a profit arose then that should be considered in the light of the next following authority.

4.5.4.3 In the Matter of the Duty on the Estate of the Incorporated Council of Law Reporting for England and Wales 22 QBD 279.

Counsel quoted part of the paragraph reported on page 293 reading:

> ' I may ask, as I asked during the course of the argument, what is it that the incorporated Council of Law Reports do if they do not carry on a business? They do something; they carry on something; they are very actively engaged in something. I confess I should have thought it capable of strong argument that they carried on a trade, because it is not essential for the carrying on of a trade but the persons engaged in it should make, or desire to make, a profit by it. Though it may be true that in the great

majority of cases the carrying on of a trade does, in fact, included the idea of profit, yet the definition of the mere word "trade" does not necessarily means something by which a profit is made. But putting aside the question whether they carry on a trade, how can it be denied that the Council carry on a business?'

4.5.4.4 JP Harrison (Watford) Limited v Griffiths (HM Inspector of Taxes) 40 TC 281.

Counsel submitted this case as analogous and quoted a passage from page 301, namely:

'It has not been, and could not be, suggested that the transaction of the company in the shares was a sham transaction. The company bought the shares, received a dividend and then sold the shares. These facts seem to me to point firmly to the conclusion that the transaction was entered into as part of a trade of dealing in shares or was an adventure in the nature of trade. The inherent nature of the transaction suggested a trading operation. It is said, however, that the inherent nature of the transaction becomes altered by virtue of the objective of the transaction. It is said that the company embarked upon a dividend-stripping operation, and that accordingly, the transaction should not be regarded as a trading transaction but a fiscal transaction.'

4.5.4.5 BR 18/76, IRBRD, vol 1, 245

Counsel submitted this case for the same reason and read paragraph 25 on page 251 of the report:

'It is abundantly clear that the taxpayers did not buy the property as an investment since it was bought for the purpose of resale to the company and the resale was effected twenty-four days after the purchase. If the resale, being for a consideration based on the market value of the shares on 14 December 1972, had been for the number of shares equivalent to the cost price to the taxpayers, there could be a substantial argument that they had merely changed the nature of their investment. But that was not the case.'

Counsel commented that this case involved a sale of an asset at market value the price being satisfied by shares. Counsel pointed out that this is exactly what happened in the instant case.

4.5.4.6 Eames (HM Inspector of Taxes) v Stepnell Properties Ltd 43 TC 678

To reinforce his submission Counsel also referred to:

4.5.4.6.1 the passage on page 701 commencing at letter G, namely:

> ‘ Therefore it seems to me that this land which was bought by the taxpayer company was land earmarked for sale, and earmarked for sale at a profit. It appears to me to matter not at all this company had been originally projected as an investment company, and that it has since acted as an investment company; it had no assets so to act at that time, its capital being £2. But of course, having received £50,000 from the County Council, it was in a position to have a portfolio of investments, which, I understand, it has since acquired. But that does not seem to me to matter. I think that this transaction, if no other, which the company entered into was undertaken with a view to resale, and resale at a profit. It is to my mind flying in face of the admitted facts to say that this could ever be regarded by the company as an investment (and that is the alternative) when you know that the piece of land that they were buying is subject to compulsory purchase powers by the County Council if and when they decided to acquire it, and when you know that the person from whom they are buying has agreed to sell. I cannot regard this transaction as an investment. We must regard it as one in which the company buys to make a profit by resale. I can see no other view open to the Commissioners.’

4.5.4.6.2 the passage from letter B on page 702:

> ‘ I think that Mr Heyworth Talbot correctly put the question which the learned Judge and this Court have to ask, namely, did the taxpayer company acquire this land on 10 July 1959 with the intention and expectation of selling it to the Warwickshire County Council at a profit pursuant to negotiations then in progress?’

4.5.4.6.3 the passage at letter D on page 704:

> ‘ Thus, on those facts and upon those to which my Lords and the learned Judge have referred, and bearing in mind what I have already said about the price at which the land would be acquired under section 4(1) of the Town and Country Planning Act 1959, it seems to me that the only conclusion on the facts as found is that the taxpayer company acquired the land with the intention and expectation of selling it to the County Council at a profit pursuant to the negotiations then in progress, and that this was an adventure in the nature of trade.’

Counsel reminded the Board that Mr A had confirmed it was the Taxpayer’s intention to sell the X Limited shares to Y Limited.

4.5.5. Counsel submitted that in the light of the above authorities the only decision that could be reached was that the transaction was an adventure in the nature of trade.

