

Case No. D39/07

Profits tax – whether or not the taxpayer’s intention was to hold the shares on a long term basis – whether or not the taxpayer’s stated intention was genuinely held, realistic and realisable – whether or not the premium paid and accounted to the taxpayer in one year on the issue of the warrants could be assessed in another year of tax assessment – sections 60, 64 and 82A of the Inland Revenue Ordinance – whether or not failure to determine an objection ‘within a reasonable time’ would have deprived her of jurisdiction or rendered her determination void

Panel: Kenneth Kwok Hing Wai SC (chairman), Lo Pui Yin and Kumar Ramanathan.

Dates of hearing: 1, 2, 3 and 6 June 2005.

Date of decision: 11 January 2008.

The taxpayer was the controlling shareholder and the managing director of a listed company. In year20, the company announced a 1-for-1 rights issue of ordinary shares. The taxpayer subscribed shares for himself, his immediate family and companies controlled by them. In Year21 a company wholly owned by the taxpayer issued warrants and each warrant entitled the warrant holder to the right to purchase one existing issued ordinary share of the company within the exercise period of two years. The premiums for the issue of the warrants were paid and accounted to the taxpayer in Year21.

The Commissioner increased the Year23/Year24 assessment and assessed the taxpayer’s gain from the issue of the warrants in Year21 and the sales of the company’s shares upon the exercise of the warrants in Year23. The taxpayer objected to the profits tax assessment raised on him.

The taxpayer contends that (1) his intention at the time of the Year20 Rights Issue was to hold the shares on a long term basis; (2) the premium paid and accounted to the taxpayer in Year21 on the issue of the warrants should not be assessed in the Year23/Year24 of assessment; (3) the Commissioner was out of time and had no power to revise the Year23/Year24 profits tax assessment to assess the gain from the sales of the company upon the exercise of the warrants in Year23.

Held:

1. The onus is on the taxpayer to prove, on a balance of probabilities, that the

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Assessment is excessive or incorrect. On the capital or trading issue, the question is one of fact – what was the taxpayer’s intention at the time of the Year20 Rights issue.

2. The Board tests the taxpayer’s intention against the objective facts. The Board also tests the taxpayer’s intention by considering whether it was on the evidence, genuinely held, realistic and realizable. The Board finds as a fact that the stated intention was genuinely held, realistic and realisable. The taxpayer intended to hold his Year20 Rights Issue shares on a long term basis.
3. The issue of the warrants was a transaction by itself. The warrant holders paid the taxpayer a premium to acquire an option to subscribe for the company shares at the exercise price within the exercise period. The warrants issue was complete upon issue of the warrants to the warrant holders and upon paying the premium (net of expenses) to the taxpayer. The premium was due, payable and paid in Year21. The taxpayer’s profits arose in or derived from Hong Kong in the Year21/Year22 year of assessment and should be charged in that year of assessment under section 14 and assessed in accordance with Part IV of the Ordinance. Whether on the earnings/accrual basis or the receipts basis, the profits in respect of the premium arose or was derived in the Year21/Year22 year of assessment.
4. Apart from additional tax assessments under section 82A, the Commissioner has no power to assess any taxpayer to tax, whether property, salary or profits. The Commissioner has no power to make additional assessments under section 60 and the limitation periods (of six and 10 years) under section 60 do not apply to her for the simple reason that she was not the assessing officer under section 60.
5. The Commissioner, in determining an objection under section 64, performs the ultimate function to confirm, reduce, increase or annul the assessment. Section 64 is not subject to section 60. They deal with different functions to be performed by different officers. The Commissioner is required by section 64(2) to determine an objection ‘within a reasonable time’. However failure to do so within a reasonable time would not have deprived her of jurisdiction or have rendered her determination void. The Commissioner has power under section 64(2) to increase an assessment and this is what the Commissioner did in respect of the Assessment (Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7 and Wang v Commissioner of Inland Revenue [1994] 1 WLR 1286 considered).

Appeal allowed.

Cases referred to:

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Ng Kam Chun (t/a Chun Mou Estate Agency Co) v Chan Wai Hing and others [1994] 2 HKLR 89
Commissioners of Inland Revenue v Reinhold (1953) 34 TC 389
West v Phillips (1958) 38 TC 203
Taylor v Good (1974) 49 TC 277
Commissioner of Inland Revenue v Dr Chang Liang-Jen (1977) 1 HKTC 975
Salt v Chamberlain (1979) 53 TC 143
Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196
Cooper v C & J Clark Ltd (1982) 54 TC 670
Marson v Morton [1986] 1 WLR 1343
Wing On Cheong Investment Co Ltd v Commissioner of Inland Revenue (1987) 3 HKTC 1
Dodge Knitting Co Ltd v Commissioner of Inland Revenue (1989) 2 HKTC 597
Waylee Investment Ltd v Commissioner of Inland Revenue (1990) 3 HKTC 410
All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750
BR11/76, (1977) IRBRD, vol 1, 239
D60/87, (1988) IRBRD, vol 3, 24
D116/95, (1996) IRBRD, vol 11, 254
D111/97, (1998) IRBRD, vol 13, 20
D103/99, (1999) IRBRD, vol 15, 214
D74/00, (2000) IRBRD, vol 15, 670
D13/03, (2003) IRBRD, vol 18, 365
Commissioner of Inland Revenue v National Mutual Centre (HK) Ltd [1988] 2 HKLRD 599
Brent v The Commissioner of Taxation of the Commonwealth of Australia (1971) 125 CLR 418
Mok Tsze Fung v Commissioner of Inland Revenue (1962) 1 HKTC 166
Commissioner of Inland Revenue v The Hong Kong Bottlers Ltd (1970) 1 HKTC 497
Whitney v Inland Revenue Commissioners [1926] AC 37
Woellner, Barkoczy, Murphy and Evans, Australian Taxation Law 2005, paras 15-100 - 15-110
Sections 14, 64 & 68 of the Inland Revenue Ordinance (Chapter 112)
Halsbury's Laws of Hong Kong, Vol 24, §370.154
Willoughby & Halkyard, Encyclopedia of Hong Kong Taxation, Vol 4, at §§5180-5220, 20435-20475
Rutledge v IRC (1929) 14 TC 490
Griffiths v JP Harrison (Watford) Ltd [1963] AC 1
Wannell v Rothwell (1996) 68 TC 719
Wing Tai Development Co Ltd v CIR (1979) 1 HKTC 1115
D56/93, IRBRD, vol 9, 1
D52/87, IRBRD, vol 2, 461
D73/97, IRBRD, vol 12, 439

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Iswera v CIR [1965] 1 WLR 663

Abbott v Philbin (HM Inspector of Taxes) 39 TC 82

Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7

Wang v Commissioner of Inland Revenue [1994] 1 WLR 1286 PC

Robert Kotewall SC leading Stewart Wong instructed by Messrs Woo Kwan Lee & Lo, Solicitors, for the taxpayer.

Ambrose Ho SC leading Jin Pao instructed by Department of Justice and Francis Kwan Senior Government Counsel for the Commissioner of Inland Revenue.

