Case No. D66/00

Profits tax – real property – whether the gains arising from the disposal of a property was liable for profits tax – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance (' IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Robert Kwok Chin Kung and Gidget Lun Kit Chi.

Date of hearing: 28 August 2000.
Date of decision: 13 October 2000.

The taxpayer was incorporated as a private company in Hong Kong. On 22 June 1989 Property 1 was assigned to the taxpayer for a consideration of $118,080,000. By a provisional agreement dated 25 February 1992 the taxpayer agreed to sell Property 1 to a purchaser at a price of $143,000,000. The sale was completed on 22 May 1992. After disposal of Property 1 the taxpayer had become dormant.

The taxpayer contended that Property 1 was acquired as long term investment for rental purpose and the taxpayer had no intention to trade Property 1 at the time of acquisition. The taxpayer originally intended to redevelop Property 1. However during the construction period, Property 1 was sold as a result of an unsolicited offer.

Held:

1. There was no evidence that it was the taxpayer' s intention to hold Property 1 on a long term basis for rental income. Nor was there evidence on whether, and if so, why the redevelopment was thought to be a viable investment. Further there was no evidence that it was the taxpayer' s intention to construct a new building and to hold the new building on a long term basis for rental income.

2. The contended intention to acquire as capital asset was unrealistic and unrealisable if the taxpayer and its ultimate holding company or companies were financially capable of acquiring but incapable of keeping on a long term basis.

Appeal dismissed.

Cases referred to:

Marson v Morton [1986] STC 463
Lionel Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750
Leomark Holdings Limited v Chik Ho Ming
HC Action No A3065 of 1997, 28 April 2000, unreported
Re ISC Computer Distribution Limited [1996] 3 HKC 440

Ng Yuk Chun for the Commissioner of Inland Revenue.
Phillis Loh Lai Ping, instructed by Ivan Tse Tak Ming Certified Public Accountant for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 7 April 2000 increasing the profits tax assessment for the year of assessment 1992/93 under charge number 1-7700003-93-7, dated 7 April 1995, showing net assessable profits of $11,339,442 (after setting off loss brought forward of $1,982,946) with tax payable thereon of $1,984,402 to assessable profits of $13,109,348 with tax payable thereon of $2,294,135.

The agreed facts

2. Paragraphs (1) to (21) under the ' facts upon which the determination was arrived at' in the determination were agreed by the Taxpayer and we find them as facts.

3. The Taxpayer has objected to the profits tax assessment for the year of assessment 1992/93 raised on it. The Taxpayer claims that the profits it derived from disposal of a property should not be assessed to profits tax.

4. The Taxpayer was incorporated as a private company in Hong Kong on 9 August 1985. At the relevant time, the directors and shareholders of the Taxpayer were:

Directors

	Appointed on	**Resigned on**
Mr A	21-2-1986	22-6-1989
Mr B	21-2-1986	22-6-1989

Mr C	22-6-1989	-
Madam D	22-6-1989	22-12-1992
Mr E	22-6-1989	-
Mr F	8-2-1991	1-7-1991
Mr G	1-7-1991	6-1-1997

Shareholders

	Ordinary share	**Acquired on**	**Remark/transferred on**
Mr A	1	23-8-1985	Transferred to Company H on 22 June 1989
Mr B	1	23-8-1985	Transferred to Company I on 22 June 1989
Company H	1	22-6-1989	-
Company I	1	22-6-1989	Transferred to Company H on 8 Aug 1990 *
Company J	1	1-8-1990	allotted on 1-8-1990
Company K	1	1-8-1990	allotted on 1-8-1990

* converted into two non-voting preferred shares of $1 each on 1 August 1990

5. The directors of the Taxpayer regarded the following companies as the Taxpayer's ultimate holding companies:

As at	**Ultimate holding company**
31-12-1989	Company L
31-12-1990	Company L
31-12-1991	Company M
31-12-1992	Company N

Company L and Company M were public companies with their shares listed in Hong Kong. At the relevant time, Mr C, Mr E and Madam D were directors of Company L and Company M.