4.5.6 Counsel then stated that if the Board did not support that contention it would be necessary to examine the transaction as a whole to determine what the other possibilities were, in which event the following authorities were relevant:

4.5.6.1 Simmons (as liquidator of Lionel Simmons Properties Ltd) v Inland Revenue Commissioners [1980] STC 350.

Counsel referred to the passage beginning at letter H on page 352 which corresponds to the passage from letter C in the report cited and quoted in paragraph 4.4.6 above.

4.5.6.2 D32/85, IRBRD, vol 2, 204:

Counsel quoted part of the paragraph on page 213 reading as follows:

> ‘ Mr Luk also asked us to note the remarks of Rowlatt J at page 379 in Rees Roturbo etc v Ducker (13 TC 366) ... What is meant by the phrase “capital asset” is that this is an asset which represents fixed capital as opposed to circulating capital, that is to say, that this is an article which is possessed by the individual in question, not that he may turn it over and make a profit by the sale of it to his advantage, but that he may keep it and use it and make a profit by its use.’

Counsel submitted that Mr A’s evidence was clear: it was not intended that the Taxpayer retain the investment. The intention was that Y Limited would get it and keep it. However, it is the intention of the Taxpayer that is relevant.

4.5.6.3 Lily Harriet Ram Iswera v Commissioner of Inland Revenue [1965] 1 WLR 663

Counsel quoted from letter B on page 668:

> ‘ In their Lordships’ judgment that is going much too far. If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effect of all the circumstances.’

Counsel commented that the present situation was not equivocal: the submission that it was not intended to trade could not stand in the face of the facts and in face of what was planned.

4.5.7 Counsel then submitted that if the Board was in doubt after those points the Board must consider all the circumstances, namely:

4.5.7.1 The paid up share capital of the Taxpayer was $200.

4.5.7.2 The Taxpayer had no assets other than the shares in X Limited.

4.5.7.3 X Limited would not have any income from the redevelopment for two years.

4.5.7.4 The Taxpayer would not obtain any income from X Limited for a period in excess of two years.

4.5.7.5 The $12,000 borrowed from the finance company would attract interest throughout and at the rates applicable at the time the debenture was issued, 20%, this would be $2,400,000 per annum.

4.5.7.6 The Taxpayer borrowed some $7,000,000 from its directors which was said to be interest free. But for how long would they permit these loans to be interest free?

4.5.7.7 How was the finance company to be repaid? Mr A, in his evidence, stated that he expected the rental from the parts of the new building to belong to X Limited to earn some $4,000,000 per annum in rent: the Y Limited prospectus forecast the annual rental at $2,750,000, refer sub-paragraph (viii) at pages 11 and 12. Assuming a gross rental of $2,750,000 was achieved, after deduction of the interest payable to the finance company little, if any, money would be left to pay any interest on the debts from the directors or any meaningful amount for dividend distribution.

4.5.8 Counsel submitted that an acquisition with a 100% financing by debt is something which one would only anticipate if it was intended to hold the asset for a short time. Counsel then referred the Board to the following cases:

4.5.8.1 D8/88, IRBRD, vol 3, 161:

Counsel quoted from paragraph on page 164 of the report reading:

> ‘ We found the stated intention of the Taxpayer to be extraordinary. This was a small company with only $1,000 issued capital. No steps were ever taken to increase the authorized capital and therefore the possible issued capital. Yet it entered into purchases of land to the extent of well

> over $4,000,000. It relied partly on interest free loans from the shareholders but, because these shareholders did not have sufficient money at the time, assistance from a bank was necessary and large amounts of interest had to be paid. That interest was $390,255, $195,678 and $360,833 for the three years ending 31 March 1984. Meanwhile the land produced no income other than the compensation received and the shareholders were losing interest on their loans to the taxpayer. It is not apparent how these loans were to be paid off, for the company had no other business. It is remarkable that the minutes of the directors' meetings at which the purchases were authorized contained nothing about the way in which the purchases were to be funded.'

Counsel reiterated that X Limited would have no income for two years and the projected income was insufficient to defray all borrowings whereby it is reasonable to infer that it was never intended for the Taxpayer to retain the investment.

4.5.8.2 Marson (Inspector of Taxes) v Morton and related appeals [1986] STC 463.

Counsel referred to passages at pages 470 and 471 being:

4.5.8.2.1 the paragraph numbered (2) at the foot of page 470 reading:

> ' Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.'

Counsel pointed out that the purchase by the Taxpayer of the X Limited shares was the first transaction and the only other transaction it undertook was the sale of the Y Limited shares.

4.5.8.2.2 the paragraph numbered (5) on page 471:

> ' What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.'