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INTRODUCTION

1. This is an appeal against the Determination of the Commissioner of Inland Revenue dated 14 June 2004 whereby:
 - (a) Profits Tax Assessment for the year of assessment Year23/Year24 dated 28 March Year30 was increased ('the Assessment').
 - (b) Profits Tax Assessment for the year of assessment Year24/Year 25 dated 27 March Year31 was annulled.
2. The appellant did not take issue with the annulment of the Year24/Year25 assessment.
3. At all material times, the appellant was the controlling shareholder and the managing director of a listed company, Listco.
4. In May Year20, Listco announced a 1-for-1 rights issue of ordinary shares at HK\$3.00 per share. As a pre-condition of the rights issue, the appellant was required to subscribe or procure subscribers for 903,204,000 ordinary shares. The appellant eventually subscribed 798,520,476 shares for himself, his immediate family and companies controlled by them.
5. In June Year21 a company wholly owned by the appellant issued a total of 400,000,000 covered warrants at an issue price of HK\$1.50 per warrant. The warrants issue was sub-participated up to 25% by a third party.
6. Each warrant entitled the warrant holder to the right to purchase one existing issued ordinary share in Listco at the exercise price of HK\$5.80 within the exercise period of two years. The premiums for the issue of the warrants were paid and accounted to the appellant in July Year21.
7. Upon expiry of the warrants in July Year23, 399,416,000 units of the warrants had been exercised and the remaining 584,000 units lapsed. With the exception of 70,000 units which were exercised on 25 March Year23, the exercise of the other units took place during the period from 7 April Year23 to 22 July Year23.
8. The Year23/Year24 assessment as increased by the Commissioner in June 2004 assessed the appellant's 75% share of the gain from:
 - (a) the issue of the warrants in July Year21; and

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- (b) the sales of the Listco shares upon the exercise of the warrants from 7 April Year23 to 22 July Year23;

to profits tax.

9. The Commissioner was of the view that when the appellant took up the shares under the Year20 Rights Issue, he had already had the intention of selling a portion of the shares. The appellant contends that his intention at the time of the Year20 Rights Issue was to hold the shares on a long term basis.

10. The appellant also contends that:

- (a) the premium paid and accounted to the appellant in July Year21 on the issue of the warrants should not be assessed in the Year23/Year23 year of assessment; and
- (b) the Commissioner was out of time and had no power to revise the Year23/Year24 profits tax assessment to assess the gain from the sales of the Listco shares upon the exercise of the warrants from 7 April Year23 to 22 July Year23.

THE AGREED FACTS

11. The following facts are agreed and we find them as facts.

12. The appellant has objected to the profits tax assessments raised on him for the years of assessment Year23/Year24 and Year24/Year25. The appellant claimed that the gains derived by him from the sale of shares in Listco by means of the issue of covered warrants in Year21, and the subsequent exercise by the warrant holders of the rights under the warrants, were capital in nature and not assessable to tax.

13. Listco is a public company incorporated in Hong Kong with its shares listed on The Stock Exchange of Hong Kong Limited ('HKSE'). The appellant was the managing director of Listco from Year1 to Year30, and has been its chairman since Year25.

14. In Year15, there was a 5-for-4 rights issue by Listco of participating preferred shares, with warrants to subscribe for new ordinary shares, to raise capital fund (the 'Year15 Rights Issue').

15. The appellant arranged from Bank1 a 5-year term loan, the Year15 Bank1 Loan, with repayment by 9 half yearly installments (the last installment repayment being in October Year20) to finance the subscription of shares in Listco under the Year15 Rights Issue.

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16. On 21 May Year20, Listco announced a major 1-for-1 rights issue of ordinary shares (the 'Year20 Rights Issue').

17. As a pre-condition of the Year20 Rights Issue and as part of the underwriting arrangements, the appellant, certain other directors of Listco and Co1, a large shareholder of Listco at the time, irrevocably undertook that they would subscribe or procure subscribers for 1,212,752,306 rights shares. Pursuant to that obligation, the appellant was required to subscribe or procure subscribers for 903,204,000 ordinary shares. The appellant eventually subscribed 798,520,476 shares for himself, his immediate family and companies controlled by them.

18. The announced net profits and dividend per share of Listco for the financial years Year14/Year15 to Year19/Year20 (the financial year of Listco commences from 1 July to 30 June of the following year) were listed in paragraph 7 of the Statement of Agreed Facts.

19. To finance in part the subscription of shares under the Year20 Rights Issue, the appellant arranged for a 5-year term personal loan from Bank1, the Year20 Bank1 Loan.

20. (a) The purposes of the Year20 Bank1 Loan were to finance the subscription of shares under the Year20 Rights Issue and to refinance a then existing term loan of HK\$200,000,000.

(b) The Year20 Bank1 Loan had a term of 5 years up to 31 May Year25 and was repayable by 9 half yearly installments. It was subject to Bank1's overriding right of withdrawal and repayment on demand and also subject to review at any time by Bank1 and in any event by 31 January Year21.

(c) The Year20 Bank1 Loan was fully repaid by the appellant as stated in paragraph 9(c) of the Statement of Agreed Facts.

(d) An up-front arrangement fee and interest were paid by the appellant in connection with the Year20 Bank1 Loan. A schedule showing the dates of payment of interest and the amount paid on each occasion is listed in paragraph 9(d) of the Statement of Agreed Facts.

21. NomineeCo is a private company incorporated in Hong Kong on 16 June Year21. It was wholly and beneficially owned and controlled by the appellant. As its accounts demonstrate, it acted in the covered warrants transaction hereinafter referred to as nominee and agent for the appellant. It accounted for all proceeds to him and made no profit or gain for itself. It had no other business or activities whatsoever.

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- 22.
- (a) On 25 June Year21 a placing agreement was entered into between NomineeCo, the appellant, Underwriter2 as the manager and certain other parties as the underwriters for the issue and placing of a total of 400,000,000 warrants ('the Warrants') at an issue price of HK\$1.50 per warrant.
 - (b) Subject to (d) below, each Warrant entitled the warrant holder to the right to purchase one existing issued ordinary share having a nominal value of HK\$0.50 in Listco at the exercise price of HK\$5.80 within the exercise period of two years from 22 July Year21 to 22 July Year23.
 - (c) The Warrants were secured by a first fixed charge over 400,000,000 shares in Listco (the 'Reserved Shares') then held by the appellant in favour of a custodian company for holders of the Warrants pursuant to the warrant security deed dated 17 July Year21 to secure NomineeCo's performance of its obligations under the Warrants.
 - (d) Each Warrant entitled the warrant holder, upon payment of the exercise price (HK\$5.80) to delivery of one share. Each share was the initial pro rata entitlement per Warrant to the Reserved Shares. NomineeCo could, at its option, elect not to transfer to any warrant holder of the Reserved Shares upon exercise of the Warrants but instead make a cash payment to him equivalent to the closing price of such shares on the business day preceding the relevant exercise date.
 - (e) The Warrants were issued on 17 July Year21. They were listed on the HKSE and dealings commenced on 22 July Year21.
 - (f) The Warrants issue was sub-participated by Co1Nominee, a wholly-owned subsidiary of Co1. An agreement dated 27 July Year21 was entered into by the appellant, NomineeCo, Co1Nominee and Co1 for Co1Nominee to sub-participate up to 25% of the issue, and in consideration of the undertakings given by Co1Nominee in the agreement, the appellant agreed to pay Co1Nominee a sum of HK\$144,250,000.
 - (g) The premiums for the issue of the Warrants (HK\$1.50 per Warrant less expenses) were paid on completion, 17 July Year21, to NomineeCo which accounted for the same to the appellant on the same date. This was in accordance with the placing document of 17 July Year21 which at page 13 under the heading 'Use of Proceeds' stated as follows:

'The proceeds of the Issue, net of the underwriting and placing commission payable under the Placing Agreement and other expenses, amounted to

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approximately HK\$577 million and have been paid by the Issuer to [the appellant] for the reduction of his personal indebtedness incurred in connection with his subscription of the rights issue of [Listco] in June Year20 and for use in connection with any arrangements which may be entered into in respect of the exercise by [the appellant] of his option under paragraph 4(F)(i) of the Terms and Conditions of the Warrants.'

