Case No. D65/88

Appeals – mistake by tax representative alleged – need for evidence.

Profits tax – sale of flats acquired on roll-over of a capital asset – whether such assets are themselves capital assets – whether profits were trading gains or realization of capital – s 14 of the Inland Revenue Ordinance.

Profits tax – sale of flats – whether profits were trading gains or realization of capital – evidential factor: sale due to low rate of return as a result of rising property market – s 14 of the Inland Revenue Ordinance.

Panel: Henry Litton QC (chairman), David B K Lam and Edwin Wong.

Dates of hearing: 12 to 16, 20 and 21 December 1988.
Date of decision: 20 January 1989.

The taxpayer company owned a property which it clearly held as a capital asset. It entered into an arrangement with a developer to redevelop the site. Under this agreement, the taxpayer sold the property to the developer for $320,000,000 and agreed to buy back 52 flats in the completed development for $80,000,000. These 52 flats constituted about 25% of the completed development: they contained the same floor area as the taxpayer previously owned, and they were expected to return at least the same or more rental income as the taxpayer previously received.

The 52 flats were not offered for sale at the time the developer marketed the remaining flats, at which time the taxpayer could have realized substantial profits.

Eighteen months after the agreement had been entered into, the taxpayer received an unsolicited offer to purchase its 52 flats at an even more substantial gain. Because of substantial increases in the property market, the anticipated rate of return from the property based on the price offered was markedly reduced, and the price was too good to reject. The taxpayer therefore agreed to sell the flats.

Before the sale was completed, the property market sharply declined. The purchaser proceeded to buy only nine flats, and forfeited deposits totalling $79,338,766 with respect to the remaining 43 flats. Due to the unfavourable property market, the taxpayer decided to rent out the 43 flats.

The IRD assessed the taxpayer to profits tax with respect to its profits from the resale of the nine flats and the amount of the forfeited deposits. The taxpayer appealed,

arguing that it had acquired the 52 flats for rental purposes as a capital investment and that the proceeds were therefore of a capital nature.

The taxpayer had no borrowings. It owned one other property for rental-producing purposes.

The taxpayer's representatives had admitted in correspondence with the IRD that the company had always intended to sell the property. Such an admission was most prejudicial to the taxpayer's case. Before the Board, the taxpayer challenged the correctness of this admission. It explained that the director who had been put in charge of liaising with the tax representatives had not been familiar with the taxpayer's intentions and had approved the admission out of ignorance. The director concerned appeared as a witness and confirmed this.

Held:

The gains were of a capital nature and not taxable.

(a) The sale of the property to the developer and the 'buy-back' of the 52 flats constituted one transaction. Because the sale of the property to the developer was clearly on capital account, there is no reason to assume that the taxpayer was engaged in trading with respect to the 52 flats which it agreed at the same time to acquire. It would be artificial to treat the acquisition as a separate and distinct transaction.

(b) The taxpayer's intention was to hold the 52 flats for rental purposes. The flats were therefore acquired as capital assets, and their disposition was on capital account.

(c) Generally, a statement made by a firm of accountants as to its client's intentions are presumably made after proper consideration. However, the evidence led by the taxpayer showed that the statements made by its tax representatives in this case were wrong and that the facts were different. The statements would therefore be disregarded.

Appeal allowed.

B W K Whaley for the Commissioner of Inland Revenue.
Robert G Kotewall instructed by Johnson, Stokes & Master for the taxpayer.

Decision:

1.1 This appeal by the taxpayer company (the company) concerns a profits tax assessment for the year ending 31 March 1984. The profits arose from the completion of an agreement entered into between the company and X Limited dated 17 May 1983, the effect of which was as follows:

(i) the company sold to X Limited 9 flats and 15 carparking spaces in P Building, then newly completed, for a consideration of $45,937,575, and

(ii) the company forfeited deposits paid by X Limited totalling $79,338,766 in respect of the sale of a further 43 flats and 51 carparking spaces which X Limited had previously agreed to purchase from the company but was unable to complete.

1.2 The profits arising from the transaction, as recorded in the company's books, were accordingly as follows:

(i) profit on the sale of the 9 flats and 15 carparking spaces: $9,654,520, and

(ii) the forfeited deposits totalling $79,338,766.

