Case No. D58/06

Profits tax – whether the selling of the property and the gain arising therefrom falls within section 14 of the Inland Revenue Ordinance ('IRO') – whether or not this is a sale of a capital asset – sections 2, 14(1) and 68(4) of the IRO – whether or not the taxpayer had an intention to trade when it acquired the subject premises – the taxpayer's intention has to be ascertained objectively by reference to the whole of the surrounding circumstances – the taxpayer's stated intention cannot be decisive – burden of proving lies on the taxpayer – necessary to look at the intentions and the acts of controlling minds of the company

Panel: Colin Cohen (chairman), James Julius Bertram and Lo Pui Yin.

Dates of hearing: 18, 19, 20 and 21 July 2006.
Date of decision: 21 November 2006.

The taxpayer is a company with the nature of business as property investment. The Building was jointly owned as tenants in common in equal shares by the taxpayer and another company called Company D. These two companies had jointly acquired the land in 1991 and in turn, demolished the Old Building and constructed the Building. There was a very close relationship between the taxpayer and Company D. The issue which the Board need to decide is whether the selling of the Ground Floor, First Floor and Second Floor of the Building ('the Subject Properties') and the gain arising therefrom falls within section 14 of the IRO. Hence the Board needs to decide whether or not this is a sale of a capital asset and therefore should not be chargeable to profits tax.

Held:

1. Under section 14(1) of the IRO, profits tax is chargeable on profits arising in or derived from Hong Kong from a person's trade, profession or business, excluding profits arising the sale of capital assets. The definition of 'trade' is very wide and includes 'every adventure and concern in the nature of trade' (section 2 of the IRO). The issue before the Board is whether or not the taxpayer had an intention to trade when it acquired the subject premises (Simmons v IRC [1980] WLR 1196 followed).

2. The proper approach to the issue in this appeal is to consider the taxpayer's intention by regard to the actual evidence that was before the Board. The taxpayer's intention has to be ascertained objectively by reference to the whole of

the surrounding circumstances, including things said and things done, not only at the time, but also beforehand and afterwards.

3. It is necessary to have regard to all the facts and circumstances of each particular case and on the interaction between the factors that are present in any given case (Marson v Morton [1986] 1 WLR 1343 followed).

4. The taxpayer' s stated intention cannot be decisive. The Board's task in the light of all the authorities put to the Board is to consider the evidence that was called and produced before the Board and in turn, to decide whether or not the taxpayer did have the intention to hold the investment for a long term purpose (All Best Wishes v CIR (1992) 3 HKTC 750 followed).

5. The burden of proving that the assessment was excessive or incorrect lies on the taxpayer. The Board refers to section 68(4) of the IRO. It is for the taxpayer to establish that the intended sale was of a capital nature and as such the intention to hold for the long term was realistic and realizable from the start.

6. Where the taxpayer is a company, it is necessary to look at the intentions and the acts of the controlling minds of the company (Brand Dragon Limited and anor v CIR [2002] 1 HKC 660 followed).

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

8. Having considered and reviewed the evidence and considered all the factors and submissions put to the Board by both parties, the Board is of the view that the taxpayer has not discharged its burden of proof to the Board' s satisfaction that the taxpayer had acquired the land with the intention of holding the New Building for a long term investment purpose.

Appeal dismissed.

Cases referred to:

D6/91, IRBRD, vol 5, 556
D49/92, IRBRD, vol 8, 1
Simmons v IRC [1980] 1 WLR 1196
Marson v Morton [1986] 1 WLR 1343
All Best Wishes v CIR (1992) 3 HKTC 750
Brand Dragon Limited and anor v CIR [2001] 1 HKC 660

Stewart Wong Counsel instructed by Messrs Betty Chan & Co, Solicitors, for the taxpayer.
Yvonne Cheng Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by Company A ('the Taxpayer') against the Deputy Commissioner of Inland Revenue's Determination dated the 30 November 2005 in respect of the Taxpayer's objection against the profits tax assessment for the year of assessment 1997/98 on assessable profits in the sum of HK$54,367,757 (after set off of loss brought forward of HK$156,018) with tax payable thereon in the sum of HK$8,073,611.

2. However, during the course of the hearing, an agreement was reached between the parties that the correct calculation in respect of the assessable profits should be HK$48,431,067 (after set off of loss brought forward of HK$156,018) with tax payable thereon of HK$7,192,013.

3. The Taxpayer asserts that the assessment of profits tax is excessive and incorrect by reason of the fact that the proceeds of the sale of the premises which are the subject matter of the appeal, three floors, namely the Ground Floor, the First Floor and the Second Floor, of a 20-storey building at Address B known as Tower C ('the Building'), were of a capital nature and were not profits arising in or derived from any trade, profession or business carried on by the Taxpayer and therefore not chargeable to profits tax.

Agreed facts

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

(1) Company D has objected to the assessor's Notice of Refusal to correct, pursuant to section 70A of the Inland Revenue Ordinance ['the Ordinance'], the 1997/98 profits tax assessment raised on it. Company D claims that an error had been made in its 1997/98 profits tax return in that a profit derived from the sale of capital assets had been erroneously returned for assessment.

(2) Company A has objected to the 1997/98 profits tax assessment raised on it. Company A claims that the profit derived by it, from the same sale of assets as in the case of Company D referred to in paragraph (1) above, is capital in nature and should not be chargeable to profits tax.

(3) Company D is a private company incorporated in Hong Kong on 10 September 1974. The nature of business carried on was described in its profits tax returns as follows:

1996/97 to 1998/99	Property development, investment holding and realty investment
1999/2000	Realty investment
2000/01 to 2003/04	Investment holding and realty investment

All the above returns and their accompanying accounts were signed by the director Mr E. Company D closed its accounts at 31 March annually.

(4) At all relevant times, Company D's authorised, issued and paid up share capital was $100,000, divided into 1,000 shares of $100 each. Its shareholders and directors were members of the family with Surname F:

	No. of shares held	Percentage held	Date appointed as director
Mr G	997	99.7%	Before 22-12-1975
Mr H	1	0.1%	22-12-1975
Mr I	1	0.1%	22-12-1975
Mr E	1	0.1%	22-12-1975
	1,000	100.0%	22-12-1975

Mr G is the father of the other three directors. Mr G, Mr H and Mr I had been directors of Company J, which is a public company incorporated in Hong Kong in 1967 and listed in Hong Kong in 1972. Company J has been engaged in the business of investment holding and property investment. Mr G is one of the founders of Company J.

In addition, on 8 October 1985, Mr K was appointed as an alternate director to Mr H.

(5) At all relevant times, Messrs L, later renamed Messrs M, Certified Public Accountants, was Company D's auditor and tax representative.

(6) Company A is a private company incorporated in Hong Kong on 1 June 1984. The nature of business carried on was described by it as follows:

1994/95 to 1997/98	Property investment
1998/99 to 2003/04	Property investment and investment holding

Company A closed its accounts at 31 March annually.

(7) At all relevant times, the directors of Company A were members of the family with Surname O:

Mr P	[Deceased on 2-10-2000]
Madam Q	
Miss R	[Resigned on 19-11-1999]
Mr T	
Mr U	
Mr V	[Appointed on 24-2-2000]

The above directors were also the directors of Company W. Company W is a private company incorporated in Hong Kong on 8 April 1962 and engaged in the business of property investment, investment holding, financing and provision of management services.

(8) At all relevant times, Company A's authorised share capital was $10,000 and its issued and paid up share capital was $1,000, divided into 1,000 shares of $1 each. Its shareholders were:

	No. of shares held	Percentage held

Mr P	1	0.1%
Company X	999	99.9%
	1,000	100.0%

Company X is a private company incorporated in Hong Kong in December 1972.

(9) At all relevant times, Messrs Y was Company A's auditor and tax representative.

(10) Mr P and Mr G are brothers.

(11) In a sale by tender ordered by the vendors, the offer to purchase the whole building ['the Old Building'] then erected on Address B for the price of $61,180,000 by Company Z was accepted by the vendors. Company Z was a related company of Company A.

(12) By a nomination dated 12 June 1991, Company Z nominated Company D and Company A to take up the assignment of the Old Building.

(13) By an assignment dated 12 June 1991, Company D and Company A acquired, as tenants in common in equal shares, the Old Building.

(14) Company D and Company A are hereinafter collectively referred to as 'the Joint Venture Partners'.