- (h) The total amount of expenses incurred in connection with the issue of the Warrants was HK\$23,454,849 as reported in NomineeCo's accounts for the period from 1 July Year22 to 30 June Year26.
- (i) The amount received by the appellant was HK\$432,295,151 (HK\$600,000,000 (premium) less HK\$23,454,849 (expenses) less HK\$144,250,000 (amount paid to Co1Nominee)).
- (j) Upon expiry of the Warrants on 22 July Year23, 399,416,000 units of the Warrants had been exercised and the remaining 584,000 units lapsed. With the exception of 70,000 units which were exercised on 25 March Year23, the exercise of the other units took place during the period from 7 April Year23 to 22 July Year23.
- (k) All warrant holders were satisfied by a transfer of shares upon exercise of their Warrants. NomineeCo did not elect for cash options.
- (l) With Co1Nominee's sub-participation, the appellant disposed 299,562,000 Listco shares [(400,000,000 - 584,000 (lapsed)) x 75%] through the Warrants issue. The total proceeds from the sale of the Reserved Shares upon exercise of the rights under the Warrants were HK\$2,316,612,800 (HK\$5.80 x 399,416,000). The appellant's 75% share was HK\$1,737,459,600.

23. On 28 March Year30, the assessor raised on the appellant the following Profits Tax Assessment for the year of assessment Year23/Year24:

Premium in respect of the Warrants [$\$1.50 \times 400,000,000$]	\$600,000,000
<u>Less: Warrant issue expenses</u>	<u>\$22,944,847</u>
Estimated assessable profits	<u>\$577,055,153</u>
Tax payable thereon	<u>\$86,558,272</u>

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24. On behalf of the appellant, the Tax Representatives objected against the Year23/Year24 assessment.

25. On 27 March Year31, the assessor raised on the appellant the following Profits Tax Assessment for the year of assessment Year 24/Year25:

Proceeds from warrants exercised [387,146,000 x \$5.80]	\$2,245,446,800
<u>Less: Cost of related shares as at 1 July Year20 [387,146,000 x \$3.25]</u>	<u>\$1,258,224,500</u>
Estimated assessable profits	<u>\$987,222,300</u>
Tax payable thereon	<u>\$148,083,345</u>

26. On behalf of the appellant, the Tax Representatives objected against the Year24/Year25 assessment.

27. In addition to the Profits Tax Assessments raised on the appellant as set out in paragraphs 23 and 25 above, the assessor has also raised on NomineeCo on divers dates the following alternative Profits Tax Assessments in connection with the issue of the Warrants:

(a) Year of assessment Year23/Year24

Premium in respect of warrants exercised up to 30 June Year23 [$1.50 \times 12,270,000$]	\$18,405,000
<u>Less: Warrant issue expenses</u> [$22,944,847 \times 12,270,000 / 400,000,000$]	<u>\$703,833</u>
Estimated assessable profits	<u>\$17,701,167</u>
Tax payable thereon	<u>\$2,920,692</u>

(b) Year of assessment Year24/Year25

Premium in respect of warrants exercised and expired during the year ended 30 June Year24 [$1.50 \times (387,146,000 + 584,000)$]	\$581,595,000
<u>Less: Warrant issue expenses</u> [$22,944,847 - 703,833$]	<u>\$22,241,014</u>
Estimated assessable profits	<u>\$559,353,986</u>
Tax payable thereon	<u>\$92,293,407</u>

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On behalf of NomineeCo, the Tax Representatives objected against the above alternative assessments.

28. The assessor considered that the Year24/Year25 assessment raised on the appellant should be annulled and the Year23/Year24 assessment should be revised as follows:

Proceeds from Warrants exercised from		
1 April to 22 July Year23:		
Premium [\$1.50 x 299,509,500]		\$449,264,250
Sale proceeds [\$5.80 x 299,509,500]	\$1,737,155,100	
<u>Less: Cost of shares [\$3 x 299,509,500]</u>	<u>\$898,528,500</u>	\$838,626,600
Premium for Warrants lapsed on 22 July Year23		
[\$1.50 x 584,000 x 3/4]		<u>\$657,000</u>
		\$1,288,547,850
<u>Less:</u>		
Issue expenses	\$23,454,849	
Loan arrangement fee		
[\$47,948,000 x 2,375,755,000/2,575,755,000]	\$44,224,975	
Loan interest		
[\$433,316,793 x 2,375,755,000/2,575,755,000]	<u>\$399,670,985</u>	<u>\$467,350,809</u>
Assessable profits		<u>\$821,197,041</u>
Tax payable thereon		<u>\$123,179,556</u>

29. By a Determination dated 14 June 2004, the Commissioner of Inland Revenue increased the Year23/Year24 assessment by revising it in the manner as stated in paragraph 28 above, and annulled the Year24/Year25 assessment.

30. By a letter dated 13 July 2004, the appellant, through his solicitors, appealed against the Determination dated 14 June 2004.

REASONS FOR THE DETERMINATION

31. The Commissioner gave the following reasons for her Determination:

- (1) The sole issue for my determination in the present case is whether the gain derived by [the appellant] from the sale of shares in Listco by means of the issue of the Warrants should be assessable to Profits Tax. It is the claim of [the appellant] that all along he has been holding the shares in Listco on a long term basis and hence any gain arising from the sale of the shares should be capital in nature not assessable [to] tax.
- (2) Whilst I do not take issue with [the appellant] that the bulk of the shares in Listco he owned was his long term assets, I endorse the Assessor's view that

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when [the appellant] took up the rights issue shares in July Year20 he has already had the intention of selling a portion of the shares.

- (3) In ascertaining [the appellant' s] intention at the time when he took up the rights issue shares in Listco, it is necessary to look into all the relevant facts and circumstances surrounding the rights issue. In this connection, it is [the appellant' s] case that [from Year19 onwards] there was expansion of business of the [Listco] Group which required substantial amount of capital funds. It was under such circumstances that the rights issue exercise was made by Listco in Year20 [*see Facts (12)(d) & (e)*]. In order to ensure the successful issue of the shares and also to enable him to maintain his control over the Group through the shareholding, it is only natural for [the appellant], as the major shareholder and director of Listco, to undertake to subscribe a certain number of the shares. The question is whether [the appellant] had really intended to hold the rights issue shares on a long term basis.
- (4) It is well established that intention connotes the ability to carry it out into effect. On the facts before me in the present case, I am not satisfied that [the appellant] has the financial ability to hold the newly acquired shares in Listco (acquired by means of the rights issue) on a long term basis. As a matter of fact, in order to take up the rights issue shares, [the appellant] has to resort to [the Year20Bank1 Loan] from Bank1. Although the Loan had a term of five years, it was subject to the bank' s overriding right of withdrawal and repayment on demand and was subject to review at any time by Bank1 [*see Fact (14)(c)*]. There is no evidence showing that [the appellant] was able to repay the Loan without resorting to sale of a portion of the rights issue shares in Listco.
- (5) I note that [the appellant] has, through the Representatives, alleged in March Year32 that he had intended to substantially finance the repayment of the Loan by way of dividend income he expected to receive from the shares in Listco owned by him [*see Fact (15)(b)*]. However, this allegation is clearly inconsistent with the Representatives' earlier statements that the repayment of the Loan was matched by the receipt of the premium and the exercise price in relation to the Warrants and that the purpose for the sale of the Listco shares through the issue of the Warrants was to discharge the financial burden arising from the commitment to take up the rights issue shares [*see Fact (12)(m)*].
- (6) I am not unmindful of [the appellant' s] claim that the shares sold by him through the issue of the Warrants were the 'old' shares accumulated before Year20 and were not the rights issue shares acquired by him in July Year20 [*see Facts (12)(k) & (15)(c)*]. However, as admitted by [the appellant] himself, the shares in Listco were all held by him in the name of nominees and hence could

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not be distinguished by reference to their respective share certificates. In other words, there is simply no evidence in support of [the appellant' s] claim that the shares sold by him were the "old" shares but not the "new" ones. I am therefore unable to accept the claim of [the appellant] in this regard.

