Case No. D69/05

Profits tax – intention of a long-term investment – whether expenses actually incurred – sections 16, 68(4) and 70A of the Inland Revenue Ordinance ('IRO').

Panel: Anna Chow Suk Han (chairman), Lawrence Lai Wai Chung and Wong Kwai Huen.

Dates of hearing: 17, 18, 19 February, 17, 18, 19, 20 May and 15 July 2004.
Date of decision: 16 January 2006.

The taxpayer, a company incorporated in Hong Kong, together with two other Hong Kong companies, were all under the control of Ministry K, a government department of Country AF. At various times, the taxpayer and the other two Hong Kong companies each acquired a property at different addresses. The taxpayer and the two Hong Kong Companies entered into an agreement to redevelop their properties and the new building was named Plaza S.

The taxpayer submitted its profits tax return for the year 1995/96 which included trading receipts and the profit derived from the sale of properties, revaluation surplus in respect of the sold properties which was considered as capital in nature and was not offered for assessment, project management fee and bank guarantee fee allegedly paid to Company B which was claimed for deduction. The taxpayer's case was that Plaza S was a long-term investment project with the support of the Ministry K and there was never any intention to trade. The sale of properties in question was a forced sale due to the Austerity Economics Programme then launched by the government of Country AF. The taxpayer was not familiar with the tax law in Hong Kong. It was upon the mistaken advice of the Representative that the taxpayer offered the profits from the sale as trading profits for assessment. In the event that the taxpayer is found liable for profits tax payment, in reliance of section 16 of the IRO, it would claim deduction of the project management fee and the bank guarantee fee as trading expenses incurred in producing the profits.

Held:

1. 'Intention' connotes an ability to carry it into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken steps to enable such intention to be implemented. The evidence before the Board is that unless the properties in question were sold the taxpayer would not have had the ability on its own account to repay the bank loans. Pursuant to section 68(4) of the IRO, the onus lies on the taxpayer to prove its case.

On the basis of the evidence the Board finds that the taxpayer has failed to discharge the burden rested upon it to prove that the property was acquired by it for investment purpose.

2. In view of the aforesaid findings that the taxpayer' s intention was to hold its properties for trading purposes, the Board needs not consider the issue on section 70A of the IRO as to whether or not to re-open the 1995/96 assessment on the ground that a mistake was made on the admission of trading stock. Had it been necessary for the Board to do so, the Board is of the view that it is not open for the Board to do the same for the following reasons. Where a taxpayer has deliberately and conscientiously made a decision to submit items of profits for assessment in its tax return, but subsequently changes his or her mind, that cannot be a correctable ' error' within the meaning of section 70A of the IRO.

3. A general deduction is allowed for outgoings and expenses incurred in the production of profits which are chargeable to tax. An outgoing or expense is ' incurred' when it is paid out or when the liability to pay arises. The documents produced by the taxpayer only confirmed the taxpayer' s agreement in respect of the project management fee and its intention in respect of the bank guarantee fee to make such payments but they are not sufficient to prove that these sums were indeed incurred and paid out by the taxpayer. In the absence of satisfactory evidence to prove that these sums had actually incurred or paid out by the taxpayer, the Board is not in the position to allow the taxpayer' s claim of deduction of them.

Appeal dismissed.

Cases referred to:

Wing On Cheong Investment v CIR (1990) 1 HKRC 35
D76/94, IRBRD, vol 9, 394
D64/87, IRBRD, vol 3, 60
Iswera v CIR (1965) 1 WLR 663
Simmons v IRC (1980) 2 All ER 798
Marson v Morton (1986) 1 WLR 1343
All Best Wishes Ltd v CIR (1992) 3 HKTC 750
D65/87, IRBRD, vol 3, 66
D17/95, IRBRD, vol 10, 151
Beautiland Co Ltd v CIR (1991) 1 HKRC
CIR v Lo and Lo (1984) HKC 220
CIR v National Mutual Centre (HK) Ltd (1998) 2 HKLRD 599
CIR v Cosmotron Manufacturing Co Ltd (1997) HKLRD 1161