(15) The Old Building was subsequently demolished and redeveloped into a 20-storey retail/commercial building known as Tower C ['the New Building']. Ground Floor to 2nd Floor of the New Building were designed as retail shops and 5th Floor to 22nd Floor as offices. Particulars of the redevelopment were as follows:

(a)	First submission of building plan	7-8-1991
(b)	Commencement of demolition	10-3-1993
(c)	Completion of demolition	18-6-1993
(d)	Final approval of building plan (after several building plans submitted)	22-4-1994
(e)	Commencement of building works	11-5-1995
(f)	Completion of construction	December 1996
(g)	Issue of occupation permit for the New Building	23-5-1997

(16) By facsimile message dated 25 March 1997, Company AA, later renamed Company AB, advised the Government Property Agency ['GPA'], inter alia, that Ground Floor, 1st Floor and 2nd Floor of the New Building ['the Subject Properties'] were available for sale on vacant possession basis.

(17) By facsimile message dated 20 May 1997, Company AB informed GPA that the selling price of the Subject Properties was $160,000,000 on vacant possession basis.

(18) On 27 May 1997, GPA, accompanied by persons from Company AB, inspected the Subject Properties.

(19) By letter dated 14 July 1997, GPA referred to its inspection of the Subject Properties on 27 May 1997 and asked Company AB to confirm whether the occupation permit of the Subject Properties had been issued and whether they were still available for sale, before GPA made its counter-offer.

(20) By letter dated 18 July 1997, Company AB replied as follows:

'… As per advised by the owner, we confirm that the occupation permit has been issued and [the Subject Properties] is still available at a revised price of HK$195 million (subject to contract). …'

(21) By letter dated 4 September 1997, GPA wrote to Mr AC of Company W for a proposed date of meeting with a view to agreeing a price for the Subject Properties. After further correspondence on 8 September 1997, the meeting was fixed on 11 September 1997.

(22) At the meeting of 11 September 1997, Company W proposed a selling price of $155,000,000 for the Subject Properties.

(23) By letter dated 31 October 1997 to Company W, GPA made an offer for the purchase of the Subject Properties at a price of $132,554,836. By letter dated 1 November 1997, Company D accepted the offer.

(24) On 22 December 1997, the agreement for sale and purchase of the Subject Properties, at a price of $132,554,836, were entered into between the Financial Secretary Incorporated, as the purchaser, and the Joint Venture Partners, as the vendor.

(25) On 22 January 1998 a deed of mutual covenant in respect of the New Building was signed between the Joint Venture Partners as the First Owner, The

Financial Secretary Incorporated as the Second Owner and Company AD as the Management Company.

(26) By an assignment dated 22 January 1998, the Subject Properties were assigned to the Financial Secretary Incorporated.

(27) Company AB received an agency fee of $662,774, which was shared equally by the Joint Venture Partners.

(28) By an appointment letter dated 6 May 1998, the Joint Venture Partners appointed Messrs AE as their sole leasing agent to exclusively market and handle leasing of all office floors/units within the New Building. The appointment period was to be three (3) months and automatically be extended for a further three (3) months.

(29) By letter dated 27 February 1998, in response to the Assessor's enquiry as regards the New Building, Messrs M claimed that 'The properties were intended to let out for rental income.' In support, Messrs M provided the Assessor with a copy of a document headed '[Company D] – MINUTES OF A MEETING OF THE COMPANY HELD ON 16TH DECEMBER 1996', which stated, inter alia, as follows:

'THE INVESTMENT PROPERTY ANNOUNCED FOR RENT

It was anticipated that the property of [Tower C], [Address B] would provide an attractive return to the company to which the property is let out. It was resolved that the whole of the property of [Tower C], be announced for rent to the public.'

(30) By another letter dated 14 May 1998, Messrs M claimed that there was no joint venture agreement prepared by the two developers of the New Building, that is, the Joint Venture Partners.

(31) On 10 November 1998, Company D submitted its 1997/98 profits tax return, tax computation (with supporting schedules) and audited accounts for the year ended 31 March 1998. In the returns, and the directors' report, Company D's principal business activity was stated to be 'property development, investment holding and realty investment'. The accounts were dated and approved by Company D's directors on 4 November 1998.

(32) In the return, Company D declared assessable profits of $64,055,045 which included a profit on disposal of the Subject Properties of $54,876,691 ['the Gain']. The Gain was shown as an 'Exceptional Item' in Company D's profit

and loss account. In its tax computation, Company D offered the Gain for assessment.

(33) The Gain was calculated as follows:

Sales proceeds [$132,554,836 x 50%]		$66,277,418
Less: Cost of properties [Note]	$11,002,957	
Legal fee [$132,765 x 50%]	66,383	
Agency fee [$662,774 x 50%]	331,387	(11,400,727)
The Gain		$54,876,691

Note: $\frac{\text{Areas of the Subject Properties}}{\text{Total areas of the New Building}}$ x Total cost of the New Building

= $\frac{7,373 \text{ sq ft}}{32,411 \text{ sq ft}}$ x $48,367,943*

= $11,002,957

*In Company D's balance sheet as at 31 March 1997, this sum was transferred and reclassified from 'properties under development' to 'investment properties'.

(34) The following appears in the notes to the financial statements of Company D for the year ended 31 March 1998:

(i) Provision for Hong Kong profits tax, of $10,580,000, at 16.5% on the estimated assessable profits for the year [Note 5 to the financial statements].

(ii) Amount due to a shareholder [Note 11 to the financial statements] 'The advance was interest-free, unsecured and not repayable until the company is in a position to do so.'

(35) On 15 December 1998, the Assessor raised on Company D the following 1997/98 profits tax assessment in accordance with the return:

Assessable profits	$64,055,045
Tax payable thereon	$10,569,082

Note: To give effect to the Tax Exemption (1997 Tax Year) Order, the tax payable was subsequently reduced by 10% to $9,512,173.

Company D did not object to this assessment, which became final and conclusive in terms of section 70 of the Ordinance.

(36) By letter dated 24 December 1998, Messrs M applied on behalf of Company D to hold over a part of the 1998/99 provisional profits tax charged in the following terms:

'During the year of assessment 1997/98, [Company D] had sold several investment properties in a very short period of time. [Company D] therefore have reported the profits on disposal of the properties for assessment. However, starting from 1st April 1998, most of the remaining investment properties held by [Company D] had been leasing out to generate rental income only. We therefore lodge an application under Section 63J of [the Ordinance], on behalf of [Company D], for a partial holdover of the 1998/99 Provisional Tax on the ground that the assessable profits for the year ending on 31st March 1999 will be less that 90% of the profits provisionally assessed.'

(37) On 30 December 1998, Company A submitted its 1997/98 profits tax return, tax computation (with supporting schedules) and audited accounts for the year ended 31 March 1998. The accounts were dated and approved by Company A's directors on 11 December 1998. The Old Building or, after redevelopment, the New Building, constituted the only property owned by Company A. The property was classified as 'properties held for re-development' in the balance sheets of Company A up to 31 March 1997 and as 'fixed assets' in its balance sheets as at 31 March 1998.

(38) In the return, Company A declared an adjusted loss of $406,197, which was arrived at after excluding, inter alia, a surplus on disposal of the Subject Properties of $38,391,833 ['the Surplus']. The Surplus was shown as an 'Exceptional Item' in the profit and loss account of Company A.

(39) Company A gave the following contentions to support its claim to exclude the Surplus from assessment:

'[Company A] acquired the land and properties of [Address B] on 12.6.91 for long term investment. The properties was re-developed to realise the maximum rental return for the long term investment. [Company A] disposed [the Subject Properties] on 22.1.98. As the properties have been held for many years and are for long term investment purposes. The surplus on disposals is of a capital nature and not assessable to profits tax.'

(40) In response to the Assessor's enquires, Messrs Y put forth the following contentions on behalf of Company A:

(a) '[The Joint Venture Partners] successfully bid a piece of land at [Address B] and re-developed into [the New Building] in 1997 with the intention of holding the property for rental income on a long term basis.'

(b) 'There was no re-development agreement made.'

(c) 'As the owners of [the Joint Venture Partners] have sibling relationship with each other, they did not find it necessary to enter into any formal written agreement or exchange of correspondence.'

(d) 'The first feasibility … was carried out by [Company A] before acquisition, [Company A's] directors have ample experience in construction as well as property investment. The second feasibility was done by [Messrs AF] (a leading firm of property consultants) in 1995 ["Messrs AF Proposal"] … and both reports showed positive results.'