- (7) Apart from arguing that the gain in question should not be subject to tax at all, I note that it is also [the appellant' s] contention that the gain should in any event not be assessed in the year of assessment Year23/Year24. It was argued that since the premium from the issue of the Warrants was payable and paid in July Year21, the respective gain should therefore be assessed in the year of assessment Year21/Year22 instead [*see Facts (8)(b), (10)(d) & (19)*]. I cannot agree to this argument.
- (8) It is common ground that the Warrants were issued as a means to sell the Listco shares held by [the appellant]. The issue of the Warrants should therefore be regarded as part and parcel of the adventure of selling the Listco shares. In my view, any gain arising from the sale of the Listco shares through the issue of the Warrants should be brought into charge at the time when the sale of the shares was completed. In the circumstances, I hold that the gain derived by [the appellant] from the exercise by the warrant holders of 299,509,000 units of the Warrants during the period from 7 April to 22 July Year23, including the premium and the exercise price, and the premium for the 438,000 units [584,000 x 3/4] of the Warrants which expired on 22 July Year23 were properly assessed to Profits Tax for the year of assessment Year23/Year24.
- (9) For the above reasons, the objection lodged by [the appellant] fails. The Year23/Year24 assessment is increased as per Fact (21) and the Year24/Year25 assessment is annulled.'

THE APPEAL HEARING

Grounds of appeal

32. The appellant' s grounds of appeal are:

- '1. [The appellant' s] disposition of shares in [Listco] constituted a sale of capital assets not assessable to profits tax. [The appellant] is the founder of Listo and all his holdings of shares in that company have been held as investments. He could only be liable to profits tax if he was a dealer in shares and had carried on, at the least, an adventure or concern in the nature of trade in respect of the acquisition and disposal of the relevant Listco shares. [The appellant] was not

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and is not a dealer in shares and his actions in relation to the relevant Listco shares bear none of the hallmarks of trading or an adventure or concern in the nature of trade.

2. In the Commissioner's Reasons for Determination there are fundamental errors of law and fact. In particular in Reason 3(3) she asks herself the wrong question: the relevant question is whether or not [the appellant] has conducted an adventure or concern in the nature of trade. What she says in paragraphs 3(4) and (5) is simply without justification as a matter of fact. What she says in paragraph 3(6) simply disregards the well known principle of law that where one cannot find a definitive attribution of a sale to a purchase one applies the principle of "first in first out". Applying that principle (which is clearly applicable here and incontrovertible as a principle) the only conclusion - even on the Commissioner's own approach (see paragraphs 3(1) and (2) of her Reasons) is that the shares disposed of were held as investments.
3. On 26 June Year32 the representatives of [the appellant] (the Tax Representatives) were invited to comment on a revised draft of the Statement of Facts. This they did on 7 October Year32 by letter from our firm to the Commissioner together with an amended revised draft statement (see attached). Despite that, key and incontrovertible facts establishing that there can be no liability have not been adopted in the statement issued by the Inland Revenue Department.
4. In our letter of 7 October Year32 to the Commissioner we drew attention to the point previously made in the notice of objection that the Year23/Year24 notice of assessment was seeking to assess income (if there was income) of an earlier year (Year21/Year22) - in which the premiums, on issue of the warrants were received - and was, therefore, invalid. In paragraph (19) of the "Facts upon which the Determination was arrived at" the Commissioner refers to this and in consequence of this, at paragraph (20), states that:

"The Assessor now takes the following [different] view in connection with the issue and exercise of the Warrants"

and in paragraph (21), in consequence, that:

"the Year23/Year24 assessment should be revised" [in the manner set out in that paragraph].

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This “action” constitutes an unlawful attempt to circumvent the statutory prohibition on raising assessments under Section 60 more than 6 years after the relevant year of assessment (as indeed did the original assessment itself).

In particular:

- (a) the Assessor has no power under the Ordinance to revise his or her assessment in this way;
- (b) the ‘revision’ is an attempt to assess something else than that which was the subject matter of the original assessment and that is effectively attempting to make another assessment (out of time);
- (c) on any view the premium proceeds, if they were receipts of a trade or income were assessable for Year21/Year22 (and not Year23/Year24); their receipt was not contingent and everything had been done that was required to be done to earn them in Year21/Year22;
- (d) in the circumstances the Commissioner had no power to increase any such “revised assessment” and for all the reasons given in this notice of appeal should have quashed the actual assessment made.

For the above reasons the content of paragraphs 3(7) and (8) of the Commissioner’s Reasons cannot be supported.

- 5. In any event, there is no basis for the computation of taxable profit on which the assessment was raised (or “revised”).’

Oral evidence

33. At the hearing of the appeal, the appellant was represented by Mr Robert Kotewall, SC and the respondent by Mr Ambrose Ho, SC.

34. Mr Kotewall called three witnesses, namely, the appellant, Witness3 and CPA.

35. Mr Ho did not adduce any oral evidence.

The Tax Representatives’s letter dated the 26 November Year30

36. In the course of objecting to the Year23/Year24 profits tax assessment (see paragraph 23 above), the Tax Representatives wrote a letter to the Inland Revenue Department (‘IRD’) dated 7 June Year30 stating that:

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‘Pursuant to the Underwriting Arrangements, [the appellant] was required to subscribe for 323 million ordinary shares at a issue price of HK\$3 each and a sum of HK\$ 969 million was required to satisfy the rights issue (“the Commitment”).

To discharge the financial burden arising from the Commitment, [the appellant] had to realize a portion of his personal capital investment in shares in Listco which he had accumulated since Listco was formed in Year1.

...

The Warrant exercise was requisite to facilitate disposal of his capital investment so as to discharge the financial burden from the Commitment arising from Listco’s group expansion and capital funding requirements. The Premium at issue was a capital receipt.’

37. By letter dated 27 July Year30, IRD asked the Tax Representatives for the following information:

‘As [the appellant’ s] commitment was discharged in June Year20 before the receipt of the premium from the issue of warrants in July Year21, explain in details how the acquisition of the rights shares was financed together with documentary evidence in support.’

38. The Tax Representatives replied by letter dated 26 November Year30 stating that:

‘4. *The Commitment to subscribe 903,304,000 shares at HK\$3 on right issue in Year20*

Our client has confirmed that pursuant to the Underwriting Arrangements, he was required to subscribe or procure subscribers for 903,204,000 ordinary shares (as he beneficially held 699,576,000 shares and had non-beneficial interest in another 203,628,000 shares) at an issue price of HK\$3 each (the “Commitment”). Please refer to page 27 of the enclosed underwriting agreement (Appendix 1) for the shareholders’ subscription undertaking.

5. *The discharge of the Commitment*

As explained in (4) above, [the appellant’ s] (*sic*) was under an obligation to subscribe or procure subscribers for 903,204,000 Listco’s right shares pursuant to the Underwriting Arrangements. In view of the required cash outlay of HK\$2,709,612,000 (903,204,000 x HK\$3) for the Commitment,

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our client decided to realize a portion of his personal capital investment in Listco, which had been held by him for many years.