D71/97, IRBRD, vol 12, 410
CIR v Swire Pacific Ltd (1979) HKLR 612
D6/91, IRBRD, vol 5, 556
D61/91, IRBRD, vol 6, 457
D54/98, IRBRD, vol 13, 314
D83/99, IRBRD, vol 14, 566
Turner v Last 42 TC 517
Chinachem Investment Co Ltd v CIR 2 HKTC 261
Extramoney v CIR 4 HKTC 394
D127/98, IRBRD, vol 13, 598
D145/98, IRBRD, vol 13, 682
D21/01, IRBRD, vol 16, 206
D11/02, IRBRD, vol 17, 443

C T Lee Counsel instructed by Messrs CWCC, Certified Public Accountants, for the taxpayer.
Jennifer Tsui Counsel instructed by Department of Justice for the Commissioner of Inland Revenue.

Decision:

The appeal

1. This appeal is commenced by Company A ('the Taxpayer'). The Taxpayer has objected to the additional profits tax assessment raised on it for the year of assessment 1995/96. It has also objected to the assessor' s notice of refusal to correct, pursuant to section 70A(2) of the Inland Revenue Ordinance ('IRO') the profits tax assessment for the year of assessment 1995/96. The Taxpayer claims that:

(a) the revaluation surplus is capital in nature and should not be assessable to tax;

(b) the profit on disposal of the properties, which is capital in nature, was wrongly offered by it for assessment; and

(c) failing which it should be entitled to deduction of the project management fee and bank guarantee fee incurred by it for the purpose of producing its assessable profits.

Agreed statement of fact

2. There is an agreed statement of facts between the Taxpayer and the Commissioner of Inland Revenue ('the Revenue').

3. The agreed facts on the background of this appeal are as follows:

3.1 The Taxpayer was incorporated as a private company in Hong Kong on 9 January 1992. At all relevant times, the immediate and ultimate holding companies of the Taxpayer are Company B and Company C which were incorporated in Hong Kong and Country AF respectively.

3.2 Company D was a private company incorporated in Hong Kong on 8 June 1982. At all relevant times the immediate holding company of Company D is Company E, formerly known as Company F, which was incorporated in Country AF.

3.3 Company G was incorporated a private company in Hong Kong on 6 July 1984. At all relevant times, the immediate and ultimate holding companies of Company G are Company H, formerly known as Company I, and Company J which were incorporated in Hong Kong and Country AF respectively.

3.4 Company C, Company F and Company J are all under the control of the Ministry K ('the Ministry'). The Ministry is a government department of Country AF and is responsible for the administration of the national railway system of Country AF.

3.5 On 22 October 1983 Company D acquired a four-storey building at Address L ('Property M') at a price of $12,000,000.

3.6 On 1 October 1985 Company G acquired a four-storey building at Address N ('Property O') at a price of $12,700,000.

3.7 At all relevant times, the ground floor of the Property O and the Property M was used as the ticketing office of the Ministry for sale of railway tickets to City P and the rest of the two properties were used by the Ministry as staff quarters.

3.8 On 28 February 1992 the Taxpayer acquired Address Q ('Property R') at a price of $350,000,000. The Property was assigned to the Taxpayer on 28 April 1992.

3.9 On 29 December 1993 the Taxpayer, Company D and Company G (collectively referred to as 'the Owners') entered into an agreement ('the 1993 Agreement') to redevelop the properties at Addressess L, N and Q.

3.10 The redevelopment of the site at Addressess L, N and Q was completed in October 1994. The occupation permit of the new building, namely 'Plaza S', was issued on 10 October 1994. The Plaza S is a 28-storey building with a shopping arcade on the basement, the ground floor and the first floor; 69 car parking spaces on the second to the fifth floors; and office units on the sixth to the twenty-eighth floor. There are no 14th Floor and 24th Floor in the redeveloped building.