(e) 'An estate agency, [Company AB], took the initiative to approach [Company A] and introduced the purchaser, the Financial Secretary Incorporated.'

(f) '[Mr AC] is the Property Manager of [Company W] which is under the control of [Surname O's] family. As [the New Building] was not for sale no sales manager was employed and [Mr AC] was requested to deal with [GPA] on behalf of [Company A].'

(g) Company A financed the redevelopment of the Old Building to the New Building with interest free advances from its ultimate holding company, Company X. The advances were made on current account basis according to the progress of construction. No loan agreement was made as to the exact amount of the loan and terms of repayment. There was no plan as to when and how Company A should repay Company X. Company A would repay Company X whenever it had surplus funds.

(h) Company A applied the sales proceeds of the Subject Properties to repay the loan from Company X and the balance as advances to Company X.

(41) Messrs Y further provided the following documents on behalf of Company A:

(a) A copy of advertisement for leasing dated 5 June 1998 (Appendix G to the Determination of Company A).

(b) A copy of Company A's minutes of meeting of its board of directors dated 20 December 1997 resolving for the sale of the Subject Properties.

(42) Messrs Y put forth the following arguments on behalf of Company A to support the capital claim in respect of the Subject Properties:

(a) Company A's original intention was to hold the redeveloped property as long-term investment for generating rental income.

(b) The two feasibility studies made in 1991 and 1995 clearly demonstrated the only intention of Company A was for leasing to derive long-term investment return.

(c) Company A had in fact appointed an agent in marketing the leasing of the remaining units and certain units have been successfully leased out.

(d) An independent report by a newspaper dated 4 June 1998 showed that the units were for letting at $13 to $16 per sq ft. The return of income on the investment was more than 10%.

(e) No sales brochure was prepared for the units. Indeed, no action for the sale of the units was taken. There was no sales manager employed.

(f) Apart from the Subject Properties being disposed at the solicitation of the purchaser as well as to enhance the rental of other floors, all the remaining units had been held for rental income.

(g) The investment was funded by internal resources and there was no financial problem in holding the property for long-term rental income.

(43) Messrs Y accounted for the offering for assessment to profits tax by Company D of its 50% share of profits from the disposal of the Subject Properties in the following terms:

'This, we understand, was caused by that the management of [Company D] was advised by the auditor that because the duration of ownership of the property disposed was so short that the I.R.D. would consider the surplus assessable. This, we submit, is not the correct view. Whether the surplus on

disposal of property is assessable does not depend solely on the length of time the property is owned prior to disposal. Rather, it depends on whether the property was acquired with the intention of trading at the time of acquisition or not.'

(44) In response to the Assessor's enquiries, Messrs AF, later renamed Messrs AG, informed that the Messrs AF Proposal (paragraph (40)(d) above) was an unsolicited proposal they prepared and sent out to the owners of the New Building for the purposes of securing a sole agency appointment. There was neither instruction nor formal request from the owners of the New Building for preparing the proposal.

(45) The Assessor was of the view that the Surplus was of a revenue nature and chargeable to profits tax. On 10 September 2003, the Assessor raised on Company A the following 1997/98 profits tax assessment:

Loss per return	($406,197)
Add: the Surplus	38,391,833
	37,985,636
Less: Loss set-off	(156,018)
Assessable profits	$37,829,618
Tax payable thereon (after 10% tax rebate)	$ 5,617,698

(46) By notice dated 23 September 2003, Messrs Y objected on behalf of Company A against the assessment in paragraph (45) above on the ground that the Surplus arose from the sale of capital assets and should be excluded from the charge to profits tax. In support of the objection, Messrs Y reiterated the claims in paragraphs (41)-(43) above and further relied on the fact that the properties were classified as 'Investment Property' and 'Fixed Asset' in the balance sheets of Company A.

(47) By letter dated 10 March 2004, Messrs Y put forth the following contentions to support the objection:

(a) '[Mr AH] of [Company AB] introduced the purchaser, [GPA] to [Mr AC] of [Company X] in around March 1997.'

(b) '… in February or March 1997 (exact date cannot be recalled) [Mr AI] and [Mr AH] of [Company AB] called to enquire about the leasing or sale of the property. They were received by [Mr AC], the property

manager of [Company W] an associated company of [Company A]. Later, [Mr AC] received an enquiry from [GPA] to ask if the company would sell [the Subject Properties]. He discussed the matter with [Mr T], Director of [Company A] who also discussed with the management of the other partner [Company D]. The consensus of opinion was that having a Government Department in the building would enhance its image and would help in the promotion of the leasing of the other units. Meetings were later held with [GPA] by [Mr AC], [Mr K] of [Company D] and [Mr T], Director of [Company A] to negotiate the terms of the sale.'

(c) 'The selling price was determined by negotiations with [GPA], by [Mr AC], [Mr K] of [Company A] and [Mr T], Director of [Company A] upon offers and counter offers made. There were two meetings during which the purchase price and terms of the sale were discussed.'

(d) 'No appointment was made to [Company AB] to be the sales agent of the property concerned, but when the sale was concluded, the company paid commission to [Company AB] according to the custom of the trade, as they were instrumental in bringing in the buyer.'

(48) The Assessor has ascertained that in computing it profits from disposal of the Subject Properties, Company D calculated the cost attributable to these three floor units by an apportionment on an area basis as follows:

Areas of the Subject Properties Total areas of the New Building		×	Total cost of the New Building
=	7,373 sq ft 32,411 sq ft	×	$48,367,943
=	$11,002,957		

(49) The Assessor asked Company A to account for the difference between the cost of the Subject Properties as computed by it and that as computed by Company D (paragraph (33) above). In reply, Messrs Y explained that it was due to the different basis being used to determine the costs and supplied a computation of the Surplus per paragraph (38) as follows:

Sales proceeds [$132,554,836 x 50%]	$66,277,418
Accrued interest received from solicitor	50,389

			66,327,807
Less:	Cost of properties [Note]	$27,538,204	
	Legal fee	66,383	
	Commission paid [$662,774 x 50%]	331,387	(27,935,974)
The Surplus			$38,391,833

Note:

	Gross area (sq ft)	Estimated monthly rental per sq ft	Estimated monthly rental	Construction cost apportionment
		$	$	$
Total construction cost				48,355,231
Estimated rental				
Shops on G/F	2,297	300	689,100	
Shops on 1/F	2,375	60	142,500	
Shops on 2/F	2,701	60	162,060	
Offices on 5/F to 22/F	25,038	30	751,140	
	32,411			
Total estimated rental			1,744,800	
Apportionment of construction cost according to estimated rental:				
Shops on G/F				19,097,656
Shops on 1/F				3,949,232
Shops on 2/F				4,491,316
Construction costs apportioned to Shops on G/F to 2/F (i.e. the Subject Properties				27,538,204
Offices on 5/F to 22/F				20,817,027
				48,355,231

(50) The Assessor maintains the view that the Surplus is of a revenue nature and chargeable to profits tax. Further, she does not accept the basis adopted by Company A in computing the cost attributable to the Subject Properties in paragraph (49). She considers it fair, reasonable and appropriate to adopt the area apportionment basis and is prepared to revise the 1997/98 profits tax assessment as follows:

Loss per return (paragraph (38) above)	($406,197)

Adds: Profit on disposal of the Subject Properties:		
The Surplus (paragraph (38) above)	38391,833	
Cost of the Subject Properties overstated (Note)	16,538,139	54,929,972
		54,523,775
Less: Loss set-off		(156,018)
Assessable profits		$54,367,757
Tax payable thereon (after 10% tax rebate)		$8,073,611

Note: Areas of the Subject Properties / Total areas of the New Building x Total cost of the New Building

= 7,373 sq ft / 32,411 sq ft x $48,355,231*

Less: Cost per paragraph (49)	27,538,204
Cost of the Subject Properties overstated	($16,538,139)

(51) By letter dated 22 September 2003, Company D authorised Messrs Y to act on its behalf for the purposes of making an application to correct under section 70A of the Ordinance its 1997/98 profits tax assessment.