6. On 22 June 1989, a property described as Property 1 was assigned to the Taxpayer for a consideration of $118,080,000.

7. Property 1 was a 14-storey composite building with ground and first floors used for commercial purposes and the upper floors for domestic use. Property 1 was acquired by the Taxpayer with existing tenancies.

8. The Taxpayer's audited accounts for the period from 22 June 1989, date of commencement of business, to 31 December 1989 showed the following particulars:

Balance Sheet as 31 December 1989

	$
Fixed asset	148,300,000
Current assets	
Accounts receivable	333,310
Utility deposits	65,100
Cash at bank	1,823,367
	2,221,777
Deduct:	
Current liabilities	
Accounts payable and accruals	159,308
Rental deposits from tenants	419,667
Amount due to immediate holding company	5,393,172
Amount due to a fellow subsidiary	118,084,850
	124,056,997
Net current liabilities	(121,835,220)
Total net assets	26,464,780
Representing:	
Share capital	2
Reserves	26,464,778
Total shareholders' assets	26,464,780

9. By a provisional agreement dated 25 February 1992, the Taxpayer agreed to sell Property 1 to Company O at a price of $143,000,000. The sale was completed on 22 May 1992.

10. After disposal of Property 1, the Taxpayer has become dormant.

11. In its profits tax return for the year of assessment 1992/93, the Taxpayer reported assessable profits of $19,017. The profit on disposal of Property 1 amounting to $13,519,445 was not offered for assessment.

12. The assessor raised enquiries with the Taxpayer on the disposal of Property 1. In reply, the Taxpayer stated that:

> ' The property was acquired as long term investment. Our company originally intended to redevelop the property by erecting a new commercial building consisting of 17 storeys over a three storey podium for earning higher rental income. However, during the construction period, the property was sold as a result of an unsolicited offer.
>
> At all relevant times, the property was classified at cost as fixed assets in [our] audited accounts and they were leased to third party tenants for rental income before the redevelopment. Moreover, our redevelopment building plans were approved by the Building Authority and part of the construction work had been carried out and completed before the sale. It is therefore apparent that our company had a clear and explicit intention to hold the property as long term investment ...
>
> After the initial stage of construction had been completed, the company was approached and offered a price to sell the developing property. Having considered the latest commercial development and the price offered, our company decided to dispose of the developing property for strategic reasons.'

13. The assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1992/93:

	$
Loss per account	197,057
Less: Profit on disposal of Property 1	13,519,445
Assessable profits	13,322,388
Less: Loss set-off	1,982,946
Net assessable profits	11,339,442
Tax payable thereon	1,984,402

14. By notice dated 20 April 1995, the Taxpayer objected to the profits tax assessment for the year of assessment 1992/93 claiming that Property 1 was acquired by the Taxpayer for long term investment and the profit on disposal was not chargeable to profits tax.

15. The Taxpayer provided the following information:

(a) The purchase of Property 1 was financed by loan of $118,084,850 advanced by Company P, a fellow subsidiary of the Taxpayer. The loan was unsecured and interest bearing, with no fixed terms of repayment.

(b) An initial building plan was submitted to the Building Authority on 31 October 1989.

(c) The building plans were approved by Building Authority on 25 January 1990.

(d) By Assignment dated 17 May 1990, the debt of $118,084,850 owed by the Taxpayer to Company P was assigned to Company Q, another fellow subsidiary of the Taxpayer.

(e) By a deed of undertaking dated 28 February 1991, Company Q agreed and undertook that it would not demand for repayment of the loan due by the Taxpayer until the expiration of one year after the issue of the occupation permit in respect of the new building.

(f) By a deed of borrowing dated 28 February 1991, Company R agreed to lend to the Taxpayer an interest free loan of up to $40,000,000 and such additional sums, if required, to cover the construction costs and compensation to the existing tenants/occupants of Property 1. The loan was to be repaid by 120 consecutive equal monthly instalments starting from 31 days immediately after the date of the occupation permit.