3.11 In pursuance of the provisional sale and purchase agreement dated 17 December 1993, the formal sale and purchase agreement for the sale of the office premises ('the Office Premises') was signed on 6 January 1994. The sale was completed on 24 January 1995 when the Office Premises were assigned to the purchaser.

3.12 By a formal sale and purchase agreement dated 17 January 1994 the Owners agreed to sell the shopping arcades on the basement, the ground floor and the first floor ('the Shop Premises') at a price of $320,000,000. The sale was completed on 25 January 1995 when the Shop Premises were assigned to the purchaser.

3.13 Apart from the Shop Premises and the 6th Floor, the units in the Plaza S were allocated to each of the Owners as follows:

40 car parking spaces	the Taxpayer
15 car parking spaces	Company G
14 car parking spaces	Company D
7/F and 8/F	the Taxpayer
9/F	Company G
10/F	Company D
11/F and 12/F	the Taxpayer
13/F	Company D
15/F	Company G
16/F to 19/F	the Taxpayer
20/F	Company G
21/F to 23/F	the Taxpayer
25/F	Company D
26/F	Company G
27/F	Company D
28/F	the Taxpayer

3.14 The Taxpayer submitted its profits tax return for the year 1995/96 together with accounts for the year ended 31 December 1995 and proposed tax

computation. The return showed assessable profits of $194,635,372 which were arrived at after taking into account the following:

(a) Sale of properties in the amount of $867,447,184 was included as trading receipts and the profit derived thereon was offered for assessment.

(b) Revaluation surplus in the amount of $95,276,095 in respect of the sold properties was considered as capital in nature and not offered for assessment.

(c) Project management fee of $22,500,000 allegedly paid to Company B was claimed for deduction.

(d) Bank guarantee fee of $8,850,000 allegedly paid to Company B for obtaining a corporate guarantee from Company B to facilitate the Taxpayer in securing bank loans was claimed for deduction.

3.15 In a schedule attached to the proposed tax computation, the Taxpayer stated the following in connection with the tax treatment of the revaluation surplus:

'The land was acquired by the company on 28 February 1992 and was originally intended to be redeveloped into a commercial building for long-term investment and rental purposes. The redeveloped building was intended to serve as the flagship of the (the Ministry) of Country AF, the beneficial owner of the company, in Hong Kong. On completion of the development of the properties, some units would be retained by the company for office use and the remaining units would be let out for rental purposes.

It was originally planned that the development of the properties would be mostly financed by loans from (the Ministry). However, due to the fund control measures enforced in Country AF, the company was unable to obtain sufficient funds from (the Ministry) for financing the development. As such, the company was forced to finance the development by borrowing bank loans. In order to service the loan repayment upon completion of the development, the company changed its intention from holding the developed properties for long term investment purposes to trading purposes. In this regard, the revaluation surplus of the land credited to the company prior to the change of intention should be capital in nature and not subject to Hong Kong Profits Tax.'

3.16 By letter dated 23 September 1996 the assessor asked Messrs T, now known as Messrs U ('the Representatives'), to supply further information in connection with the profits tax return of the Taxpayer for the year 1995/96.

3.17 On the basis of the return submitted and subject to queries issued, the assessor on 26 September 1996 raised on the Taxpayer the following profits tax assessment for the year of assessment 1995/96:

Assessable profits per return	$194,635,372
Less : Loss brought forward set-off	980,533
Net assessable profits	$193,654,839
Tax payable thereon	$31,953,048

The Taxpayer did not object against the above assessment.

3.18 In the absence of any reply to the letter dated 23 September 1996 within the stipulated time, the assessor on 16 June 1997 raised on the Taxpayer the following additional profits tax assessment for the year of assessment 1995/96:

Project management fee	$22,500,000
Bank guarantee fee	8,850,000
Revaluation surplus	95,276,095
Additional net assessable profits	$126,626,095
Additional tax payable thereon	$20,893,306

3.19 On behalf of the Taxpayer, the Representatives objected against the additional assessment on 15 July 1997 on the grounds that the revaluation surplus should be capital in nature not subject to Hong Kong profits tax and that the project management fee and bank guarantee fee were incurred by the Taxpayer for the production of its assessable profits and should be deductible under section 16(1) of the IRO.