(52) By letter dated 3 October 2003, Messrs Y, on behalf of Company D, applied to correct under section 70A of the Ordinance the 1997/98 profits tax assessment in the following terms:

'We submit that an error has been made in the tax computation and Profits Tax Return of [Company D] for the year of assessment 1997/98 in that Profit on disposal of Investment Properties amounting to $54,876,691 [i.e. the Gain [paras 32 and 33 above] has been wrongly added back to the accounting profits of [Company D] in the tax computation for the year of assessment 1997/98 and thus returned as assessable profits in its Profit Tax Return resulting in tax of $9,054,654 (54,876,591 x 16.5%) having been excessively charged. We therefore make an application under Section 70A to have the error corrected and the relevant tax refunded.'

(53) In correspondence with the Assessor, Messrs Y gave the following contentions in support of Company D's application:

By letter dated 3 October 2003

(a) '[The Gain] is profit from sale of capital asset and, as such, should not have been included as assessable profit in the tax computation and tax return.'

(b) 'That [the Gain] is profit from sale of capital asset is demonstrated in the accounts and tax computation of [Company D] in the following manner:

(i) The profit was classified as Exceptional Item in the Profit and Loss Account of [Company D].

(ii) The property concerned has been classified as Investment Properties in the Balance sheet of [Company D] under Non-Current Asset.

(iii) Commercial Rebuilding allowance under Section 36 on the property was claimed and allowed. This demonstrates that the property has been accepted as Capital Asset.'

(c) 'Apart from the above observation, that the property concerned is a capital asset can be justified from the following facts:-

(i) In June, 1991 [Company D], jointly with another Company [Company A] (owned by [Mr P] who is the brother of the Managing Director of [Company D] [Mr G]) acquired a piece of land from Government at [Address B]. The land was subsequently developed into a Commercial Complex known as [Tower C] in 1997. [Company D] and [Company A] each owns 50% in the interest of this Commercial Complex. The cost of re-development was provided by internal resources. No external borrowings were required.

(ii) [Messrs AF] had made an offer to be appointed the leasing agent for the leasing of the properties in March 1995 ['the Messrs AF Proposal']. Promotional Advertisement were made for the leasing of properties in newspapers in June 1998.

(iii) The unsolicited sale of the 3 units [i.e. the Subject Properties] was made to Government through [GPA], which expressed that the Government would like to acquire the units rather than to lease. It was considered that with the presence of a Government Department in the Building, it would enhance the traffic flow of

the building and therefore would be easier to attract tenants for the other floors. [The Gain] was of a capital nature and not assessable.'

(d) '… there is ample evidence to suggest that [the New Building] was not acquired with the intention of sale for profit but with the intention of holding it for rental income on a long term basis.'

As regards the interpretation of 'error' under section 70A, Messrs Y referred the Assessor to the Board of Review Decisions in D6/91, IRBRD, vol 5, 556 and D49/92, IRBRD, vol 8, 1.

By letter dated 5 December 2003

(e) 'The original intention was to re-develop the old buildings into a commercial building for letting for rental income on a long term basis.'

(f) 'As [Company D] is a family company beneficially owned by the father and his children, no Director' s minutes were made [as regards the intention with the redeveloped building] … However, whether the property was intended to hold for long term investment or not should be judged by the fact of the case as demonstrated by the conducts … rather than by a piece of paper.'

(g) Feasibility studies were conducted as to the viability of the project. The first one was done by Company D [see paragraph (54) below] whereas the second one was done by Messrs AF, that is, the Messrs AF Proposal.

(h) 'The project was financed by a loan from the major shareholder [Mr G] in the amount of 173,479,217. No external borrowings were required.'

(i) Company AB acted as the agent for the sale of the Subject Properties and received the agency fee as referred to in paragraph (27) above.

(j) 'The negotiation for the purchase of [the Subject Properties] was carried out between [Mr AC], the Sales Manager of [Company W] and Mr XXX of [GPA] … (N.B.: [Company W] is an associated company and [Mr AC] acted on behalf of [the Joint Venture Partners]).'

(54) Messrs Y on behalf of Company D also provided the Assessor with copies of the following documents:

(a) An undated feasibility study, which Messrs Y stated was done by Company D in May 1991.

(b) A fee note dated 15 January 1998 issued by Messrs AJ in respect of legal fees of $132,765 for the sale of the Subject Properties.

(55) By notice dated 6 January 2004, the Assessor refused to correct Company D's 1997/98 profits tax assessment as per paragraph (35) above under section 70A of the Ordinance.

(56) By letter dated 3 February 2004, Company D, through Messrs Y, objected to the Assessor's refusal on the following grounds:

(a) It had been discovered that an error was made in Company D's 1997/98 profits tax return in that the Gain had been erroneously returned for assessment resulting in tax having been over-charged.

(b) The New Building was built with the intention of holding it for long-term rental income, as could be demonstrated from the following facts:

'(a) In May, 1991 when the site was first acquired, a feasibility study was made by the management as to the viability of building a property for long term investment has been made …

(b) In March, 1995 long before the property was completed [Messrs AF] made a marketing proposal as to the strategy for leasing of the property …

(c) The sale of the 3 units to Government was an isolated transaction and was made in consideration not only of the price but for the prestige of having the presence of a Government Department in the Building. There have been no sale of any other units of the building ever since …

(e) No external borrowings were required for the acquisition of the property. This makes the holding of the property as long term investment a more viable project.

(f) We submit herewith photo-copies of newspaper cuttings advertising the lease of the units which should demonstrate that original intention of the units was for letting and not for sale …

(g) The rental yield in the investment was more than 10%.'

(c) The sale of the Subject Properties during the year 1997/98 was a sale of capital assets. There had been no sale of the other units of the New Building which had ever since been held for rental income.

(57) Messrs Y had since put forth the following further contentions:

(a) '[Company D]' is a family company beneficially owned by the father and his children. As such, no formal Director's Meeting was held (in the sense that all the directors sit together to discuss matters for which a meeting is convened). If a decision made is required to be documented, a minute of director's meeting is prepared for circulation to the directors. It might be that the date and time of director's meeting mentioned by [Messrs M] (paragraph (29) above) referred to preparation of the document of the minutes.'

(b) '… [Company D] is a family company controlled by the father [Mr G] who owns 99.7% of its share capital. Whenever [Company D] required money, [Mr G] would arrange funds to be injected into [Company D] from his resources or from other companies under his control. When [Company D] has surplus cash it would repay [Mr G] or other companies. This has been done on an on-going basis. Up to the year ending 31st March, 1997, when [the New Building] was near completion, [Company D] owed [Mr G] an amount of 173,479,217 against the assets of cost of investment properties of 125,796,677 and properties under development of 44,338,805 as reflected in the Balance Sheet of [Company D]. Except for a small amount of bank overdraft of 233,130, which was adjustment of unpresented cheques at Balance Sheet date there were no borrowings from third parties to finance the cost of [the New Building].'

(c) 'The Building was intended to be kept as capital asset for long term rental income when it was first designed in 1991 … The only disposal of [the Subject Properties] in 1997 was disposal of capital assets prompted by the desire of having a Government presence in [the New Building] which would add prestige to the image of [the New Building] and thus is conducive to the promotion of the leasing of the units. There have never been any change of intention.'

(d) '[Company AB] has not been appointed as agent in the letting and disposal of [the New Building]. However, [Company D] paid commission to [Company AB] when the sale of the units to Government was completed according to custom of the trade as they were instrumental in bringing in the buyer.'

(e) 'No contemporary records were kept of the dates and events leading to the sales of [the Subject Properties] to Government. However according to the recollections of the persons involved in the transactions, it was sometime in February or March 1997, a [Mr AI] and [Mr AH] of [Company AB] called to enquire about the leasing or sale of [the New Building]. They were received by [Mr AC], the property manager of [Company W] which is an associated company of the other partner [Company A]. Later, [Mr AC] received an enquiry from [GPA] to ask if [the Subject Properties] would be sold. It was considered that having a Government Department in [the New Building] would add prestige to the image of [the New Building] and would help in the promotion of the leasing of the other units. Meetings were later held with [GPA] by [Mr K] of [Company D], [Mr AC] of [Company W] and [Mr T], Director of [Company A] to negotiate the terms of the sale.'

(f) '[Mr K], Company Secretary of [Company D], [Mr AC] manager of [Company W] and [Mr T], Director of [Company A] were responsible in the negotiation with the purchaser.'

(g) 'The shareholders of [Company D] and the shareholders of [Company A] are close relatives. The sale of part of the property [i.e. the Subject Properties] at the sale price was discussed and agreed verbally. No written agreement was made.'

(h) 'Sales proceeds of 66M were transferred to a related company [Company AK] [Note] for term deposit.'