(g) The Taxpayer appointed solicitors to take all the steps to repossess Property 1 from the then existing tenants and occupants including by making applications to the Lands Tribunal.

(h) The demolition of the old building was commenced on 9 August 1991 and completed on 6 December 1991.

(i) The foundation work was commenced on 19 November 1991 and completed on 28 April 1992.

(j) There was no relationship between the Taxpayer and Company O.

16. During the period Property 1 was owned by the Taxpayer, the directors of the Taxpayer were also directors of Company R and Company Q.

17. In support of its claim, the Taxpayer provided the following documents:

A copy of the minutes of a meeting of directors on 12 June 1989 resolving to purchase Property 1;

A copy of the draft feasibility study report prepared by Company S dated January 1990;

A copy of an invoice dated 26 March 1990 of amount $35,000 issued by Company S to Company H in respect of feasibility report on Property 1;

Assignment of debt owned by the Taxpayer dated 17 May 1990;

A copy the minutes of a meeting of directors on 28 February 1991;

Deed of undertaking dated 28 February 1991 issued by Company Q;

Deed of borrowing dated 28 February 1991 between the Taxpayer and Company R;

Agreement for sale and purchase of Property 1 dated 19 March 1992 made among the Taxpayer, Company O and Company H.

18. The Taxpayer made adjustment in its tax computation for the year of assessment 1990/91 to exclude expense of $35,000 on feasibility report for redevelopment of property paid to Company S. It was stated that the sum was ' non-deductible expenses but ranking for rebuilding allowance when the redevelopment of the property is completed and rental income is earned' .

19. By letter dated 15 October 1996 the Taxpayer contended, among other things, that:

> ' [Property 1] is situated at the heart of District T with partial sea view of the harbour. Developments in the immediate vicinity comprise hotels and multi-storey commercial buildings. All sorts of transport facilities are conveniently available. The MTR District T Station is within walking distance. Buses, public light buses and taxis plying along the road where Property 1 lies on. Such property is viewed to have a great long term investment potential, especially for rental as commercial premises. It was therefore decided that the property be redeveloped into a new commercial building for rental purpose.
>
> The company' s intention to redevelop the property for rental purpose can be supported by the following facts:
>
> (a) The property was classified as "investment property" in the company' s audited

accounts and the group' s published accounts.

(b) Adjustment was made in schedule 6 of our tax computation for year of assessment 1990/91 ... to exclude expense on feasibility report which was stated to be claimed upon completion of redevelopment and when rental income derived.

(c) Deeds signed between the company and [Company R] and [Company Q] respectively in respect of the loans from the two companies. [Company R] undertook not to demand for the repayment of loan during redevelopment of he property and repayment was to be made by 120 consecutive equal monthly payment starting one month after date of issue of occupation permit while Company Q undertook not to demand repayment of loan until the expiration of one year after the issue of occupation permit. Such undertakings were to cater for the company' s intention to redevelop the property for rental and match with the company' s mode of income generation so that loan could be repaid from the company' s rental income derived from the property.

(d) As per feasibility report prepared by Company S, you can see that the company is very concerned in attracting tenants of the right callibre (sic). If the company was holding the property as trading stock, the company would not care who were going to be tenants of the building.'

20. The assessor requested the Taxpayer to supply a copy of the feasibility report as to the viability of the acquisition of the property in terms of return on capital and servicing of the loan. In reply, the Taxpayer stated that:

' The company did undertake feasibility study on the redevelopment of the property. As the group is experienced in long term property redevelopment projects, it usually does not reduce such analysis into writing ... It was the company' s plan to repay the loan by rental income generated from re-developed property. Given with the location of the property and the prestigious quality of the redeveloped building, the company believes that the property will bring good rental return.'

21. In elaborating the reason for selling Property 1, the Taxpayer stated that:

' During [the year of assessment 1992/93], several major properties of the group were under refurbishment which required a substantial amount of cash. Development projects in (the mainland of China) had commenced and expenditure at various scheduled stages were required. In addition, the privatisation of Company H in (1992/93) reduced the level of cash resources within the group.