The time gap between the collection of the sales proceeds from the disposal of the shares and effecting the right subscription payment was temporarily accommodated by a bank loan (i.e., equivalent to a bridging loan), which was subsequently repaid by the net proceeds from issue of the Warrants and the price received from the warrant holders on the exercise of the Warrants.

As explained above and in our earlier letter, the Warrants were issued to facilitate the disposal of the relevant shares which were held as a capital investment. The reason for disposing of the investment and hence the issue of the Warrant was explicit in the Placement Document (enclosed as Appendix 4 to our letter dated 7 June Year30) under the section ‘Use of Proceeds’ on page 13 as follows:

“The proceeds of the Issue [i.e. the Premium], net of the underwriting and placing commission payable under the Placing Agreement and other expenses, amounted to approximately HK\$577 million ... have been paid by the Issuer [i.e. NomineeCo Limited] to [the appellant] for the reduction of his personal indebtedness incurred in connection with his subscription of the rights issue of [Listco] in June Year20 ...”

The “personal indebtedness” referred to in the Placement Document was [the Year20 Bank1 Loan] obtained by [the appellant] in June Year20 from [Bank1]. Please refer to Appendix 2.

To discharge the financial burden (i.e., his personal indebtedness) arising from the Commitment, [the appellant] was required to realize a portion of his personal capital investment in Listco, which he had accumulated since Listco was formed in Year1. We submit that the shares being disposed of via the issue of the Warrants were the shares accumulated prior to the right issue, not the shares subscribed by [the appellant] in the right issue.

The issuance and placement of the Warrants became unconditional and were completed on 17 July Year21. The Premium on the issue of the Warrants (before deduction of commission and other expenses) amounted to HK\$600 million.

During the two-year exercise period, 399,416,000 warrants were exercised which resulted in [the appellant] receiving HK\$2,316,612,800 (399,416,000 x HK\$5.8). With the Premium and the proceeds from the realization of his

long-term investment in Listco, the loan from [Bank1] was gradually repaid by [the appellant] during the period from 28 May Year21 to November Year23. Please refer to Appendix 3.

II REPLY TO YOUR SPECIFIC QUESTIONS

Based on the background details regarding the issue of the Warrants, the answers to your specific questions should become apparent and we reply to your specific questions on behalf of our client as follows:-

...

- (2) As explained in (I)(5) above, the time gap between the collection of the proceeds from realization of [the appellant' s] long term investment in Listco and the aforementioned rights subscription payment under the Commitment was temporarily accommodated by a bank loan (i.e., equivalent to a bridging loan), which was subsequently repaid by the net proceeds from the issue of the Warrants and the price received from the warrant holders upon the exercise of the Warrants.

...

III CONCLUSION

...

3. There was a genuine need for [the appellant] to dispose of a portion of his long-term investment. The Warrants were issued as a means to facilitate the disposal of [the appellant' s] capital asset and to release the financial burden of [the appellant] from the Commitment arising from Listco' s group expansion and capital funding requirements. The Warrants issue is thus a transaction of a capital nature. We trust you accede that a capital investment would not change into a trading stock on the grounds that it was sold. We submit that the Premium arising from the issue of the Warrants (a capital transaction) is a capital receipt and therefore not assessable under Section 14 and / or Section 60 of the IRO.'

Preparation of witness statements

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39. The evidence in chief of the witnesses called by the appellant was commendably brief. Their evidence in chief did not go beyond the adoption of their respective witness statements as their evidence.

40. This is how witness statements should be prepared. The witness statements should contain the whole of the witnesses' evidence in the detail in which the witnesses would have given it if his/her evidence had been elicited by oral questions at the trial, see Ng Kam Chun (t/a Chun Mou Estate Agency Co) v Chan Wai Hing and others [1994] 2 HKLR 89. Unfortunately, this tends to be the exception rather than the rule for appeals to the Board. This case was a pleasant exception.

The appellant's evidence

41. In his witness statement, the appellant stated that he and his father were the founders of the Listco group and that he was the managing director of Listco from Year1 to Year30.

42. He acquired and maintained his portfolio of shares in Listco as his personal long term investment from its listing in Year1 to Year22 as listed in paragraph 7 of his witness statement.

43. From Year9 onwards, the Listco group embarked on projects which were very attractive because of their potential huge returns and required very substantial equity financing on a long term basis.

44. In Year15, he subscribed for his entitlement under the Year15 Rights Issue and an additional shares. His subscription was financed by the Year15Ban1 Loan. He intended to fund the repayment of the Year15Bank1 Loan principally through dividends from his Listco shareholding.

45. By mid-Year20, Listco had become a conglomerate and was on the verge of another phase of very substantial growth. Estimated funding of HK\$5.5 billion to HK\$6 billion was required. He consulted Witness3, described as 'a very good friend', who was deeply involved in the Year15 Rights Issue and who was in Year20 the managing director of the Underwriter2 group on the methods to raise equity funds. The appellant rejected all those which had a dilution effect on his percentage shareholding. Based on the success of the Year15 Rights Issue, Witness3 and the appellant decided on a 1-for-1 rights issue.

46. At the time of the planning of the Year20 Rights Issue, the appellant's intention was to hold the newly subscribed shares on a long term basis because:

- (a) as its founder and the person in the driving seat, he wished to show his support and commitment to Listco;

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- (b) Listco had been a good investment and he was totally convinced and confident in its future and prospects;
- (c) he was convinced that Listco shares were substantially undervalued;
- (d) Listco was in very strong financial health; and
- (e) with the Year20 Bank1 Loan, he had the financial ability to finance and hold the shares to be acquired as a long term investment.

47. The Year20 Bank1 Loan included a refinancing of a then existing HK\$200,000,000 term loan granted in about April Year20 to finance in part his exercise of the Year15 warrants under the Year15 Rights Issue.

48. He relied on the estimated dividend income from the Listco shares to be supplemented by extra cash from the sale of his interest in a family property called the Property 1. If there were any shortfall:

- (a) it was 'very workable' for him to re-schedule or refinance the Year20 Bank1 Loan, Bank1 having been the banker for two generations and a strong supporter of the appellant;
- (b) he had other assets, investments and income, including Listco shares not pledged; and
- (c) he could rely on financial assistance and support from his siblings.

49. He projected the amount of dividend over the 5-year period.

50. From January Year21 onwards, the price and daily turnover of Listco shares rose. The suggestions made by various investment bankers including Witness3 that the appellant sold some of his Listco shares by way of placement were turned down by the appellant because his Listco shareholding was his major long term investment.

51. In mid-Year21, Witness3 advised that it would be prudent for him to mitigate his financial exposure under the Year20 Rights Issue and the Year20 Bank1 Loan and initiated him into the idea of covered warrants. The appellant was eventually persuaded.

52. The issue of the Warrants was the only warrant exercise by the appellant since Listco was listed in Year1.

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53. The appellant gave a detailed explanation of the letter dated the 26 November Year30 letter by the Tax Representatives to IRD. He said that he was surprised by the Year23/Year24 profits tax assessment issued to him on 28 March Year30, about 10 years after the Year20 Rights Issue and the issue of the Warrants. He emphasised that his intention in mid-Year20 was entirely different from his intention in mid-Year21. He explained that his attention was focused (wrongly) on his intention in mid-Year21 because:

- (a) IRD taxed the gain from the [Year21] Warrants; and
- (b) the enquiry was on the [Year21] Warrants.

54. When the possible confusion was discovered, the matter was clarified in a subsequent letter dated 13 March Year32.

55. The appellant was cross-examined at some length by Mr Ho.

56. Under cross-examination, the appellant said that he sold the Property2 and Property3 to make early repayment of the Year15 Bank1 Loan.