Note: The full name of the company is AK Investment Company Limited ['Company AK']. At the material times, all the directors of [Company D] were directors of [Company AK] and, other than [Mr K], shareholders of [Company AK].

(58) The following appears in the Notes to Company D's Financial Statements for the years 1998/99 to 2003/04, which were approved by its directors on divers dates after 3 November 1999:

'JOINT VENTURES – JOINTLY CONTROLLED ASSETS
The Company has entered into three joint venture agreements in the form of jointly controlled assets to develop and erect properties on land for investment purposes. An analysis of the company's participating interest in each joint venture is as follows:-

Name of property	**Participating interest**
[Centre AL]	45%
[Tower C]	50%
[i.e. 'the New Building']	
[Centre AM]	45% '

'AMOUNT DUE TO A SHAREHOLDER
The amount is interest-free unsecured and not repayable until the company is in a position to do so.'

Note: The 'amount due to a shareholder' stood at $173,479,217 as per Company D's balance shares as at 31 March 1997 to 2004.

(59) Since the year 1997/98, Company D claimed and was granted rebuilding allowances for 5/F to 22/F of the New Building. No rebuilding allowance was granted to Company D for the Subject Properties.

(60) Contentions were put forth by the Legal Representative of Company D in a letter dated 31st March 2005 Letter which included, inter alia, the following:

(a) 'Although there is a reference to "sales representative" (**售樓代理**) on the last page of the brochure [printed for the New Building], that was a mistake as the brochure was not for sale of property but for the purpose of leasing. This can be illustrated by the facts that no sales price list for the units was prepared and printed and not a single unit was sold to the public. The property market was booming and hectic during the months May 1997 to October 1997. If [Company D] had intended to sell the property, there is no reason that none was sold as a result of the brochure. The 3 units sold to the Government were through the unsolicited introduction of [Company AB].

… This brochure was prepared by [Mr AN], the sales manager of [Company AO] who copies the exact format, including the words '**售樓代理**", from brochures used in the 1980s, when the companies of the two families were engaging in sales of developed properties…

[Company AO] is a company wholly owned by the [Surname F's] family. …'

(b) Company D could not re-collect whether there was any public announcement for rent made subsequent to the meeting of 16 December 1996 as referred to in [paragraph (29) above] and prior to the appointment of Messrs AE in May 1998.

(c) 'According to [Company D's] re-collection, [Company D] had not instructed [Messrs AF] to make [the Messrs AF Proposal], which was made at its own volition, [Messrs AF] was not chosen to be the Leasing Agent by the Management. [Company D] agreed with [Messrs AF's] response as recorded in [paragraph (44) above].' The statement in Messrs Y's letter dated 10 March 2004 where it was stated that Messrs AF as instructed by [Mr K] of Company D to prepare the Messrs AF Proposal was incorrect.

(d) The letter from Messrs M dated 12 January 1993 which stated that Address B (that is, the address of [the New Building]) was for resale, was incorrect. The incorrect statements made by Messrs M about the nature of the properties (that is, whether they were for resale or long-term investment purposes) should be disregarded.

(61) By a Determination dated 30 November 2005, the Deputy Commissioner of Inland Revenue upheld the Assessor's Notice of Refusal dated 6 January 2004 to correct the profits tax assessment for the year of assessment 1997/98, and the profits tax assessment for the year of assessment 1997/98 under charge number 1-1087886-98-6, dated 15 December 1998, showing assessable profits of $64,055,045 with tax payable thereon of $9,512,173 (after deduction of 10% tax rebate to give effect to the Tax Exemption (1997 Tax Year) Order) was confirmed.

(62) By a separate Determination also dated 30 November 2005, the Deputy Commissioner of Inland Revenue increased the profits tax assessment for the year of assessment 1997/98 under charge number 1-2911639-98-5, dated 10 September 2003, showing assessable profits of $37,829,618 (after set off of loss brought forward of $156,018) with tax payable thereon of $5,617,698 to assessable profits of $54,367,757 (after set off of loss brought forward of $156,018) with tax payable thereon of $8,073,611.

(63) By notices of appeal dated 28 December 2005, Company D and Company A appeal to the Board of Review against the aforesaid Notice of Refusal and Assessment respectively.

(64) By a letter dated 4 July 2006 from its legal representative, Company D withdrew its appeal under section 68(1A)(a) of the Ordinance for the reasons stated therein.

(65) At the hearing, Company A applied for leave to amend ground (b) of its Statement of Grounds of Appeal as follows:

'If, which is denied, any gain or surplus derived by the Appellant from the disposal of the Subject Properties was chargeable to profits tax, the said tax should not be charged on the gain or surplus of HK$54,929,972 as adopted and used by the Assessor, in that the calculation of the said gain or surplus of HK$54,929,972 was based on apportioning the total cost of the Building by reference to the proportion of the area of the Subject Properties to the total area of the Building. Such a method of calculating the proportional cost of the Subject Properties is not a proper or correct or acceptable method from a commercial and/or accounting point of view. The proper, correct and acceptable method of calculating the proportional cost of the Subject Properties is:

(i) to apportion the total construction cost of the Building to each floor by reference to the respective gross area of each floor; and

(ii) to apportion the land cost (including the stamp duty and legal fees) to each floor by reference to the respective capital value of each floor as at the date of the Assignment by the [Appellant ?] and [Company D] of the Subject Properties (which would be of a higher proportion than the apportionment based on the respective gross floor area) from which the gain or surplus the subject of this appeal was derived.

The gain or surplus as calculated by the Assessor is therefore based on a wrong method, and profits tax charged thereon is excessive and incorrect.'

(66) The Commissioner did not oppose the application and the Board granted leave to amend as stated in paragraph (65) above.

(67) The Appellant and the Commissioner now agree that, in the event that Company A's gain or surplus from the sale of the Subject Properties is assessable to profits tax (which Company A denies), then notwithstanding

paragraphs (49) and (50) above, the amount of the gain is $48,993,282, and taking into account various losses and a 10% tax rebate, the tax payable by Company A is $7,192,013, calculated as follows:

Sales proceeds plus accrued interest		66,327,807
Less: Cost of properties		16,936,755
Legal fee		66,383
Commission paid		331,387
	Gain:	48,993,282

Assessment

Loss per return		(406,197)
Add: Profit on disposal of Subject Properties		48,993,282
Less: Loss set-off		(156,018)
	Assessable profits:	48,431,067

Tax payable thereon (after 10% rebate, 48,431,067 x 16.5% x 90%)	$7,192,013

(68) It is also agreed by Company A and the Commissioner that in the event that the tax is payable on the gain or surplus (which Company A denies), the order which the Board should make in such an event is as follows:

'Profits tax assessment for the year of assessment 1997/98 under Charge Number 1-2911639-98-5, dated 10 September 2003, showing Assessable Profits of $37,829,618 (after set off of loss brought forward of $156,018) with Tax Payable thereon of $5,617,698, which was increased (by the Deputy Commissioner of Inland Revenue in the Determination dated 30 November 2005) to Assessable Profits of $54,367,757 (after set off of loss brought forward of $156,018) with Tax Payable thereon of $8,073,611, is hereby reduced to Assessable Profits of $48,431,067 (after set off of loss brought forward of $156,018) with Tax Payable thereon of $7,192,013.'

The issues

5. The Building was jointly owned (as tenants in common in equal shares) by the Taxpayer and another company called Company D. It can be seen from the Agreed Facts that these two companies had jointly acquired the land in 1991 and in turn, demolished the Old Building and constructed the Building.

6. It should be noted that Company D is a company controlled by Mr G and his family and the Surname F family was and is also the owner and controller of a company known as

Company AO. The Taxpayer is a company owned by Company X. Company X is a company owned and controlled by the late Mr P and his family. That family also owned and controlled and still owns and controls a company known as Company W. From the Agreed Facts as well as from evidence that was before us, there was a very close relationship between the Taxpayer and Company D. The two families were sophisticated property developers and had considerable experience of the property market.

7. We would mention at this stage that the Taxpayer's appeal was to be heard at the same time as an intended appeal by Company D, however, Company D's appeal was withdrawn shortly before the hearing commenced.

8. The issue which we need to decide is whether the selling of the Ground Floor, First Floor and Second Floor of the Building ('the Subject Properties') and the gain (now agreed upon in the sum of HK$48,993,282) arising therefrom falls within section 14 of the Inland Revenue Ordinance ('IRO').