The company was approached and offered a quite attractive price to sell the developing property. Having considered the availability of funds to supplement the cash resources of the group and to channel to other profitable investment, the latest commercial development and the price offered, it was decided that the property be disposed of.'

22. The Taxpayer claimed that because it had moved office and godown several time it could not locate the following documents:

(a) loan agreement signed between Company P and the Taxpayer in 1989,

(b) the letter of instruction sent to Company S on 1 November 1989,

(c) record on the exact date which the Taxpayer was first approached by Company O for selling Property 1.

23. In reply to enquiries raised by the assessor, Company O, through its tax representatives, confirmed that the purchase of Property 1 by the company was introduced by a property agency, and the company did not approach the vendor for the purchase.

24. The assessor maintained her view that Property 1 was acquired for trading and considered that rebuilding allowance should not be granted in respect of Property 1. She proposed to revise profits tax assessment for the year of assessment 1992/93 as follows:

	$	$
Loss per account		197,057
Less : Profit on disposal of Property 1		13,519,445
		13,322,388
Less : Professional fee for preparation of feasibility report	35,000	
Legal fee for sale and purchase	178,040	213,040
Assessable profits		13,109,348
Tax payable thereon		2,294,135
Statement of loss		
Loss brought forward		1,982,946
Less : Rebuilding allowance granted in		
1989/90	454,979	
1990/91	1,213,277	
1991/92	1,213,277	
restricted to		1,982,946
Loss available for set off		Nil

The Taxpayer's case of appeal

25. Miss Phillis Loh, counsel for the Taxpayer told us in her opening address that the only issue for us to decide was 'whether the property was acquired by [the Taxpayer] as a trading stock or a capital asset'. The ground as formulated in paragraph 1 of the grounds of appeal is that:

> 'Property 1 was acquired by the company as long-term investment asset of redevelopment for rental purpose and the company had no intention to trade Property 1 at the time of acquisition of the Property 1.'

26. In addition to putting bundles of documents approximately three inches in thickness before us, the Taxpayer called a Mr U as a 'witness' to give evidence.

Our decision

Relevant authorities

27. Section 68(4) of the IRO, chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Taxpayer. Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

28. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Lionel Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wiberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

29. In All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771, Mortimer J, as he then was, was reported to have said:

> '*Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.' (at page 770).*
>
> *The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.*

I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? 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.' (at page 771).

Mr U as a 'witness'

30. Mr U claimed to have joined Company M in June 1989 as financial controller of Company M and its subsidiaries, despite the fact that in the letter dated 30 September 1994 from the Taxpayer to the Inland Revenue Department ('IRD'), he signed as 'assistant group assistant controller'. His salaries tax return for the year of assessment 1993/94 was shown to him in cross-examination and he agreed that his salary during that year of assessment was something around $220,000. He worked under the finance director, Mr F, who 'is also a director' of Taxpayer. Mr F had been a director, but for less than five months, that is from 8 February 1991 to 1 July 1991 (see paragraph 4 above) which means that Mr F was not a director at the time of purchase and was not a director at the time of sale. It is clear from the minutes of the board meeting held on 28 February 1991 by Mr E and Mr C that Mr F was appointed the authorised representative of the Taxpayer for the purpose of the Lands Tribunal proceedings commenced by the Taxpayer against the then tenants and scheduled to be heard on 6 to 8 March 1991.

31. '"Witness" is a simple English word, but it is sensible to remind oneself of its meaning. According to the Concise Oxford Dictionary, a "witness" is "person present at some event and able to give information about it"', see Leomark Holdings Limited v Chik Ho Ming, HK Action No A3065 of 1997, 28 April 2000, unreported.

32. (a) Mr U has never been a director of the Taxpayer.

(b) He has not been a director of Company M.

(c) He was not involved in the decision-making process of buying and selling properties.

(d) He did not know Mr A.