1.3 As regards the item of profit amounting to $9,654,520, this appeared in the company's financial statements for the year ending 31 March 1984 as an extraordinary item, although a provision for tax was made in the sum of $1,593,000.

As regards the forfeited deposits of $79,338,766, these were not offered for assessment in the company's profits tax return but were applied to reduce the cost of the flats in the new P Building, after making a tax provision of $15,327,000.

1.4 The assessor treated these two items as profits arising in and derived from the carrying on of a trade or business by the company and assessed the company accordingly under section 14 of the Inland Revenue Ordinance.

1.5 On the company objecting against the assessment to the Commissioner, the assessment to profits tax in respect of the forfeited deposits was confirmed but the amount of assessable profits in respect of the sale of the 9 flats and 15 carparking spaces was increased to the sum of $22,670,549.

1.6 The company has not appealed against the increase in the assessable profits by the Commissioner from $9,654,520 to $22,670,549, but argues that none of the profits are assessable under section 14 of the Inland Revenue Ordinance.

1.7 The burden of proof is, of course, on the company to satisfy us that the assessment is erroneous. The company's case is that it did not, at any material time, embark upon any business or adventure in the nature of trade from which the profits in question were derived.

Background Facts

2.1 The company was incorporated in 1952 and has, as its first object, the following:

> ‘ (a) To acquire by purchase, lease, exchange, or otherwise land, buildings ... and any rights over or connected with such land, buildings ... and to develop and turn the same to account as may seem expedient’.

2.2 The subscribers to the memorandum of association of the company were respectively Mr A and Mr B. The shares in the company have at all times been owned by members of the two families.

2.3 The company has, from time to time, engaged in trading in shares and in foreign currencies. The profits from these ventures have been reflected in the profit and loss accounts. As regards real estate, however, the company has, since 1952, owned only two properties as follows:

(i) 50% of Property Q from which the company has, throughout, derived rental income.

(ii) Property R which was developed by the company as P Building. The first block of flats forming P Building was completed in 1957 and a further two blocks were completed in 1960, making a total development of 110 flats. Four flats were occupied by Mr B and his family for their own use and the rest of the flats were let to tenants for rental income.

2.4 By an agreement dated September 1978, the company agreed to sell the entire P Building property to Y Limited for a consideration of $320,000,000. The company undertook to submit general building plans within one month of the date of the agreement for approval by the Building Authority to the redevelopment of the site comprising the following:

(a) 709,600 square feet of gross domestic building floor area;

(b) 17,170 square feet of gross non-domestic floor area; and

(c) 173,300 square feet of carparking spaces.

Completion of the sale and purchase was to take place within seven days from the receipt by Y Limited of notification from the architect of the approval of the general building plans, with a proviso for cancellation of the sale if the general building plans were not approved within five months. By the same instrument, the company agreed to purchase from Y Limited 60 new flats with a gross covered floor area of 170,000 square feet (at a

price of $730 per square foot) and also 100 carparking spaces (at a price of $40,000 per carparking space).

2.5 As regards payment by the company to Y Limited, the agreement provided for an immediate payment of $8,000,000 as deposit for the 60 flats and 100 carparking spaces, and a further sum of $72,000,000 as further deposit on the date of completion of the sale of the property to Y Limited. As regards the balance of the purchase price for the 60 flats and 100 carparking spaces, the agreement provided that this should be paid 'in the same manner and proportion and in accordance with payment schedule required by [Y Limited] for advance sale of flats from other purchasers of other flats in the proposed new building payable from time to time in relation to building progress. The intention of the parties ... is that not more than 60% of the balance of the purchase price of the said 60 flats and 100 carparking spaces shall be payable until seven days after the issue of the occupation permit of the proposed new building'.

2.6 Under the agreement of September 1978, Y Limited was required to pay a deposit of $32,000,000. The result of the buy-back arrangement regarding the 60 flats and 100 carparking spaces was that Y Limited's obligation regarding the payment of the deposit was reduced by $8,000,000. As to the balance of the purchase price of $320,000,000 to be paid on the date of completion, Y Limited's obligation to pay was reduced by the buy-back arrangement by $72,000,000.

2.7 Sometime after September 1978, and after completion of the sale of the P Building property to Y Limited, the plot ratio for the site was increased. This enabled Y Limited to undertake a higher density of development. The building plans were radically changed and this in turn led to a modification of the agreement between the company and Y Limited with the result that, ultimately, 52 flats (but still having a total approximate floor area of 170,000 square feet) and 82 carparking spaces were agreed to be sold back to the company by Y Limited.