9. Hence, we need to decide whether or not this is a sale of a capital asset and therefore should not be chargeable to profits tax.

The law

10. Under section 14(1) of the IRO, profits tax is chargeable on profits arising in or derived from Hong Kong from a person's trade, profession or business, excluding profits arising the sale of capital assets. The definition of '*trade*' is very wide and includes '*every adventure and concern in the nature of trade*' (section 2 of the IRO). The issue before us is whether or not the Taxpayer had an intention to trade when it acquired the subject premises (see Simmons v IRC [1980] 1 WLR 1196 at 1199A-D, per Lord Wilberforce).

11. During the course of the hearing, extensive submissions were made and evidence was called with regard to the way not only the Taxpayer operated but also how the group of companies of which the Taxpayer was part, operated and was run. However, we are of the view that the proper approach to the issue in this appeal is to consider the Taxpayer's intention by regard to the actual evidence that was before us.

12. We accept the submissions put forward to us by Miss Yvonne Cheng ('Miss Cheng') that such an intention has to be ascertained objectively by reference to the whole of the surrounding circumstances, including things said and things done, not only at the time, but also beforehand and afterwards.

13. It is necessary to have regard to all the facts and circumstances of each particular case and on the interaction between the factors that are present in any given case (Marson v Morton [1986] 1 WLR 1343 1348B).

14. It is also accepted that the Taxpayer' s stated intention cannot be decisive. We were referred to All Best Wishes v CIR (1992) 3 HKTC 750 at 770-771. In that case, the Taxpayer together with three other companies purchased properties for development. The Taxpayer produced a written resolution stating that it was to acquire properties for development and thereafter 'be maintained for long term investment'. However, in that case, it is clear that the Board nevertheless found that the badges of trade were indeed present.

15. Our task in the light of all the authorities put to us is to consider the evidence that was called and produced before us and in turn, to decide whether or not the Taxpayer did have the intention to hold the investment for a long term purpose. Indeed, we find this passage in All Best Wishes v CIR (1992) 3 HKTC 750 at 770-771 to be of assistance. There, Mortimer J said:

> *'The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person' s intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.'*

16. Again, we remind ourselves of the burden of proving that the assessment was excessive or incorrect lies on the Taxpayer. We refer to section 68(4) of the IRO. We accept that it is for the Taxpayer to establish that the intended sale was of a capital nature and as such the intention to hold for the long term was realistic and realisable from the start.

17. We also accept that where the Taxpayer is a company, there are particular points that we need to bear in mind when we review and consider the evidence. It is necessary to look at the intentions and the acts of the controlling minds of the company (Brand Dragon Limited and anor v CIR [2002] 1 HKC 660) and in turn, it is quite clear that in the present case before us, regard must be had to the fact that the Taxpayer was set up as a corporate vehicle by the Surname O family which in turn, had a history of trading and other dealings in property.

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

Evidence

19. The task which we now need to embark upon is to carefully consider the evidence before us to ascertain the intention of the Taxpayer.

Mr T

20. Mr T provided us with the history and background in respect of this matter. It is quite clear that the Taxpayer is but one of numerous corporate vehicles that were utilized by the Surname O family in their property dealing empire. He made it very clear in his evidence that his father and his uncle were very close to each other and they decided to do business together in order to develop various properties.

21. He also drew to our attention that from the 1960s to the early 1980s, both his father and his uncle were heavily involved in the property business. In particular, they built properties for resale and often borrowed money from banks to finance such developments.

22. He drew to our attention the fact that due to the failure of various projects in the 1980s, both his father and his uncle decided to change their business policy and philosophy. In short, they were shifting to a concept of building property for rental income and long-term capital growth.

23. He drew to our attention that between 1991 and 1998, there were some 21 properties within the group of companies which resulted in rental income of approximately HK$805,000,000. He emphasized after this change of policy, all properties that were built or acquired were for long-term holding. On cross-examination, he agreed that of the some 21 properties which were set out in a schedule that was placed before us, there were some properties that were held for sale. One only needs to look at the annual report of the listed company, Company AP, to find support for this particular proposition.

24. However, in any event, in relation to the task which we need to embark upon having regard to his evidence, this particular policy is neither here nor there. What we need to look at and

examine is the actual intention which is relevant to the Subject Properties before us. We do not find the schedule to be helpful in that the schedule itself clearly is not completely accurate and on closer examination of the various properties set out in that schedule, some of them were clearly for sale.

25. Mr T drew our attention to the fact that the Taxpayer relied heavily on a feasibility study to show that it intended to rent out the New Building once it had been constructed.

26. However, having had the opportunity to look at and consider the feasibility study document, we consider that this document could be best described as merely some notes and figures that were penned on one sheet of paper which in turn was a very basic calculation as to potential rental income that might be obtained. It is also of interest to note that in that particular calculation, there was a mention of interest costs. However, it is quite clear that since the Taxpayer did not borrow any money to construct the building, it seems somewhat strange that the feasibility study included such a calculation. When this was put to Mr T in cross-examination, he could not give a satisfactory explanation with regard to this particular issue. We are of the view that the feasibility study was never a truly detailed study and we accept Miss Cheng's submissions that this really was a 'back-of-the-envelope' job.

27. Mr T also gave evidence as to the fact that there was a facility letter from Bank AQ dated the 19 August 1992. This provided an offer of a loan of HK$25,000,000 for the construction of the New Building. However, no real explanation was given to us as to why such a facility letter was needed. In his evidence, he made it clear that the Taxpayer had 'massive' funds available to deal with the construction costs. There was evidence before us that the Old Building was previously occupied by tenants and repossession proceedings had to be taken. In his evidence, he indicated that the facility offered by Bank AQ was required to satisfy the court's requirement that the Taxpayer had the means to rebuild. However, we have to say that such an explanation did not make sense and indeed, there was no other witness called to give any further explanation on this particular issue.

28. During his evidence, he drew our attention to the fact that he had previously rejected some offers to buy the site [in Address B] or the Old Building before it was redeveloped, that is, in its original state. He drew our attention to the offer from Company AR in 1991 and a further enquiry from Messrs AF in 1992. However, again, we have to say that these particular offers are irrelevant. There was clear evidence before us that the Taxpayer and Company D intended to demolish the Old Building and erect the New Building in its place. Again, we repeat the issue before us is whether the Taxpayer intended to sell or lease the New Building not what they wished to do with respect to the previous site.

29. Mr T also drew our attention to the second feasibility study that was carried out in 1995 by Messrs AF. In this regard, Mr T's attention was drawn to a letter dated the 9 September 1999 from Messrs Y. There, they drew to the IRD's attention:

> 'Furthermore, in March 1995, a marketing proposal for leasing was done by [Messrs AF] which showed a monthly rental of HK$1,731,947 or a 22.1% return on investment. This is indeed a very attractive investment return.'

30. By a further letter dated the 10 March 2005, again, Messrs Y also indicated to the IRD that Messrs AF were asked to prepare a marketing proposal for the leasing of the property in March 1995. Hence, an impression was given that this was part of the Taxpayer's ongoing efforts to plan to lease out the New Building. On cross-examination, he agreed that he had seen both of these letters and he would have approved them before they were dispatched. However, it is clear that if one looks at Messrs AF's report the so-called study was not a feasibility study. It was just a straightforward marketing proposal prepared by Messrs AF to solicit an appointment as sole leasing agent. Again, on cross-examination, he admitted that the impression given by his tax representatives was not correct.

31. Mr T's attention was drawn to the various sale brochures that were printed in January 1997 to advertise the New Building. It was suggested in his evidence that these brochures were for the purpose of leasing. In particular, we refer to a letter from Messrs AS dated the 31 March 2005 which was written on behalf of the Taxpayer.

32. He was asked to explain why these brochures were not made available to the IRD earlier having regard to the fact that there was a letter from the IRD dated the 20 January 2000 requesting such brochures and advertisements. The Taxpayer's representatives at that time only enclosed a newspaper advertisement which was dated the 5 June 1998. His response was that although he had not seen these particular letters, it was always his family's standard practice to produce brochures for each and every single building for the purpose of leasing. We are of the view that if indeed that was the case, then it would be very simple for the Taxpayer's representatives at that time to have provided the brochures. His explanation for not providing the brochures earlier was that he was of the view that the IRD could no doubt obtain these brochures without having to resort to the Taxpayer. We have to say that we found this explanation somewhat implausible. We will revert to the sale brochures at a later stage when we examine the evidence of the other witnesses called by the Taxpayer.