(e) He did not know Mr B. We note that Mr A and Mr B had been directors of the Taxpayer from 21 February 1986 to 22 June 1989 (see paragraph 4 above) and that according to the minutes of the meeting of directors on 12 June 1989 referred to in paragraph 17 above, Mr A and Mr B were the two directors who attended that meeting and resolved to purchase. They ceased to be directors ten days later on 22 June 1989.

(f) He did not know which person or persons made the decision to purchase.

(g) He was not responsible for taxation matters of the group.

(h) Apart from the letter dated 30 September 1994 referred to in paragraph 30 above, he was no ' directly involved' in the exchange of correspondence between the Taxpayer and the Respondent.

(i) He did not know why Company S was instructed in November 1989 by Company H to conduct a feasibility study on a conversion of the old building from domestic to commercial usage.

(j) When he was asked by Miss Loh whether the Taxpayer solicited the offer by Company O to purchase, he said:

' A [The Taxpayer] did not solicit that offer.

Q Did you take any step to ascertain that?

A Actually, our colleague has contact with the people or the staff in the property department and ascertained that fact.

Q People in the property department? You mean in the property department of your company?

A Yes.

Q Who, presumably, were involved if there was any sales or

advertising work?

A Right.

Chairman Who told you that?

A It is a staff from the property department.

Chairman Has he got a name?

A A woman.

Chairman You don' s even know her name?

A Actually, it is not myself who asked the property people. It is one of my colleagues.

Chairman What was the name of that colleague?

A She is called Ms V but she has left the company.

Chairman Mr V told you she asked the property department?

A Actually, Ms V is the person who was responsible for preparing a reply to the Inland Revenue at that time. She has talked with staff in the property department to confirm the fact.

Chairman How much is he giving evidence of personal knowledge and how much is hearsay and secondhand hearsay?

Miss Loh I do apologise about that. I will lead further evidence from Mr U in relation to his own knowledge as to the advertising and sales work.

Q Mr U, is it within your knowledge whether there was any advertising or sales work undertaken by [the Taxpayer] with a view to selling the property at that time?

A There was no such expenditure as seen from the accounting records.

Q So, it is evidenced from the accounts that no such work was ever

done. Was it also within your knowledge that any of such work was being undertaken?

A As far as I know, there was no such work undertaken by the company.'

(k) Despite the above, Mr U claimed in re-examination in answer to a leading question by Miss Loh that it was within his knowledge that the group of the Taxpayer did not appoint a property agent in the sale to Company O.

The building from which rental was to be derived

33. In considering the Taxpayer's contended intention of long-term investment for rental purpose, it is important to identify with precision the building from which rental was to be derived. There are three possibilities:

(a) At the time of acquisition, the building was a 14-storey composite building with ground and first floors being used for commercial purposes and upper floors mainly for domestic use and was approximately 18 years old, according to the architect's report dated 8 February 1991 ('the Architect's report'). This was the old building.

(b) Company S was instructed in November 1989 by Company H to conduct a feasibility study on a conversion of the old building from domestic to commercial usage. This would have been the old building to be converted to commercial usage.

(c) An entirely new building to be constructed on the land after demolishing the old building. This is a proposed new building.

34. In the course of Miss Loh's submission, the Chairman asked her whether it was the Taxpayer's case to hold the old building on a long term basis, or to convert the old building, or to demolish the old building and construct a new one. Miss Loh's initial reply was 'for rental income for the redeveloped building'. Upon being asked why Company S was instructed to report on a converstion of the old building if the intention was to construct a new building, Miss Loh submitted that the intention was for long term rental income, whether by way of redeveloping it into a new building or by converting it and upgrading it. As Rogers J (as he then was) said in Re ICS Company Distribution Limited [1996] 3 HKC 440 at page 449A, 'this seems to be an attempt to raise an argument without the fundamental evidence to support it'.

35. The case as formulated in the grounds of appeal is one of redevelopment.

The old building

36. There is no evidence that it was the Taxpayer' s intention to hold the old building on a long term basis for rental income.