<u>Sale to X Limited</u>

3.1 In April 1980, when the site was under development, the company entered into an agreement with X Limited for the sale of its interests in the 52 flats and 80 carparking spaces. The average price per square foot for the flats agreed to be sold to X Limited represented a very considerable increase on the price under the Y Limited agreement: from $730 per square foot to $1,525 per square foot.

3.2 By a supplementary agreement in May 1982, the number of carparking spaces agreed to be purchased by X Limited was reduced from 80 to 66.

3.3 In the latter part of 1982, the property market in Hong Kong went into a sharp decline. X Limited did not want to complete the purchase of the 52 flats. This led to negotiations between the directors of the two companies. Eventually, the rescission agreement of May 1983 (referred to in paragraph 1.1 above) was entered into whereby the

company and X Limited agreed to complete the purchase of nine flats together with 15 carparking spaces, and also agreed to the cancellation of the purchase of the remaining units and the forfeiture of the deposits totalling $79,338,766 by the company.

3.4 The remaining units and carparking spaces have since been retained for rental income.

Trade or Investment

4.1 Apart from the relatively short space of time between the date of agreement to purchase the flats and carparking spaces from Y Limited (September 1978) and the sale of the same to X Limited (April 1980), a space of approximately eighteen months, there is nothing to indicate from the recital of facts so far that the company intended to embark upon an adventure in the nature of trade.

It is plain, and this is accepted by the Commissioner, that up to the date of the agreement with Y Limited (September 1978) the P Building property was, in the hands of the company, a capital asset. P Building was developed by the company in stages for investment income and, for many years, the company derived rental income from the letting of the units in P Building, in the same way as it derived rental income from the flats it owned in Property Q. Indeed, the profit which the company derived from the sale of the property to Y Limited was accepted by the Commissioner as a capital profit.

The Commissioner, in his determination, treated however the buy-back of the 60 flats and the 100 carparking spaces under the agreement of September 1978 as a separate and distinct transaction which he thought could be severed from the sale of the P Building property. It seems to us that this is an artificial way of looking at the matter. The reality is that the parties entered into the transactions simultaneously and by the same instrument. As we have mentioned in paragraph 2.6 above, the effect of the arrangement was that the purchaser Y Limited was relieved of part of its obligation to pay the deposit under the transaction and, upon completion, its obligation to pay the full purchase price was diminished by $72,000,000. We see no logical basis upon which the transactions should be severed. If the sale of P Building property should properly be regarded as the sale of a capital asset, we see no reason why the buy-back of approximately one quarter of the development, under the arrangements as we have summarised above, should, ipso facto, be regarded as evidence of the company's intention to embark upon an adventure in the nature of trade. The company was in the comfortable position of having realised a capital profit on the sale of the property and was relieved of all the expense and trouble of redevelopment but would, on completion of the redevelopment, get back as much gross floor area in the new building as it formerly owned. What was the reason for the company to embark upon an adventure in these circumstances?

4.2 At the hearing before us, it was strongly argued by Mr Whaley, on behalf of the Commissioner, that there is evidence to show that, by the time the agreement with Y Limited was made (September 1978), the company had formed the firm intention of

re-selling the 60 flats and 100 carparking spaces. What is suggested on behalf of the Commissioner is that the only reason for purchasing the 60 flats and 100 carparking spaces from Y Limited was that the company had resolved upon a trade and that the purchase from Y Limited was for the purpose of re-sale. Mr Whaley argued that, whilst this might have been a 'one-off' transaction, a 'one-off' transaction can nevertheless be an adventure in the nature of trade (see Marson v Morton [1986] STC 463) and this, it was argued, was precisely what the company here intended. Mr Whaley placed much reliance upon two pieces of evidence:

(i) a letter dated January 1985 written by the company's tax representatives objecting to the profits tax assessment in this case in which the tax representatives said:

> 'We understand from our client that it was always the intention that the property comprising the original site would be sold in its entirety ... As indicated above, the original site was to be sold outright, and it was for this reason that the company contracted to sell the new flats to [X Limited]. This transaction merely represented the final phase of the realisation of the profit from the disposal of the original site and as such would have been capital in nature had it in fact been received ... Therefore, although the new flats were to be sold, they were fixed assets of the company, held for investment purposes, effectively representing part of the original site.'