33. We have given careful consideration to the evidence given by Mr T to us with regard to the negotiation process with the GPA and the state of the property market at that time.

34. We acknowledge that the sale of the Ground Floor and the First and Second Floor represented the 'lion's share' and prime parts of the building. This is illustrated by the fact the Subject Properties amounted to 56.9% of the total value of the Building and the actual assignment shows that 1,440 out of the 2,684 undivided shares went to the Government.

35. Mr T accepted that the Ground Floor, at any rate, was a prime part of the New Building and that the First and Second Floors were valuable but not as much as the Ground Floor.

36. When considering the Taxpayer's intention, it seems somewhat strange, if the true intention was to hold the building for the long-term and to derive income from it, for them to choose to sell over half of it, and indeed the best half, without trying to see what rental income could have been derived from that part.

37. Mr T gave evidence as to the reasons for the sale to the Government. We must have regard to the circumstances of the property market prevailing at the particular time whilst such negotiations were taking place. He confirmed that the property market had been rising and peaked at new heights between July and September 1997. During the course of his evidence, he also indicated that his uncle was always optimistic as far as the property market was concerned and as such, he accepted that his uncle was not keen on selling because he wanted to achieve the best possible price that could be obtained.

38. We have no hesitation in accepting the evidence that the Taxpayer by entering into negotiations with GPA clearly showed that at that time they were interested in selling the Subject Properties.

39. Mr T tried to suggest to us that the price of HK$160,000,000 put to Company AB and in turn, conveyed to GPA on the 20 May 1997, was really just an attempt to test the market.

40. We would comment at this stage that if the Taxpayer's true intention was to keep the premises as a long-term investment, why would they even wish to consider testing the market at that time? In re-examination, he was asked why he would wish to test the market if there was no intention to enter the market. In response, he stated that by testing the market and by obtaining listing prices of neighbouring properties, this might help him to fix the leasing price for the New Building. However, this particular point was never contained in his witness statement nor was it mentioned in cross-examination. In our view, what we have here is the Taxpayer trying to see whether or not they could sell the Subject Properties for more than HK$160,000,000. We find that there was an intention to sell the Subject Properties if the price was acceptable.

41. It is also clear from his witness statement that he increased the price to HK$195,000,000. In his witness statement, he suggested that this was an exaggerated price and was an attempt to try and persuade Company AB to go away. However, on cross-examination, he did not pursue this particular suggestion and accepted that the HK$195,000,000, being 20% to 30% above the market price, was part of the serious negotiation process with GPA. He agreed that this was not a ridiculous price nor was it intended to put GPA off.

42. We also need to have regard to the fact that after July 1997, the property market was cooling off quite considerably. On cross-examination, Mr T accepted the reason for the price drop from HK$195,000,000 to HK$155,000,000 in September 1997 was because of firstly the ongoing negotiating process and secondly the cooling of the property market.

43. Again, the evidence is clear, there was an intention to sell the Subject Properties.

44. We also have no hesitation in finding that it was not only in September 1997 that the Taxpayer was seriously considering selling the Subject Properties.

45. From the evidence before us, Company AB had already asked the Taxpayer to confirm in July 1997 whether the Subject Properties were still available for sale and the answer was an unequivocal yes. In particular, we refer to a letter dated the 18 July 1997 addressed to GPA from Company AB which clearly supports this as well as there to the handwritten manuscript note on that letter which referred to actual area of the premises and the offer price.

46. His evidence also showed that the Taxpayer had permitted and allowed inspections by the GPA in around May and June 1997. There is a series of communications and correspondence between Company AB and the GPA reflecting this.

47. If in his evidence he tried to suggest that he really was not keen to sell, why would he have allowed the continuous negotiations between the GPA and the Taxpayer to take place? We find that throughout this particular period of time, there were ongoing negotiations which demonstrate the Taxpayer' s keenness on pursuing the sale.

48. Mr T also drew our attention to the fact that the discount of 5% (to HK$132,550,000 which the GPA sought after the price had already been agreed at HK$140,000,000) was only reluctantly accepted by them so as not to cause any difficulties or resulting grievance. We have to say that we do accept Miss Cheng' s submissions that if the Taxpayer had genuinely not wanted to sell the Subject Properties, why would they accept an apparently unattractive figure? It was clear from the evidence that the Taxpayer had the necessary financial resources to enable them to hold the Subject Properties had they wished to. In his evidence Mr T took the view that the final offer by the GPA of HK$140,000,000 was a very attractive offer and by mid-October 1997 when he accepted it, the market has started to fall. Again, this reinforces the fact that in our view the Taxpayer was prepared to sell.

49. Mr T accepted that no detailed steps were taken to rent out any other units in the New Building until the market had fallen significantly. It is quite clear that the Taxpayer did not appoint a letting agent until May 1998. Before that date, no efforts had ever been made to try to let out the premises. We note with interest that Messrs AF' s 1995 Marketing Proposal which we have referred to previously was never followed up by the Taxpayer. The appointment of a letting agent in May 1998 was a year after the occupation permit was issued and indeed, six months after they had accepted the GPA' s offer on the 1 November 1997 to sell the Subject Properties. He stated that steps could not be taken to lease the various units in the New Building until the occupation permit had been obtained. The occupation permit having been obtained in May 1997,

when asked to provide an explanation as to why no steps were taken between May 1997 and May 1998 to lease the units, he stated the following:

(a) Firstly, he indicated there was a need to renovate the lobby of the New Building which he said took some months. However, we would comment that this particular point was never raised in a letter dated the 10 March 2004 to the IRD nor did he ever put this forward in his witness statement. This in our view does not really explain why estate agents could not have been instructed to take this matter forward. We do not accept this particular explanation.

(b) Secondly, Mr T drew our attention to the fact that he had tried internally through other estate agents (other than Messrs AE) to let out the building. However, such attempts were unsuccessful. Hence, the reason for Messrs AE's appointment in May 1998. However, again we note that this point was never raised before and in particular, in his witness statement, he made it clear that the only agent appointed in this matter was Messrs AE. He also suggested in re-examination that there was a leasing office in the New Building in the upper floors and perhaps lack of visitors to these upper floors explained the lack of success in the leasing attempt. Again, this was never mentioned by any of the other witnesses.

50. In any event, we do not accept his explanation nor his evidence in respect of this particular issue. We conclude that the only attempt to let out the New Building was when Messrs AE was appointed in May 1998. No steps nor any attempts were taken beforehand to promote the leasing of any units in the building. Indeed, during the course of his evidence, he did not set out any attempts to lease out the units in the New Building. This in our view does not lend support to the Taxpayer's assertion that they intended to hold such an investment for the long term.

51. Further, it is of interest we note that not one single tenant was found for the building until after Messrs AE was appointed.

52. During the course of his evidence, Mr T was asked as to the reasons for the sale of these floors to the Government. It was originally stated in correspondence that having a Government presence in the New Building would 'definitely enhance the traffic flow of the building and therefore would be easier to attract tenants for the other floors'. We refer to the letter dated the 9 September 1999 written by Messrs Y. When asked about traffic flow, Mr T said that what he meant by this was he thought many people would get to know the building by visiting the offices of the Government placed on the premises. However, he did not attempt to find out what Government Department was going to be placed there and in any event, if Government was to purchase the Subject Properties, the Taxpayer would not have had any control over which Department would be housed in the New Building.

53. We accept the submissions by Miss Cheng that an enhancement of traffic flow was really never an argument that could be made out nor one which had substance to it. Regard should also be had to the letter of the 3 February 2004 of Messrs Y on behalf of Company D. In that letter, there was reference to the fact that the sale to Government 'was made in consideration not only as to the price but also the prestige of having presence of a Government Department in the building'. A subsequent letter of Messrs Y on behalf of the Taxpayer, dated 10 March 2004, stated that 'the consensus opinion was that having a Government Department, the building will enhance its image or to help in its promotion of leasing other units'. This cannot be made out. The Taxpayer had at no time ever attempted to find out in advance as to which part of the Government was going to occupy the premises. At the time it was known that the Social Welfare Department was looking for premises. The Social Welfare Department runs numerous services, such as clinics for drug abusers, rehabilitation for criminal offenders, psychology clinics, etc. and it is clear that such potential tenants or uses would not necessarily support the proposition put forward by Messrs Y in their letter. Therefore, we have no hesitation in rejecting Mr T's evidence that a prestigious occupant or enhancing traffic flow was a valid reason for accepting the Government's offer. Moreover, in his evidence, Mr T did accept that his main consideration was the price.