37. There is no evidence on whether, and if so, why this was thought to be a viable investment.

38. The sale of the old building was subject to existing tenancies (see paragraph 7 above). Domestic tenancies were subject to the control under Part IV of the Landlord and Tenant (Consolidation) Ordinance, Chapter 7 (' Part IV').

The old building to be converted to commercial usage

39. There is no evidence that it was the Taxpayer' s intention to hold the old building, convert it to commercial usage and hold the converted building on a long term basis for rental income.

40. There is no evidence on whether, and if so, why this was thought to be a viable investment.

41. Tenants of domestic tenancies enjoyed security of tenure under Part IV and the Taxpayer could not evict them on the ground that it wished to convert the old building. Unless all the domestic tenants were evicted or agreed to surrender vacant possession, it would have been idle to talk about conversion.

A proposed new building

42. There is no evidence that it was the Taxpayer' s intention to construct a new building and to hold the new building on a long term basis for rental income.

43. There is no explanation why Company S was instructed in November 1989 to conduct a feasibility study on a conversion of the old building from domestic to commercial usage.

44. Miss Loh submitted that the Taxpayer' s investment intention was evidenced by the rights issue document dated 18 September 1989 of the Taxpayer' s then holding company. We have only been supplied with an *extract* of that document. It stated that:

> ' ... Since the beginning of this year, the group has made the following investments:
>
> Property 1

> The property consists of a 14-storey composite building with two shops and 23 residential apartments with a total gross floor area of approximately 39,200 square feet, occupying a site of approximately 3,400 square feet. The shops comprise an aggregate floor area of approximately 6,800 square feet and the residential apartments comprise an aggregate floor area of approximately 32,400 square feet. Payment of the consideration for the property, amounting to approximately $145 million (sic) in cash, was completed on 22 June 1989.'

If the intention were to demolish the old building and construct a new one, such intention would clearly have been material to the rights issue and would and should have been disclosed. Based on the *extract* which the Taxpayer placed before us, we see no mention of any intention to redevelop, no mention of the estimated building costs and no mention of any proposed new building. On the contrary, it would appear from the passage quoted above that the old building was being put forward as the subject matter of the investment. If we understand the Taxpayer' s case correctly, it has never been the Taxpayer' s case that it wished to retain the old building on a long term basis for rental income.

45. It is one thing to claim that no written feasibility study was necessary. It is another to tell us nothing whatsoever about the area of any proposed new building, nothing about the anticipated unit rental rate, nothing about the anticipated occupancy or vacancy rate, nothing about the costs of servicing the interest element of any long term loan, and nothing about repaying the principal of any long term loan. In short, there is simply no evidence on whether, and if so, why this was thought to be a viable investment.

Financial ability

46. The contended intention to acquire as capital asset was unrealistic and unrealisable if the Taxpayer and its ultimate holding company or companies were financially capable of acquiring but incapable of keeping on a long term basis.

47. The acquisition was on 22 June 1989.

48. The acquisition was financed by a loan of $118,084,850 advanced by Company P which the Taxpayer claimed was unsecured and interest bearing, with no fixed terms of repayment [see paragraph 15 (a) above]. By an assignment dated 17 May 1990, Company P assigned the debt to Company Q. By recital (a), Company P represented that the debt was not interest bearing. By clause 3, the Taxpayer confirmed that the debt existed, was not interest-bearing and was repayable on demand. As Miss Ng Yuk-chun who appeared for the Respondent correctly pointed out, the debt assigned to Company Q was repayable on demand at any time between 17 May 1990 and 28 February 1991 when Company Q undertook by deed dated 28 February 1999 that ' unless with your prior consent we shall not demand ... payment ... unless and until the expiration of

ONE year after the occupation permit'. Even then that is in our view a short term loan. Rental income during the one year period from the issue of the occupation permit would clearly have been insufficient to pay off the debt, bearing in mind that the Taxpayer would have been liable to pay monthly instalment payments to Company R had Company R advanced any loan under the deed dated 28 February 1991 [see paragraph 15(f) above].