57. He said that there were probably a lot of mistakes made by his Tax Representatives in their answers to IRD because a lot of the documents which were in storage had not yet been dug out.

58. In response to questions in the morning of the first day of hearing on the HK\$200 million loan, he produced two facilities letters from Bank1 in the afternoon. The first was a letter dated 30 April Year20 offering him a term loan of HK\$200 million to 'partially finance the conversion of warrants into ordinary shares' in Listco, HK\$100 million of which was repayable on 30 November Year20 and the remaining HK\$100 million on 31 May Year21. The second letter was dated 10 May Year20 varying the terms of the 30 April Year20 letter by adding an overdraft facility of HK\$15 million and by stipulating the securities required.

59. By letter dated 21 May Year20, Bank1 offered a term loan. The Year20 Bank1 Loan was a consolidation of this offer with the HK\$200 million term loan (with the repayment terms rescheduled).

60. He also produced a chart called '5 year Repaymenyt (*sic*)' which included interest payments.

61. On the second day of hearing, after he had been re-examined and answered questions asked by the Board to clarify certain matters, he produced a 'cashflow reconstruction' chart.

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62. Mr Kotewall suggested that they would do further work on the chart, and if it would be of assistance to the Board, they would annex a table to their closing submission.

63. Mr Ho asked the appellant to look for facilities letters of the other banks.

Wintness3's evidence

64. In his witness statement, Wintness3 stated that he had been an investment banker for over 24 years, being experienced in corporate finance matters.

65. In Year15, whilst he was with Underwriter3, he was involved in the Year15 Rights Issue.

66. In Year20, whilst he was with the Underwriter2 group, he was the principal financial adviser of Listco in the Year20 Rights Issue and was primarily responsible for its structuring. It was underwritten by Underwiter1 and Underwriter2 as lead underwriters. One key issue for the underwriters was how the appellant would finance his subscription and what he intended to do with his shares. As part of the due diligence exercise, the investment banker had a duty to ensure that the appellant had sufficient financial resources to make his subscription as undertaken. The reasons were that:

- (a) if the appellant could not subscribe as undertaken, the deal would collapse;
- (b) If the rights issue were undersubscribed, the underwriters had to take up the shortfall in which case the presence of an orderly and stable market would be important to the underwriters so that they could minimise their possible financial loss. If the appellant chose or was forced to sell a substantial chunk of his Listco shares in the market shortly after the rights issue, the market would be very nervous and de-stabilised, thereby significantly increasing the underwriters' risk. The trading volume of Listco shares at around the time was low and he did not believe the market had enough liquidity to absorb disposals by both the underwriters and the appellant at the same time.

67. Based on the projections shown to him by the appellant, he was satisfied with the financing by Bank1. His team took comfort in the fact that Bank1, a very prudent and proper bank, accepted the appellant's ability to repay. He added that there might be some shortfall, but considered that it was manageable because the appellant had other financial resources which included proceeds from disposal of his interest in a family property and because the loan could be refinanced. He knew that the appellant had had a long term relationship with Bank1 who had all along been a strong supporter of the appellant, including the financing of the Year15 Rights Issue.

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68. In the course of his due diligence discussions with the appellant, the appellant was very bullish about Listco and did not have any plan or intention to sell any of his shareholding in Listco. At or before the time of the Year20 Rights Issue, neither the idea to issue covered warrants nor any plans to do so had been raised in his discussions with the appellant.

69. Subsequent to the Year20 Rights Issue, he approached the appellant in the early part of Year21 to see if he would sell some of his Listco shares by way of placement. The appellant refused.

70. As the strong demand for Listco shares continued, he approached the appellant in mid-Year21 to introduce the idea of covered warrants to him. The appellant initially refused. After he had explained to the appellant that it would be prudent for him to take advantage of the favourable market conditions to do something to improve his personal financial position and that there was no down-side risk or loss for him, the appellant was finally persuaded to do a covered warrant issue. He remembered the appellant telling him that the appellant was not concerned with the risk of warrant holders not exercising the option because the appellant had not planned to sell any of his shares and was content with the upfront premium.

71. Under cross-examination, he said that in his assessment made at the time of the Year20 Rights Issue, the appellant could easily refinance the remaining balance of the loan in the event that he was unable to service the loan, both principal and interest, out of dividends.

72. In mid-Year21, the only reason why he approached the appellant was that he wanted to do a deal.

73. There was no re-examination.

CPA's evidence

74. In her witness statement, she stated that she joined the Tax Representatives in Year19 as a tax manager and had been a tax partner since Year25. In April Year30, the appellant instructed Tax Representatives to object against the profits tax assessment for Year23/Year24. She was intimately involved in this matter as part of the Tax Representatives team handling the matter.

75. Although the Tax Representatives had been the auditors and Tax Representatives of Listco and its group companies since Year26, the Tax Representatives had not hitherto handled the personal financial and tax affairs of the appellant and was not familiar with the background of the Warrants issue in Year21.

76. She and her colleagues attended a meeting with the appellant on 4 May Year30 during which the appellant said that his intention was always to hold and had always held his Listco

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shares for long term investment. The Tax Representatives asked the appellant about his state of mind in mid-Year21, and the appellant explained that the Warrants were issued to facilitate the disposal of part of his capital investment and the proceeds were used to repay the Year20 Bank1 Loan.

77. At the conclusion of the meeting, the appellant instructed the Tax Representatives to contact his staff for further information. As the appellant did not carry on any business by himself, he did not keep his personal records and papers systematically. When the Tax Representatives wrote to IRD in Year20, the Tax Representatives did not have full information or documentation, e.g. they did not have a copy of the facility letter for the Year20 Bank1 Loan. She explained that in preparing the Tax Representatives' letter of 26 November Year30, the Tax Representatives was focusing attention on IRD's question quoted in paragraph 37 above. Information which the Tax Representatives asked for came in dribs and drabs.

78. By early Year32, the Tax Representatives had much clearer information about the events leading up to the appellant's subscription under the Year20 Rights Issue and made appropriate clarifications in the letter dated 13 March Year32.

79. Under cross-examination, she agreed that she had been an assessor with IRD for more than 10 years before joining the Tax Representatives.

80. She said that the appellant explained at the meeting that he had sold capital investment and used the proceeds to repay a loan and the Tax Representatives noted that the statement in the placement documents that he applied the proceeds to reduce his indebtedness. The Tax Representatives put them together and stated in the letter to IRD that he 'had' to sell.

81. The Tax Representatives would look at the question and, based on its background understanding and information provided by its client, replied to the question to the best of its knowledge. She said:

'We try our best to find an explanation and then our manager will forward it to the client to review our reply.'

82. She also told us that the client looked and tried very hard but had difficulty in retrieving information or documents which existed in Year20.

83. There was no re-examination.

Production of further documents and tables

84. On the third day of hearing and before the closing submission of Mr Kotewall, the appellant produced (without any objection by Mr Ho):

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- (a) copy documents to show other banking facilities (including a term loan of HK\$200,000,000 from Bank2) available to the appellant as at 30 June Year20;
- (b) a note on funding of subscription and cash flow;
- (c) a table on total indebtedness as at 30 June Year20; and
- (d) a table called 'Cashflow Reconstruction 3'.

85. The appellant submitted that the documents showed:

- (a) the total indebtedness as at 30 June Year20;
- (b) that he would be able to service the repayment of principal and interest from his projected dividend income and other sources of funding except for:
 - (i) a short period in December Year20 and January Year21 (which could be covered by the proceeds of sale on 27 May Year21 of his interest in Property1); and
 - (ii) May Year24 to May Year25 (when there should be no difficulty in rescheduling).