(ii) in the minutes of the company's directors' meeting dated 4 October 1983, concerning the cancellation of the X Limited agreement and the forfeiture of the deposits paid by X Limited, the chairman's report (in referring to the remaining units left in the company's hands) said: 'owing to the unfavourable market conditions, the company has decided to let out the 43 residential flats left'. This led Mr Whaley to argue that, but for the 'unfavourable market conditions' the company would most probably have found another buyer and sold the remaining units.

4.3 It seems to us that point (ii) above constitutes scant evidence of what the company intended in September 1978 when the Y Limited agreement was made. By the time of the meeting (4 October 1983), the company had, of course, decided to sell the units: it could hardly have entered into the X Limited transaction without intending to sell. A reference in the chairman's report to the conditions which led X Limited to renege on its agreement to buy could hardly constitute real evidence of what the company intended a few years before when the agreement with Y Limited was made.

4.4 The letter dated 10 January 1985, referred to in paragraph 4.2(i) above is, however, a very different matter. It contains a positive statement of the company's intention which, of course, is a matter of fact. It would be a reasonable assumption that, before a firm of accountants puts forward a statement like that on behalf of its client, it has satisfied itself that the factual foundations for such a statement are correct. The statement is clear and

unequivocal. The accountants state their understanding to be that 'it was always the intention that the property ... would be sold in its entirety'.

4.5 At the hearing before us, the case as put forward on behalf of the company is that the company at all times intended to retain the new flats and the carparking spaces at P Building for rental income and that, when the Y Limited transaction of September 1978 was entered into, the company had no intention to sell. In substantiation of this point, there was put before us a price list for the flats offered for sale by Y Limited dated 'August 1979' which sets out the units in the new P Building available for purchase, together with their offer prices, but not including the company's 52 flats. In other words, they were not being offered for sale.

(We should add in parenthesis that what was put before us was a photocopy of one sheet only with the date 'August 1979' apparently typed onto the sheet and a certificate of Y Limited certifying that this was a 'certified true copy'. No original brochure was produced in evidence before us, nor have we seen the original from which the photocopy was made. This exhibit hardly constitutes the best evidence available but, as no objection to the admissibility of the document was raised by the Commissioner's representative, we allowed it to be adduced in evidence.)

4.6 This price list goes some way to show the company's intentions at about that time. The directors of the company and of Y Limited were on friendly terms. If the company's intentions were to offer the flats for re-sale, it would have been a simple matter to have constituted Y Limited the company's agent for that purpose and to have included the 60 flats in Y Limited's sales brochure. The prices at which the new P Building flats were being offered for sale in the brochure ranged from $1,330 per square foot to $980 per square foot. The higher in elevation, the higher the unit price. The 52 flats agreed to be purchased from Limited occupied the middle section of the tower blocks and, based upon the prices set out in the price list, the 60 flats could well have been offered at prices between about $1,160 per square foot to $1,245 per square foot, a very considerable increase on the purchase price of $730 per square foot. It seems to us that this constitutes fairly strong evidence that the case put forward on behalf of the company at the hearing is correct, namely, that at the material time there was no intention to re-sell the flats.

The oral evidence

5.1 At the hearing before us, a number of witnesses were called on behalf of the company in support of its case. They were as follows.

5.2 Mr B

Mr B is now 79 years of age. He founded the company together with Mr A in 1952. No evidence was adduced before us with regard to the precise shareholding in the company from time to time, but the impression we gained from the evidence is that, as Mr B and Mr A became older, more and more of their personal shareholdings were transferred to

their sons and nephews. Mr A died in June 1979 and the impression we formed from the evidence is that, prior to Mr A's death, the dominant minds of the company were in fact Mr B and Mr A although their sons and nephews did, in fact, participate in the decision-making processes of the company.

5.3 Mr B gave evidence to the effect that in the late 1970's he discussed with Mr A the possibility of redeveloping the P Building site to increase the floor area for rental purposes. Plans were drawn up for two tower blocks with a total floor area of about 650,000 square feet. Discussions were then initiated with well-known local developers with a view to forming a joint venture to redevelop the site. Mr B said that eventually the decision was made to sell the entire property but to retain approximately one quarter of the redevelopment (amounting to approximately 170,000 square feet) for rental income. This led, eventually, to the agreement with Y Limited of September 1978.