4.5.8.2.3 the paragraph numbered (8) on page 471 reading:

> ' What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is

already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of deal. However, as far as I can see, this is in no sense decisive by itself.'

4.5.9 Counsel concluded by stating that on Mr A's evidence, it was his intention to sell. It was an adventure in the nature of trade. The circumstances indicated an intention to repay the debt as soon as possible by a resale. Counsel submitted that it was irrelevant whether there was a proper motive. The evidence of Mr A was that it was his intention that the Taxpayer would sell the X Limited shares to Y Limited. However, the intention of Mr A and the intention of Y Limited were irrelevant. The transaction was a trading adventure.

4.6 Reply on behalf of the Taxpayer

4.6.1 Counsel for the Taxpayer submitted that to find the intentions of a company one must look at the individuals and, from the evidence, Mr A was the individual who made the decisions so far as the Taxpayer was concerned.

4.6.2 Counsel then proceeded to comment on the authorities cited by Counsel for the Revenue.

4.6.2.1 The Marson case:

The Taxpayer had no history. The transaction was a one-off transaction to get the property owned by X Limited to a company which was going public and that this was on the advice of merchant bankers. The project was financed by debt, but which project is not so financed? Obtaining finance is irrelevant. How was the interest on the Taxpayer's borrowing to be paid? Counsel referred to exhibit R-5 which, in schedule one, showed that borrowings were repaid.

4.6.2.2 D8/88:

Counsel commented that in that case no development was in mind, see the final paragraph on page 164 of the report. However, in the instant case plans existed and an income forecast could be made.

4.6.2.3 The Lily Harriet Ram Iswera case:

Counsel requested the Board to look at the facts: what was the Taxpayer forced to do? The Taxpayer was forced to buy a larger area of land to acquire the land she wanted. That case was decided on the particular facts and should not be regarded as relevant to the determination of the appeal.

4.6.2.4 D32/85:

Again it was necessary to look at the facts to ascertain the motives. Was the asset to be retained and a profit made from its use? This authority is no more than authority for the proposition that it is necessary to look at the overall intentions and not intentions in isolation.

4.6.2.5 The Eames case:

Counsel referred to the paragraph on page 701 at letter D reading:

> ' This sort of property is not of any use to a building company, nor can it be considered as a form of investment of any sort, for as it was, and without purchase by the County Council, it was a mere piece of agricultural land yielding about 2% on its price, not an investment which any family company formed for investment purposes would consider.'

Counsel pointed out the facts differ and the intentions of the Taxpayer in that case differ.

4.6.2.6 BR 18/76:

Counsel advised the Board that when considering paragraph 25 of this report the Board should remember that Mr A's evidence had been: that if he were buying for trading purposes he would normally expect to achieve the resale within sixty days. Counsel suggested that in Hong Kong when property is purchased with a view to resale, normally a buyer is already in mind.

4.6.2.7 The Harrison case:

Counsel submitted that this case was authority for the proposition that a body constituted to discharge duties such as the Board was required to examine each case on its own. The last paragraph on page 301 of the report explained what the Board had to consider. The passage in question reads:

> ' My Lords, it seems to me that a trading transaction does not cease to be such merely because it is entered into in the confident hope that, under an existing state of the law, some fiscal advantage will result. In Judging as to the essential nature of a transaction it will often be relevant and of assistance to consider the objects and intentions which are the inspiration of the transaction.'

4.6.2.8 The Rutledge case:

Counsel referred the Board to page 497 of the report and the passage in the first paragraph on that page reading:

> ' It is no doubt true that the question whether a particular advantage is "in the nature of trade" or not must depend on its character and circumstances but if – as in the present case – the purchase is made for no purpose except that of resale at a profit, there seems little difficulty in arriving at the conclusion that the deal was "in the nature of trade", though it may be wholly insufficient to constitute by itself a trade. It is not difficult, on the other hand, to imagine circumstances in which the question might become very narrow.'

Counsel submitted that the Rutledge made the same point as the Harrison case.

4.6.2.9 The Californian Copper case:

Counsel submitted that this case did not establish anything different from the Harrison case.

4.6.3 Counsel concluded by stating that the transfer from the Taxpayer to Y Limited was part of a strategy and that, as such the Taxpayer had never had any intention to undertake any trading.

5. REASONS FOR THE DECISION

5.1 For the Taxpayer to succeed in this appeal it is for the Taxpayer to satisfy the Board that when it acquired the X Limited shares they were acquired for long term investment and that when, within less than one hundred days, it was decided to dispose of them the purpose was to acquire another investment thought to be more satisfactory and without regard to whether the investment is sold at a profit or loss, refer Simmons v IRC [1980] 1 WLR 1196 at 1199 and the passage quoted in paragraph 4.4.5 above.