Appellant's list of authorities

86. The appellant furnished us with a bundle of the following authorities:

1. Commissioners of Inland Revenue v Reinhold (1953) 34 TC 389
2. West v Phillips (1958) 38 TC 203
3. Taylor v Good (1974) 49 TC 277
4. Commissioner of Inland Revenue v Dr Chang Liang-Jen (1977) 1 HKTC 975
5. Salt v Chamberlain (1979) 53 TC 143
6. Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196
7. Cooper v C & J Clark Ltd (1982) 54 TC 670
8. Marson v Morton [1986] 1 WLR 1343
9. Wing On Cheong Investment Co Ltd v Commissioner of Inland Revenue (1987) 3 HKTC 1
10. Dodge Knitting Co Ltd v Commissioner of Inland Revenue (1989) 2 HKTC 597

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11. Waylee Investment Ltd v Commissioner of Inland Revenue (1990) 3 HKTC 410
12. All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750
13. BR11/76, (1977) IRBRD, vol 1, 239
14. D60/87, (1988) IRBRD, vol 3, 24
15. D116/95, (1996) IRBRD, vol 11, 254
16. D111/97, (1998) IRBRD, vol 13, 20
17. D103/99, (1999) IRBRD, vol 15, 214
18. D74/00, (2000) IRBRD, vol 15, 670
19. D13/03, (2003) IRBRD, vol 18, 365
20. Commissioner of Inland Revenue v National Mutual Centre (HK) Ltd [1988] 2 HKLRD 599
21. Brent v The Commissioner of Taxation of the Commonwealth of Australia (1971) 125 CLR 418
22. Mok Tsze Fung v Commissioner of Inland Revenue (1962) 1 HKTC 166
23. Commissioner of Inland Revenue v The Hong Kong Bottlers Ltd (1970) 1 HKTC 497
24. Whitney v Inland Revenue Commissioners [1926] AC 37
25. Woellner, Barkoczy, Murphy and Evans, Australian Taxation Law 2005, paras 15-100 - 15-110

87. Mr Kotewall told us that he was not taking the ‘first in first out’ point.

Respondent’s list of authorities

88. The respondent furnished us with a bundle of the following authorities:

1. Sections 14, 64 & 68 of the Inland Revenue Ordinance (Chapter 112).
2. Halsbury’s Laws of Hong Kong, Vol 24, §370.154.
3. Willoughby & Halkyard, Encyclopedia of Hong Kong Taxation, Vol 4, at §§5180-5220, 20435-20475.
4. Rutledge v IRC (1929) 14 TC 490.
5. Griffiths v JP Harrison (Watford) Ltd [1963] AC 1.
6. Wannell v Rothwell (1996) 68 TC 719.
7. Wing Tai Development Co Ltd v CIR (1979) 1 HKTC 1115.
8. D56/93, IRBRD, vol 9, 1.
9. D52/87, IRBRD, vol 2, 461.
10. D73/97, IRBRD, vol 12, 439.
11. Iswera v CIR [1965] 1 WLR 663
12. Abbott v Philbin (HM Inspector of Taxes) 39 TC 82
13. Departmental Interpretation and Practice Notes No. 38 (Revised)

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14. Taxation of New Financial Instruments by Organisation for Economic Co-operation and Development

BOARD'S DECISION

Capital or trading – governing authorities/principles

89. Section 68(4) of the Inland Revenue Ordinance, Chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.

90. Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

91. Mr Ho told us that he did not intend to go further than the obvious propositions stated in the following authorities:

- (a) what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471;
- (b) what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495); and
- (c) what Mortimer J (as he then was) said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at pages 770 and 771.

Capital or trading – analysis

92. The appellant's stated intention was to hold the Year20 Rights Issue shares on a long term basis.

93. The Commissioner took the view that 'intention connotes the ability to carry it into effect'.

94. Mr Ho submitted that:

- (a) the burden of proof is on the appellant;

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- (b) the appellant did not have the financial means to service the Year20 Bank1 Loan for the entirety of its term and could not have intended to hold the shares as a long term investment;
- (c) the evidence in support of his alleged financial ability to repay is evolving and is far from satisfactory and is much less than sufficient to discharge the burden of proof under section 68(4).

95. The onus is on the appellant to prove, on a balance of probabilities, that the Assessment is excessive or incorrect. On the capital or trading issue, the question is one of fact – what was the appellant’s intention at the time of the Year20 Rights Issue.

96. We accept that the evidence in support is evolving. That is a matter to be born in mind. However, the real issue is whether the documents produced in the course of the objection and the appeal are authentic and whether the evidence is credible. Mr Ho did not challenge the authenticity of any of the documents relied on by the appellant.

97. We test the appellant’s intention against the objective facts. We also test the appellant’s intention by considering whether it was on the evidence, genuinely held, realistic and realisable.

98. The appellant was one of the founders of Listco and had been the person in the driving seat since Year1. He had been its controlling shareholder since its listing in Year1. From Year1 to the time of the Year20 Rights Issue he had always been acquiring more Listco shares and had never sold a single Listco share. He had no difficulty in borrowing and had borrowed the Year15 Bank1 Loan and HK\$200 million from Bank1 and had sold other properties to build up his portfolio of Listco shares. He had a controlling shareholding throughout. These facts all point to investment holding.

99. The appellant knew the Listco group better than anybody else; was convinced that Listco shares had been substantially undervalued and was very bullish about Listco’s prospects.

100. The appellant, Witness3 and CPA were subject to an able and probing cross-examination by Mr Ho. In our decision, none of them was shaken. We accept their evidence.

101. We find as a fact that the stated intention was genuinely held.

102. The appellant’s case is that he had the financial ability to hold the Year20 Rights Issue shares on a long term basis.

103. The appellant said he had worked out a chart at the time showing his ability to service the Year20 Bank1 Loan from projected dividend income.

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104. We are mindful that he has not produced the original or a copy of the chart. Nevertheless, we are satisfied on a balance of probabilities that he must have carried out some projection and calculation exercises and satisfied himself, Bank1 and the underwriters that he had the financial ability to subscribe and service the Year20 Bank1 Loan.

105. In view of his attachment to Listco, the inherent probabilities are that he must have satisfied himself on the question of his own financial ability. A forced sale of his holding of Listco shares would have been the last thing he would want to see.

106. In view of the size of the Year20 Bank1 Loan, a prudent bank such as Bank1, must, in our view, have required the appellant to satisfy it on the question of ability to repay. The fact that Bank1 granted the Year20 Bank1 Loan suggests that Bank1 must have been so satisfied.

107. Mr Ho described Witness3 and CAP as ‘independent witnesses’. On the evidence of Witness3, the underwriters had a duty to ensure that the appellant had sufficient financial resources to make his subscription as undertaken and to hold on to them in order to minimise their possible risk in the event of the rights issue being undersubscribed. Witness3 said he was satisfied. The fact that the underwriters underwrote the Year20 Rights Issue suggests that they must have been so satisfied.

108. The appellant also said that he had in mind the proceeds from the intended sale of his interests in Property1. This is consistent with his previous sale of the Property2 and Property3 to effect early repayment of the Year15 Bank1 Loan. On balance, we accept that it was his intention at the time of the Year20 Rights Issue to rely on the proceeds from the intended sale of his interests in Property1 to fund his acquisition and holding of the Year20 Rights Issue shares.