5.4 Whilst a bare declaration of intent by a self-interested witness would not, by itself, carry much evidential weight, Mr B's evidence was corroborated to some extent by the minutes of a directors' meeting held on 5 September 1978. This was a formal meeting in the sense that the directors actually met together to discuss the matters in issue and there was a secretary present who took notes of the matters for the record. Minutes were then produced from these notes which were put into the hard-covered minute book of the company and signed as correct by the chairman at the next meeting.

5.5 The minutes of the directors' meeting of 5 September 1978 (which were almost contemporaneous with the Y Limited agreement) dealt with a peripheral matter. Up to that time, the company offered 'specially preferential rates' to directors who rented flats in P Building. Mr B as chairman proposed at the meeting that this should be abolished in the case of the 60 flats 'recently bought back'. However, in view of the directors' 'considerable contribution to the company, the merits of which should not be forgotten', Mr B proposed that the directors should be given a one-off payment of $100,000 by way of a 'house allowance'. This proposal was adopted by the directors.

5.6 Whilst the minutes of 5 September 1978 are by no means conclusive, they are consistent with Mr B's evidence regarding the company's intentions.

5.7 Mr B gave evidence, which we accept, to the effect that the company did nothing to solicit offers to purchase the units. A wholly unsolicited offer was made to one of the directors of the company, Mr C, by Mr E. By that time Mr A had died and, from the tenor of Mr B's evidence, it appears that the impetus for the decision to sell came from the 'younger generation' and Mr B went along with the decision to sell. It appears that the decision to sell was made within a fairly short span of time – a matter of a few weeks.

5.8 <u>Mr F</u>

Mr F is the son of Mr B. He became a director of the company only in September 1978. His evidence added little to the case for the company. He said in evidence

that his understanding was, all along, that the company intended to retain the redeveloped property for rental income. This was a view which he derived from his father and Mr A. We attach no weight to this evidence.

5.9 Mr G

Mr G is a solicitor and his firm acted for the company in the Y Limited transaction in 1978. Mr G is an old friend of Mr B and, for the past 17 years or so, they have met each other for coffee practically every morning.

6.1 Mr G gave evidence to the effect that he drafted the Y Limited agreement as one package because that was how the parties regarded the transaction. Effectively, the agreement resulted in the site being redeveloped and the company having a slice of the redevelopment without becoming involved in the details. Mr G also gave evidence to the effect that, after the redevelopment, the company would be able to derive as much rental income, if not more, from the flats than before the redevelopment. Whilst we do not regard this as strong evidence of the company's intentions, coming as it does at least at second-hand, it is certainly evidence consistent with the company's case.

6.2 Mr C

Mr C is the eldest son of Mr A and, since 1975, he has been a director of the company.

6.3 Mr C gave evidence to the effect that, at a meeting on 30 August 1978 with his late father, Mr A, Mr B, another director and himself, a decision was made to redevelop the P Building site in partnership with a third party. Mr C produced in evidence a minute of that date, which he himself had made shortly after the meeting, which stated, among other matters, as follows:

> 'The company would purchase 170,000 square feet, 100 car parks and the mid-levels of the two towers at a cost of $550 per square foot. This would bring in a net rental income, after all expenses, of approximately 8M. It was also decided that a special board meeting should be called urgently on 31 August to approve this policy.'

6.4 The production of this minute was unchallenged by Mr Whaley and we accept it as a minute made by Mr C, shortly after the meeting, of what was discussed at the meeting. It is clear from this note that the directors of the company were, at that time, thinking of retaining the 170,000 square feet and the 100 car parks for rental purposes.

6.5 Mr C also said in evidence that, from his discussions with his late father, Mr A, from time to time, he understood the policy of the company had always been to hold the P Building property for rental income.