49. The Taxpayer produced a document which it called a term sheet. This is another incomplete document. It came from Bank W setting out the terms and conditions of banking facilities for Company Q, secured by, inter alia, a land mortgage and a building mortgage by the Taxpayer; was dated 21 November 1991; and countersigned by the Taxpayer and Company Q. $18,000,000 was for refinancing the purchase of Property 1 or for refinancing the inter-company loan by Company Q to the Taxpayer. Another $35,000,000 was for financing the estimated constructed costs of the proposed new building. Interest was at 1.25% over three months HIBOR. The repayment date was 24 months after the date of first drawing or 6 months after the issue of the occupation permit, whichever was the *earlier*. Mr U was asked about this term sheet in his evidenced in chief and he said (emphasis added):

> ' Q ... did you obtain or try to obtain **long-term** financing to hold the property from external sources?
>
> A Yes. Sometime in November 1991 the company has approached Bank W with a view to arrange an external funding of $53,000,000 Hong Kong. Out of this $53,000,000, $35,000,000 is planned for the future construction costs. The remaining $18,000,000 is to **recoup** part of the costs of the properties.
>
> Q I understand a term sheet was signed in respect of this transaction.
>
> A Yes.
>
> Q Would you like to refer to an exhibit to your affidavit, LKW 4. This is the term sheet signed between the taxpayer and Bank W at that time, right?
>
> A Right.
>
> Q And the date was 21 November 1991?
>
> A Correct.
>
> Q Why was this refinancing obtained some two years after the company purchased the property?

A Normally, it is the group' s policy to obtain external funding sometime around the commencement of the construction work of the redevelopment project.

Q Why?

A **Because at that time the funding is really needed to finance the construction work to proceed.**'

50. The term sheet was accepted by Company Q and the Taxpayer subject to:

' 1. the Lands Tribunal shall agree on [the Taxpayer' s] application to vary the terms of the order of possession to permit the Facilities above to be set up in substitution of the intercompany loan facilities to be advanced by [Company R] to [the Taxpayer]

2. The Lands Tribunal will release [the Taxpayer, Company R and Company Q] from the three Deeds of Undertakings viz. Deed of Undertaking given by [Company Q] dated 28 February 1991; Deed of Undertaking given by [Company R] dated 4 March 1991 and Deed of Undertakings given to the Lands Tribunal dated 6 March 1991 by [the Taxpayer, Company R and Company Q].'

51. The deed of undertaking by Company R referred to in the term sheet was dated 4 March 1991 and would appear to be different from the one referred to in paragraph 15(f) above which was dated 28 February 1991.

52. On Mr U' s own testimony, by 21 November 1991:

(a) Company Q wished to ' **recoup**' $18,000,000 in respect of the acquisition costs;

(b) Company R wished to **back out** of its undertakings by deed to provide loan facilities to the Taxpayer; and

(c) funding was ' **really needed**' to finance the construction work to proceed.

There is no allegation and no evidence of any or any material change in circumstances between 28 February 1991 and 21 November 1991. If the intention were to construct a new building for rental income, why would anybody have wished to ' recoup' part of the acquisition cost before the old building had been completely demolished [see paragraph 15(h) above]? Why would Company R have wished to back out from its undertakings by deed? Had Company R any intention of honouring its undertakings?

Conclusion

53. For the reasons we have given, the Taxpayer has not proved any of the following:

(a) at the time of acquisition in June 1989, the intention of the Taxpayer was to hold, on a long term basis, the land and:

(i) the old building, or

(ii) the old building to be converted to commercial usage, or

(iii) a proposed new building;

(b) such intention was genuinely held, realistic, or realisable; or

(c) its financial ability to keep, on a long term basis, the land and:

(i) the old building, or

(ii) the old building to be converted to commercial usage, or

(iii) a proposed new building.

54. The Taxpayer has not discharged the onus under section 68(4) of the IRO of proving that the assessment appealed against is excessive or incorrect and we confirm the assessment as increased by the Commissioner.