109. The appellant also said that he was confident that Bank1 would be accommodating and would agree to refinance in the event of any (unexpected) shortfall. The facts are that Bank1 granted the Year15 Bank1 Loan; the HK\$200 million term loan in late April and early May Year20; and the Year20 Bank1 Loan. The HK\$200 million term loan to fund the conversion of the warrants under the Year15 Rights Issue into shares was repayable as to HK\$100 million within about six months and the remaining HK\$100 million within about 12 months. The HK\$200 million term loan was rescheduled under the Year20 Bank1 Loan to be repayable by nine half yearly installments over a term of five years. We find as a fact that the appellant believed that Bank1 would agree to refinance in the event of any (unexpected) shortfall and that his belief was genuine held and reasonable.

110. The appellant had also obtained a HK\$200 million loan by Bank2 on about 21 June Year20, repayable within two years.

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111. Mr Ho placed heavy reliance on the letters dated 7 June Year30 and 26 November Year30 ('the Year30 letters') from the Tax Representatives to IRD.

112. We have carefully considered Mr Ho's submission and the explanations offered by the appellant and CPA. We accept the appellant's and CPA's explanations. The appellant and the Tax Representatives were, wrongly in our view, focusing their attention on his state of mind in mid-Year21, instead of his state of mind in mid-Year20. Many of the relevant documents which came into existence in Year20 were in storage and the appellant probably did not spend as much time as he should have, or did, by the time of the conclusion of the hearing of his appeal to look for the relevant documents and information. The Tax Representatives did not even have the facility letter for the Year20 Bank1 Loan. If it had, it would not have described Year20 Bank1 Loan as a 'bridging' loan. The reference to '323 million ordinary shares' was clearly factually wrong. In our view, the explanation for the inaccuracies and inconsistencies in the Year30 letters lies in the Tax Representatives' attempt 'to try [its] best to find an explanation' in the absence of a full picture and complete documentation. The Tax Representatives noted the statement in the Year21 placement documents that the appellant applied the proceeds to reduce his indebtedness and the appellant's instructions that he had sold capital investment and used the proceeds to repay a loan. Doing its best to find an explanation, the Tax Representatives put two and two together and stated that the appellant 'was required to realize a portion of his personal capital investment in Listco, which he had accumulated since Listco was formed in Year1'. The Tax Representatives invoked the 'first in first out' rule. In our view, that approach was wrong, but that is quite beside the point. The Tax Representatives tried to put forward and build a case by invoking the 'first in first out' rule. The Tax Representatives took a bad point and built on it.

113. Quite apart from what we find to be the explanation, the assertion in Year30 that the appellant 'had to' sell shares in July Year21 overlooked the fact that on about 27 May Year21, the appellant had already disposed of his interest in Property1 and had received more than HK\$451 million.

114. Moreover, if he 'had' to sell in July Year21 in order to discharge a 'bridging' loan, he would and should, in our decision, have proceeded by way of placement instead of warrants. The warrant holders had up to two years to exercise the warrants and the appellant would have to wait up to two years from the issue of warrants to receive \$5.80 per share exercise price. Taking the warrants route also ran the risk that the value of Listco shares might fall below the exercise price. If this should happen, the appellant would receive nothing further from the warrant holders and the appellant would face the greatest difficulty in funding what he 'had' to do, to pay off the 'bridging' loan. Given Witness3's expertise and experience in corporate finance matters, he would and should have advised the appellant against taking the warrants route if the appellant 'had' to sell to repay a 'bridging' loan.

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115. There is another reason why the assertion is incorrect. By comparing the repayment provisions in the facility letter for the Year20 Bank1 Loan with repayments listed in paragraph 9(c) of the Statement of Agreed Facts, one sees that there was no early repayment until 29 July Year23.

116. For these reasons, we do not accept Mr Ho's submission based on the Year30 letters.

117. Mr Ho argued that the Year20 Bank1 Loan documentation indicated that the appellant had intended to take up the Year20 Rights Issue shares and to sell them, using the Year20 Bank1 Loan as the initial source of finance. Mr Ho pointed out that there was no penalty for early repayment and that there was no assignment of the Listco share dividend.

118. We disagree. It was a commercial transaction and there was no reason why the appellant should have insisted on less favourable terms to himself so long as Bank1 was agreeable to the terms under the loan documentation. If the Year20 Bank1 Loan were intended as a bridging loan pending the disposal of at least some of the Year20 Rights Issue shares, the appellant would not have agreed to incur a substantial upfront fee of 2%. Moreover, the appellant did not make early repayment upon receipt of the premium for the issue of the Warrants.

119. The lending bank's overriding right to demand repayment was and is a standard banking practice and we are unable to draw any adverse inference against the appellant.

120. We are of the view that the stated intention was genuinely held, realistic and realisable.

Conclusion on the capital or trading issue

121. We find in favour of the appellant on the factual question of his intention as at the time of the Year20 Rights Issue. He intended to hold his Year20 Rights Issue shares on a long term basis.

122. We also find that in mid-Year21 the appellant eventually went along with Witness3's suggestion to issue covered warrants. That was a new and unexpected development arising from Witness3's success in mid-Year21 in talking the appellant into doing a deal.

123. In view of our finding on the question of intention at the time of the Year20 Rights Issue, the appeal should be allowed and the Assessment should be annulled.

Premium for the Warrants – whether assessable in Year23/Year24

124. It is not necessary for us to decide the issues summarised in paragraph 10 above.

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125. We will comment briefly on how we would have dealt with them had it been necessary for us to do so.

126. The issue of the Warrants was a transaction by itself. The warrant holders paid the appellant a premium to acquire an option to subscribe for Listco shares at the exercise price within the exercise period. The warrants issue was complete upon issue of the warrants to the warrant holders and upon paying the premium (net of expenses) to the appellant. The premium was due, payable and paid in July Year21. The appellant's profits arose in or derived from Hong Kong in the Year21/Year22 year of assessment and should be charged in that year of assessment under section 14 and assessed in accordance with Part IV of the Ordinance. Whether on the earnings/accrual basis or the receipts basis, the profits in respect of the premium arose or was derived in the Year21/Year22 year of assessment.

127. Had it been necessary for us to do so, we would have decided in favour of the appellant on this issue.

Whether the Commissioner was out of time in revising the Year23/Year24 profits tax assessment

128. Whether the assessor was out of time if the assessor had revised the Year23/Year24 profits tax assessment at about the time of the Determination is irrelevant. The assessor did not in fact revise the Assessment. It was the Commissioner who determined the objection by increasing the Assessment.

129. Apart from additional tax assessments under section 82A, the Commissioner has no power to assess any taxpayer to tax, whether property, salary or profits.

130. The Commissioner has no power to make additional assessments under section 60 and the limitation periods (of six and 10 years) under section 60 do not apply to her for the simple reason that she was not the assessing officer under section 60.

131. The Commissioner, in determining an objection under section 64, performs the ultimate function to confirm, reduce, increase or annul the assessment, Commissioner of Inland Revenue v Nina T H Wang [1993] 1 HKLR 7 at page 23, CA.

132. Section 64 is not subject to section 60. They deal with different functions to be performed by different officers. The Commissioner is required by section 64(2) to determine an objection 'within a reasonable time'. However, failure to do so within a reasonable time would not have deprived her of jurisdiction or have rendered her determination void, Wang v Commissioner of Inland Revenue [1994] 1 WLR 1286, PC, on appeal from Hong Kong.

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133. The Commissioner has power under section 64(2) to increase an assessment and this is what the Commissioner did in respect of the Assessment.

134. Had it been necessary for us to do so, we would have decided in favour of the Commissioner and held that she was not out of time when she increased the Assessment in the way she did under section 64.

DISPOSITION AND ACKNOWLEDGMENT

135. We allow the appeal and annul the Assessment.

136. It remains for us to thank the team led by Mr Kotewall and the team led by Mr Ho for their able and helpful assistance.