6.6 Mr C also gave evidence to the effect that, on 24 October 1979, at a lunch to which Mr E had invited him, Mr E offered to purchase the company's interest in the redeveloped P Building. This was totally unsolicited. At a cocktail party on 1 November 1979, Mr E pressed Mr C for an answer. Eventually, Mr C received an offer in writing (dated 13 December 1979) from Mr E's company to purchase the flats at a price of $1,525 per square foot. In the meanwhile Mr C discussed the offer with Mr B and, on 9 November 1979, a directors' meeting was held to discuss the matter. The minutes of this meeting were also put before us. There was no mention of the identity of the party making the offer because, according to Mr C's evidence, Mr E had wished the identity of the offerer to be kept confidential at that stage as it was a public company and, according to the stock exchange rules, this would have been a notifiable transaction. The minutes record the proposal put by the chairman Mr B in the following terms:

> ' According to the current market price, the transacted price for higher level residential units in the new P Building is $1,700 per square foot; even the lower level units fetch $1,300 per square foot. If calculated at 6% (on return of investment), the monthly rent per unit should be as high as, say, $35,000. Such being the case, to be able to afford the rental, a tenant's income should be at least $1,500,000 per annum. Even rental allowances for Government servants and diplomatic personnel cannot reach this level. Therefore, I am of the opinion that after completion, if these units are intended for leasing purposes, it might prove difficult to obtain such high rentals and we could only get about 6% per annum – a great difference when compared with the existing 14% to 15%. I therefore propose that it would be better to sell our 52 residential units in the new P Building ...'
>
> The proposal was adopted.

6.7 Mr H

Mr H returned to Hong Kong from overseas studies in 1978 and was appointed a director of the company on 5 September 1978. He was then only a very 'junior' director of the company and took no part in the decision-making process with regard to the sale of the property. He was simply told by his father, Mr A, of the agreement with Y Limited. As regards the sale to X Limited, again he was not consulted nor did he take part in the negotiations. He said in his evidence: 'I was simply told of the transactions by my brother, Mr C. At that time I had no knowledge of what went on. I was simply told the end result'.

6.8 The statements which we have put in quotations in the paragraph above have caused us some anxiety because we note that, in the minutes of the meeting of 9 November 1979, Mr H was recorded as being present at that meeting. However, he was not cross-examined as to that and the position, at the end of the case, was that his statement to the effect that he did not know what was going on within the company at the time of the Y Limited and X Limited agreements was not contradicted by evidence.

6.9 Mr H gave evidence to the effect that it was he, and he alone, who had dealings with the tax representatives at the time when the company objected to the tax assessment. He was the person who had responsibilities for the day-to-day affairs of the company and he was simply told to deal with the tax dispute on behalf of the company. At that time, Mr B was already fairly elderly and did not work out of the offices of the company; Mr C was extremely busy with other important affairs; and Mr F was also preoccupied with other matters and was frequently absent from Hong Kong. The result was that Mr H consulted no one else in the company when it came to giving instructions to the tax representatives and he simply assumed that the matters stated in the letter from the tax representatives dated 10 January 1985 were correct. It was only recently, when he came to discuss the appeal with Mr B and Mr C, that he realised that the statement to the effect that the company always intended to re-sell the flats was incorrect.

Our findings

7.1 The matter which has given us the greatest anxiety is, naturally, the veracity of Mr H's testimony. At first blush, the casual way in which the tax objection was dealt with seemed improbable. However, having regard to all the evidence which has been adduced, we conclude that Mr H was telling the truth. At the time when Mr H was giving instructions to the accountants, the accountants must have been in possession of the background facts as we have summarised in paragraphs 1.1 to 3.4 above. With those facts in their possession, the accountants might well have concluded that it made little difference precisely when the company resolved to sell the 52 flats. They might well have concluded that, whenever the decision to sell might have been made, the profit on the 9 flats sold to X Limited and the forfeited deposits would not have been chargeable to profits tax under section 14 of the Ordinance. Therefore, the kind of detailed enquiry into background facts which one might expect accountants to have normally conducted before making a statement of intention of behalf of a client was simply omitted in the present case. Whilst we make no finding to this effect, this is a possibility arising from the circumstances of this case which we bear in mind.

7.2 Mr B and Mr C were both hard-pressed in cross-examination regarding the tax representatives' letter of 10 January 1985. They both stated that they had nothing to do with the instructions given to the tax representatives. We accept their testimony in this regard.

7.3 It seems to us that, apart from the letter of 10 January 1985, the evidence in its cumulative effect in support of the company's case is quite overwhelming. Putting aside for the moment the testimony of Mr F and Mr G, we have two of the principal decision-makers of the company, Mr B and Mr C, giving evidence which was quite unequivocal that the company had, until the wholly unsolicited offer to purchase was made by Mr E, intended to retain the 52 flats and 80 carparking spaces for rental income. Mr B was one of the two founders of the company and, from its inception, one of the principal decision-makers of the company. Mr C was Mr A's eldest son and, sometime after Mr A's death in June 1979, became the deputy chairman of the company. Their testimony was entirely credible and was consistent with all the documentary evidence which was put before us. (By documentary

evidence we mean the price list, the minutes of directors' meetings and Mr C's note of the meeting held on 30 August 1978.)