5.2 The Board is also satisfied that in the absence of any incontrovertible contemporary documentary evidence, for example a resolution of the board of directors passed at the time the acquisition was approved or at a meeting when the decision to sell was taken, the oral evidence adduced in support of an appeal as to the contemporary intentions has to be weighed for plausibility by reference to the established facts and the demeanor of, in this particular case, the only witness called to prove those intentions.

5.3 The established facts:

5.3.1 Acquisition of the X Limited shares.

5.3.1.1 The Taxpayer acquired the entirety of the issued share capital of X Limited pursuant to the X Limited agreement. The decision to do so was taken at the board meeting held on 12 January 1981, refer paragraphs 2.1.1 and 2.4.1 above.

5.3.1.2 The minutes of this board meeting are silent as to how the purchase was to be funded or whether the shares purchased were to be held for investment or for sale, refer paragraph 2.4.1 above.

5.3.1.3 The purchase price was entirely borrowed the details being in paragraphs 2.4.2 above. The interest rate is detailed in paragraph 4.2.2.2.7 above.

5.3.1.4 The Taxpayer had received $200 in respect of the two shares issued, refer the Taxpayer's balance sheet at 30 June 1981 at appendix F to the Commissioner's determination.

5.3.1.5 The purchase price for the shares of X Limited was $18,671,230. However, in addition the Taxpayer had to pay stamp duty of $56,024, legal fees of $48,600 and commission and brokerage of $180,000, refer the Taxpayer's tax computation at appendix F to the Commissioner's determination.

5.3.1.6 The Taxpayer needed to borrow 100% of the cost of the X Limited shares, including stamp duties, legal fees and commission and brokerage, and before any yield accrued from X Limited's interest in the joint development substantial interest payments would have to be funded, refer paragraphs 4.2.2.2.7, 4.2.2.2.8 and 4.2.2.2.9 above.

5.3.2 Disposal of the X Limited shares.

5.3.2.1 Between Mr A negotiating the price for the X Limited shares in October 1980 and the sale of the X Limited shares pursuant to the Y Limited agreement on 1 May 1981 the value of the investment had increased to $34,671,153, refer paragraph 2.5 above.

5.3.2.2 On completion by Y Limited of the acquisition of the X Limited shares Y Limited paid the Taxpayer $34,671,153 and the Taxpayer subscribed for shares in Y Limited, refer paragraph 4.2.1.10 above. Mr A was not questioned as to how much of the $34,671,153 the Taxpayer used to subscribe for shares in Y Limited although his evidence-in-chief implied that the price to be paid by Y Limited for the X Limited shares was actually satisfied by an issue of shares, refer paragraph 4.2.1.9 above. This evidence was less than frank and the true position is documented.

5.3.2.2.1 The Taxpayer's audited accounts for the year ended 30 June 1982 show a holding of quoted shares at a cost of $58,000. Annexed to its tax computation for the year of assessment 1982/83 is a statement showing 'movement of share

investments'. This discloses that as at 1 July 1981 the Taxpayer owned no shares but purchased 6,826,000 shares at a cost of $1 per share of which all but 58,000 were sold during the year at a profit of $4,926.50 over cost, refer paragraph 2.7.2 above.

5.3.2.2.2 The X Limited shares, which were purchased for some $19,000,000 in October were sold for $34,671,153 six months later and the X Limited asset was professionally valued at $37,700,000 as at 30 June 1981, an almost 100% increase in just over eight months. After retirement of all debt, fees and expenses the Taxpayer had made a profit of $13,610,074, refer appendix F to the determination of the Commissioner. However, only $6,826,000 was used to subscribe for Y Limited shares.

5.3.3 Dividend.

The Taxpayer's audited accounts disclose that during the Taxpayer's year ended 30 June 1982 a dividend of $8,000,000 was paid, the issued share capital still being two shares of $100, refer paragraph 3.3.3 above.

5.3.4 The Y Limited prospectus.

The material parts of the Y Limited prospectus are referred to in paragraph 2.6 above.

5.4 The oral evidence.

5.4.1 The Board found Mr A an unsatisfactory witness in that under cross-examination many of his answers were evasive to the point at which they conflicted with his evidence-in-chief whereby the Board has been obliged to look to the documents for corroboration of the material parts of his evidence. The Board is only prepared to accept as true those parts of his evidence which are so corroborated.