4. In reply to the assessor's enquiries, the Taxpayer's Representatives supplied certain information in connection with the redevelopment of the Plaza S. Of all the information contained in various letters, the following facts were agreed between the parties.

4.1 The Representatives supplied relevant information in connection with the redevelopment of the Plaza S in reply to the assessor's enquiries. Of all the information contained in various letters, the following facts can be agreed.

(a) The sale proceeds of $867,447,184 were made up as follows:

Unit sold	Date of S & P agreement	Sale proceeds	
Basement, G/F & 1/F	17-1-1994	$187,513,600	*
26 car parking spaces	6-1-1994	16,600,000	
6/F	6-1-1994	22,233,584	*
7/F, 8/F, 11/F, 12/F & 16/F	6-1-1994	360,100,000	
17/F	6-1-1994	70,000,000	
18/F & 22/F	6-1-1994	141,000,000	
19/F	6-1-1994	70,000,000	

* The basement, G/F, 1/F and 6/F were jointly owned by the Taxpayer, Company D and Company G. The amounts stated above represented the Taxpayer's share of the proceeds determined by reference to the Taxpayer's share of floor area in these floors.

(b) The remaining car parking spaces, 21/F and 23/F of the Plaza S which were allocated to the Taxpayer were let out to third parties for rental income.

(c) 28/F was used by Company I as office. The Taxpayer had not entered into any agreement with Company I and did not charge any rent on Company I regarding such use.

(d) Banking facilities were obtained for financing the redevelopment. During the years from 1992 to 1995, the Taxpayer was granted banking facilities of a maximum aggregate amount of $885,000,000. The loans were all under guarantee by Company B. A summary of the bank loans is at Appendix D to the determination.

(e) With regard to Loan C mentioned in the summary at Appendix D of the determination dated 12 March 2003, $175,000,000 was drawn down by the Taxpayer in April 1992 to finance the acquisition of the Property R. A further amount of $30,000,000 was drawn down by the Taxpayer in November 1992.

4.2 By letter dated 27 April 1999 the Representatives applied on behalf of the Taxpayer to reopen the profits tax assessment for the year 1995/96 under section 70A of the IRO on the ground that the Taxpayer had 'inadvertently omitted to claim the capital gain on disposal of the properties located at the [Plaza S] (excluding shops) in the amount of $164,982,344 as non-taxable income in the 1995/96 profits tax return'. The Representatives contended that the Plaza S was developed by the Taxpayer for long term investment purpose and was intended to be used as the flagship and headquarters of the Ministry in Hong Kong.

4.3 By notice dated 27 December 2000 the assessor refused to correct the profits tax assessment for the year of assessment 1995/96. The representatives on behalf of the Taxpayer objected against the assessor's notice of refusal.

4.4 With regard to the project management fee of $22,500,000 charged in the Taxpayer's account, the Representatives furnished a copy of an agreement dated 6 June 1992 entered into between the Taxpayer and Company B.

4.5 With regard to the bank guarantee fee of $8,850,000, the Representatives furnished a copy of a directors' minutes of the Taxpayer dated 30 December 1995 resolving the payment of the fee to Company B.

The Taxpayer's case

5. Plaza S was an investment project with the support of the Ministry K of Country AF. It was intended as a long-term investment and there was never any intention to trade.

6. The sale of the Shop Premises and the Office Premises in question was a forced sale due to the Austerity Economics Programme ('AEP') then launched by the government of Country AF. The sale did not represent any change of intention on the part of the Taxpayer. The sale was a forced sale to recover money to pay off the bank loans.

7. The Taxpayer was not familiar with the tax law in Hong Kong and did not realize that capital gain would be exempted from tax. It was upon the mistaken advice of the Representatives that the Taxpayer offered the profits from the sale as trading profits for assessment for the year of assessment 1995/96.