7.4 As regards Mr F's evidence, this did not carry the case for the company very far since most of his understanding of the company's intentions seemed to have been derived from his father Mr B. However, his evidence was consistent with the company's case. He thought the price offered by Mr E was a 'very good one' and that it was 'too good an offer to turn down at that time'. This seems to us to be entirely credible. As events turned out, Mr F's assessment was right: the price offered by X Limited to purchase the 52 flats was, having regard to eventual developments in the market, far too high and resulted in X Limited being unable to complete the April 1980 transaction.

7.5 As regards Mr G's evidence, whilst he was unable to give any direct evidence regarding the intentions of the company's directors, he himself not being a director, one piece of evidence from him did carry some weight. It is this: his understanding of the Y Limited agreement which he drafted was for the purchaser Y Limited to redevelop the site and, after the redevelopment, for the company to retain a number of flats with a view to obtaining as much, if not more, income than from the old development. Mr G's testimony was attacked by Mr Whaley on a number of grounds: that he was a close friend of Mr B and therefore unable to give objective evidence, and that he was equivocal in his answers at to whether he knew that the company's intentions were a 'crucial issue' in this case. We have borne these observations in mind when we conclude that Mr G gave truthful testimony. Whilst his <u>understanding</u> of the company's intentions cannot, by itself, establish those intentions as a matter of fact, his understanding is certainly consistent with the company's case.

7.6 The reality is that the company was, at the time when it entered into the Y Limited agreement, in a very strong position. There was no particular reason for it to embark upon an adventure in the nature of trade with regard to the flats and carparking spaces purchased from Y Limited. It had already made a handsome capital profit on the sale of the property to Y Limited. It was, at that time, collecting rent on the old P Building property and on Property Q. The price of $730 per square foot on the new flats was by no means a high and risky price. On Mr B's evidence, which we accept, it was at a slight discount to market value. It was at what Mr B called a 'friendship price'. The company had no borrowings which it might have been required to repay out of the proceeds of re-sale. All these factors tend to show that the company regarded the flats bought-back from Y Limited as investments for rental income.

7.7 In short, apart from the fact of sale of the flats and carparking spaces to X Limited within approximately 15 months of the Y Limited agreement, there were no activities at any material time which indicated that the company had embarked upon a trade or business in respect of the flats and carparking spaces. As regards the circumstances of sale, these were wholly consistent with the realisation of a capital asset. These circumstances were described by Mr C (see paragraph 6.6 above) whose testimony in this regard we accept.

7.8 We note, of course, that the case as put to us on behalf of the company is different from that appearing in the tax representatives' letter of 10 January 1985. Accountants are, of course, not infallible and when something like this occurs it behoves the Board of Review to examine with astuteness the evidence as presented to it, bearing in mind the fact that such evidence is in contradiction with the previous statement. However, at the end of the day, our function is to evaluate all the evidence, including the evidence contained in the letter of 10 January 1985. It seems to us, however, that Mr Whaley puts the matter far too high when he says that only clear evidence of a genuine misunderstanding of its instructions by the tax representatives could 'conceivably enable the company to now go behind the case as then presented on its behalf'. It is no part of our function to embark upon a separate enquiry as to how the 'misunderstanding' arose. In any case, upon the basis of the instructions the tax representatives then received, there was no misunderstanding. Mr H has explained to us that he simply gave instructions to the tax representatives based on his own understanding of the position, without consulting the other directors. Whether, in these circumstances, the tax representatives should have simply accepted the say-so of a director (and a junior one at that) without looking at the primary material such as the minute book or the company's records (which included Mr C's minute of 30 August 1978) is quite beside the point. The tax representatives' conduct of the case on behalf of their client (whether it be careful or careless) cannot alter the primary facts.

Conclusion

8.1 In our view, the profits realised on the sale of the flats and carparking spaces were profits on the sale of capital assets. It follows that the appeal is allowed and the assessment to profits tax is discharged.