5.4.2 Relevant parts of Mr A's evidence accepted by the Board in amplification of the documents:

5.4.2.1 Between his arrival in Hong Kong in 1962 and the autumn of 1980 he had been successful in his businesses and owned in conjunction with his co-venturers several companies which, in turn, owned several sites which were in varying stages of development, refer paragraph 4.2.1.4 above and the Y Limited prospectus.

5.4.2.2 In the autumn of 1980, refer paragraphs 4.2.1.7, 4.2.2.2.2 and 4.2.2.2.4 above, Mr A started taking professional advice with respect to floating a company which, eventually, was Y Limited.

5.4.3 Evidence rejected.

Mr A originally said that the Taxpayer was formed with the intention it might go public, refer paragraph 4.2.1.7 above. He also said the transfer of the X Limited shares to Y Limited was because the Taxpayer could not go public with a sole asset, refer paragraph 4.2.1.8 above. The Board rejects this as a credible explanation as to why the Taxpayer could not have been the purchaser of all the other shares eventually acquired by Limited. By 1 May 1981, the acquisition date under the Limited agreement, the value of the X Limited shares exceeded the historical cost by some $15,000,000 and by 17 August 1981, the date of publication of the Y Limited prospectus, by some $18,000,000. The real explanation was more likely to be that Mr A's financial advisers were opposed to the public company having encumbered assets. Factually, however, a sale by the Taxpayer to another company, Y Limited, because of market conditions would achieve two things. Y Limited would acquire the asset unencumbered and the Taxpayer would be in a position to discharge all debt incurred in the acquisition of the X Limited shares and show a substantial profit.

5.5 Conclusions to be drawn from the established facts and the accepted oral evidence.

5.5.1 In the autumn of 1980 Mr A was in active discussions with professional advisers with a view to floating a public company whose assets would be the companies owned directly or indirectly by Mr A, Mr B and their business associates.

5.5.2 Mr A considered the interest of X Limited in the joint development a suitable addition to the assets of the proposed public company. X Limited's contribution to the cost of the new building was limited to $450,000, of which $250,000 was paid on signing of the joint development agreement, refer paragraph 2.2.3 above, and any upward movement in property values would enhance the value of the investment.

5.5.3 A vehicle was needed for this acquisition as completion of the acquisition of the X Limited shares could not be deferred beyond the completion date specified in the X Limited agreement to await finalisation of the floatation plans and the Taxpayer was formed or acquired to complete this purchase.

5.5.4 In the months following the acquisition by the Taxpayer of the X Limited shares the value of that investment was increasing along with the general interest in property values occurring at this time. Mr A was an experienced property developer and, no doubt, soon appreciated that the increase in value presented an opportunity which, perhaps, he had not anticipated at the time he entered into the X Limited agreement. By the time the prospectus of a public company

could be issued X Limited's interest in the building under development had appreciated beyond the point at which it could be sold at a price which would enable all debts to be retired and a substantial profit earned. By selling the X Limited shares free from encumbrances their value to the public company would be substantial and, at the same time, the Taxpayer, and hence Mr A and Mr B, could make a substantial profit.

5.6 Was the acquisition of the X Limited shares for investment or for trading?

5.6.1 As already stated, Mr A was not a reliable witness and as the Board has been obliged to reject his evidence, save in so far as it is corroborated by the documents, the Board has been obliged to endeavour to consider this appeal on what the documents disclose. The documents and the events which the documents established do not establish the case submitted on behalf of the Taxpayer.

5.6.2 The conclusions to be drawn from the acceptable evidence has to be that, initially, the X Limited shares were acquired by the Taxpayer as part of the package with which it would go public. At or about the time at which the documentation needed for the offering of shares to the public was nearing finalisation, the shares had increased to a value which dictated they be sold but, as matters eventuated, not, adopting the words of Lord Wilberforce in Simmons 'to acquire another investment thought to be more satisfactory'. If that had been the case there was considerably more profit in the transaction for the Taxpayer than the $6,826,000 actually applied from the proceeds of sale of the X Limited shares to subscribe for shares in Y Limited. Further, within the year in which those shares were subscribed all but 58,000 were sold and the proceeds of that sale were not applied in purchasing another 'alternative and more suitable investment': a dividend of $8,000,000 was paid.

5.6.3 Even assuming that the Taxpayer was, initially the proposed public company and even assuming that on the date of acquisition of the X Limited shares by the Taxpayer on 12 January 1981, a decision had been taken to retain the X Limited shares for the rental income from its part of the joint development, all subsequent events point to the Board of the Taxpayer having altered that decision.

5.7 The Board, having reminded itself that the onus of proof is on the Taxpayer, finds that the Taxpayer has failed to discharge that burden.

6. DECISION

For the reasons given the Board dismisses this appeal.