54. Mr T was also questioned over the preparation of the Deed and Mutual Covenant ('DMC'). He indicated that if it was the Taxpayer's intention to sell all the units in the building, it would have prepared a DMC much earlier. However, if one looks at the DMC, it seems that this document may very well illustrate an intention that is inconsistent with an intention to hold the building in the long run. In particular, there was a right to give the Government the ability to rename the building after a period of five years and it was also agreed that the Government would have the right to hold 1,440 out of the 2,684 undivided shares which meant the Government could very well have control over various voting resolutions. In cross-examination, Mr T indicated that it was Company D's solicitors who were responsible for preparing the DMC and he took the view that it must have been the GPA who wished these conditions included. However, there was no evidence from any other parties to support this issue.

55. Having considered Mr T's evidence carefully, we conclude that he had not provided us with any satisfactory evidence to show and support the claim that it was the intention of the Taxpayer to hold and maintain the building for a long-term investment purpose. Indeed, we conclude that the evidence before us would show that there was an intention to trade and not to hold the Subject Properties for the long term.

Mr AN

56. Mr AN informed us that he was responsible for the leasing and selling the real property developed by the Surname F family. He said that he was also responsible for the co-ordination of the compilation and printing of property specifications. He confirmed that he was responsible for the arrangement and compilation of the printing of the specifications in a brochure for the New Building that is the subject matter of the present proceedings before us.

57. However, he indicated that he used the brochure of a previous property known as 'Centre AL' as a blueprint for the brochure for the New Building after making appropriate amendments. Moreover, he confirmed that the words 'sales agents' which appeared on the last page and referred to Company AT and Company AO suggested that the wording on the back page 'sales agents' did not in his view mean that the building was actually for sale.

58. He indicated that the wording 'sales agents' was exactly the same as that which previously appeared in the Centre AL brochures. However, during his evidence, he emphasized the importance of ensuring that the names and logos were correct. He indicated that during his time with the Surname O and Surname F families, no other properties that had been constructed since 1982 had been sold.

59. However, when pressed in cross-examination as to why the words 'sales agents' were included, he was unable to give any satisfactory, coherent or cogent reason for the inclusion of such a wording on the brochures.

60. Indeed, he took the view that he was just following instructions and in the end of the day, any responsibility in respect of this matter was attributable 'to the Company'.

61. However, it is also of interest to note from his evidence that he was aware that the units in the New Building would be leased out. However, it is also clear that he allowed the term 'sales agents' to be placed in the brochures. In his evidence, he again took the view that the focus of the readers' attention was to be drawn to the names of Company AT and Company AO and not the intended description of sale agents.

62. He indicated to us that it was the past practice of the company for units to be leased but when asked why the wording of 'sales agents' were included, he answered that it was due to the fact that it was the same wording that had been used in past brochures and he paid no attention to this particular wording. In short, it was being put to us that the wording of 'sales agents' that found its way on to the brochures was a mistake.

63. In the correspondence dated 31 March 2005 from Messrs AS, they asserted that the reference to 'sales representatives' on the last page of the brochure, was a mistake as the brochure was not for sale of property but for the leasing.

64. However, it is clear that 5,000 copies of the brochures were printed and the total cost amounted to HK$75,000. Mr AN also admitted that the pricelists in respect of these particular brochures were printed separately.

65. Mr AN also indicated to us that these brochures in his understanding had never been distributed to the public. He also asserted the wording could have been changed at a later stage from sales agents to leasing agents if it would not be too late to do so.

66. In our view, this explanation does not seem credible and in our view, the wording 'sales agents' on the brochure was not a mistake. Again, we conclude that this is another example to illustrate the Taxpayer's intention not to hold the Subject Properties for the long term.

Mr AI

67. He advised us he had been working as an estate agent since 1989 and had over 17 years' experience in the property market and estate agency business. He had joined Company AB in 1993. He had known Mr T of the Surname O family for some years and kept in regular contact with him and Mr AC. He also indicated to us that some time prior to March 1997, he had learnt from Mr AC that there was a property being redeveloped at Address B and that the redevelopment was close to completion.

68. He was keen to obtain some information with regard to this particular property. As usual, he asked Mr AC for information about the development to see if Company AB could offer any services to them. He indicated to us that at that time the property market was booming and that he was eager to know whether or not they would entertain the possibility of selling the development.

69. He confirmed to us that he had asked Mr AC if his boss would consider selling and the response he got was that he could not exclude the possibility but everything would depend upon the price and circumstances.

70. In his witness statement, Mr AI said that a colleague of his, Mr AH, had received an enquiry from GPA who indicated that they were looking for commercial space. Mr AI's witness statement may seem to suggest that it was GPA who perhaps initiated the process leading up to the sale. In cross-examination, he confirmed that as stated in a letter he wrote on the 26 February 2004, he could not recall or was unable to ascertain whether it was the Government or the Taxpayer which had first expressed an interest in the sale. During the course of his evidence, Mr AI also indicated that his attention was only on the buying and selling side and he was not involved in any leasing of the premises.

Mr AC

71. Mr AC was a Senior Business Manager of Company W. His duties were to take care of the leasing and selling of properties developed by the Group of Companies and those companies of the Surname O family. He informed us that Mr T appointed him to deal with various enquiries relating to the New Building.

72. In early 1997, he advised us that Mr AI and Mr AH of Company AB contacted him to enquire as to the leasing and/or selling of the new property. He was asked if his boss (Mr T) would sell the various units. In turn, he replied that his boss would consider selling the property dependent upon circumstances and price.

73. In his evidence, he confirmed that all that Company AB was trying to do was to find out whether or not the property was available and whether or not it was worthwhile for them to find a buyer.

74. We accept that it was Mr AC who was dealing with Mr AI and Mr AC took the view that all that Company AB wanted to do was to find out whether or not it was intended to put the Subject Properties on the market so that a buyer could be sought.

75. In the course of his examination, he confirmed that he did not ask Company AB to do the leasing of the New Building units.

76. It is also of interest to note that during the course of his evidence and in particular in cross-examination, he did not give any precise information as to what steps were taken to promote the leasing of the New Building. He indicated that agents were telephoned but he did not provide us with any concrete and succinct evidence as to the actual steps taken with regard to the marketing and leasing of the New Building.

Ms AU

77. Ms AU was employed by Messrs AF as a Negotiator in their Commercial Department. Ms AU gave evidence that if one was constructing a building for the purpose of leasing one would generally appoint leasing agents well in advance of completion of the building because work needs to be done in order to prepare for the marketing of the building in question.

78. During the course of her evidence, she said that the New Building could be described as a pencil building. She indicated that the reason why Messrs AF did not take this matter up because it really was not 'their cup of tea', and as such they were not interested. However, during the course of her evidence, she did indicate that for a building such as the New Building, she would have expected that a leasing agent would have been appointed around a year, or at least six months, before the building was completed. She also confirmed that six months would be considered to be quite tight. She indicated that time was needed to prepare the relevant brochures and marketing materials. It is also clear from her evidence that Messrs AF's 1995 Marketing Proposal was not taken up by the Taxpayer.

Mr AV

79. Mr Stewart Wong, Counsel for the Taxpayer ('Mr Wong') indicated that he was not in a position to call Mr AV but asked us to look at his witness statement.

80. We have considered his witness statement but since he was not available for cross-examination, we attach no weight to the evidence contained in his statement.

Company D's Position

81. As we have previously indicated shortly before this appeal was heard, Company D withdrew its appeal. We accept the submissions of Mr Wong that we should draw no inference from Company D' s payment of tax and withdrawal of their appeal. There may be many reasons as to why it took such a course of action but it will not be right for us to speculate one way or other.

Conclusions

82. We have carefully considered and reviewed the evidence and considered all the factors and submissions put to us by both parties. However, in our view the Taxpayer has not discharged its burden of proof to our satisfaction that it had acquired the Address B site with the intention of holding the New Building for a long term investment purpose. Indeed, it is clear from the evidence that this was indeed not the case. We therefore have no hesitation in dismissing the appeal and upholding the Assessment confirming that the correct calculation in respect of the assessable profits should be HK$48,431,067 (after set off of the loss brought forward of HK$156,018) with tax payable thereon of HK$7,192,013. Finally, we wish to thank the parties for their assistance in respect of this appeal.