8. The revaluation surplus should also be exempted from tax as it was a capital gain rather than trading profits. Thus, the Taxpayer should be exempted from liability to pay the additional tax.

9. In the event that the Taxpayer is found liable for profits tax payment, in reliance of section 16 of the IRO, it would claim deduction of the project management fee of $22,500,000 and the bank guarantee fee of $8,850,000 as trading expenses incurred in producing the profits.

The Revenue's case

10. Having regard to the circumstances and facts of this case, the Revenue takes the view that the Taxpayer had all along contemplated the sale of its share of the properties in Plaza S and therefore the revaluation surplus and the profits on the sale of the sold units are properly assessed to tax.

11. The claim of the intention of a long-term investment is not convincing.

12. Although the original assessment for the year 1995/96 was made per the return submitted by the Taxpayer asserting a change of intention, it was made clear to the Taxpayer in a letter dated 23 September 1996 that the assessment was subject to queries raised. Based on the Taxpayer's own proposal for not offering the revaluation surplus for assessment, the assessor raised the profits tax assessment for the year of assessment 1995/96.

13. The Taxpayer did not lodge any objection against the said assessment.

14. The Taxpayer changed its case from time to time. Even in its application for revision of the 1995/96 assessment under section 70A of the IRO, the Taxpayer's capital claim did not include the Shop Premises. The Taxpayer however changed its case again at the hearing by claiming that the entire Plaza S including the Shop Premises was a capital asset.

15. The allegation of a mistake made by the Taxpayer is not supported by evidence.

16. The sale of the properties in question was a quick sale. Provisional sale and purchase agreements for them were signed in December 1993 which was well before the completion of the construction of Plaza S in October 1994. A quick sale infers the intention of trading unless there is a satisfactory explanation.

17. As to the Taxpayer's explanation of the unexpected AEP launched by Country AF government in 1993 which stopped funding from the Ministry and Company C, the Revenue found it unconvincing and unsatisfactory. The reason is that there had never been any prior approval or commitment of funding from these authorities for this large-scale project. This makes the stated intention of a long-term investment unrealistic and unbelievable.

18. From the documents produced it is shown that the bank borrowings had from the outset been the major source of finance.

19. There was never any analysis of financial viability or servicing of the bank loans. The ability of the Taxpayer to repay the bank loans without sale is dubious.

The issues for the Board to determine

20. What was the Taxpayer's intention in developing Plaza S at the time of acquiring Address Q? Was Plaza S for long-term investment or for trading?

21. In the event that the intention was found to be for long-term investment, can the Taxpayer rely on section 70A of the IRO to re-open the 1995/96 assessment on the ground that a mistake was made in the admission of trading stock?

22. If additional assessment is upheld, can the Taxpayer claim deduction in respect of the project management fee and the bank guarantee fee?

The authorities

23. The Taxpayer produced the following authorities in support of its case:

(1) Wing On Cheong Investment v CIR (1990) 1 HKRC 35
(2) D76/94, IRBRD, vol 9, 394
(3) D64/87, IRBRD, vol 3, 60
(4) Iswera v CIR (1965) 1 WLR 663
(5) Simmons v IRC (1980) 2 All ER 798
(6) Marson v Morton (1986) 1 WLR 1343
(7) All Best Wishes Ltd v CIR (1992) 3 HKTC 750
(8) D65/87, IRBRD, vol 3, 66
(9) D17/95, IRBRD, vol 10, 151
(10) Beautiland Co Ltd v CIR (1991) 1 HKRC
(11) CIR v Lo and Lo (1984) HKC 220
(12) CIR v National Mutual Centre (HK) Ltd (1998) 2 HKLRD 599
(13) CIR v Cosmotron Manufacturing Co Ltd (1997) HKLRD 1161
(14) D71/97, IRBRD, vol 12, 410
(15) CIR v Swire Pacific Ltd (1979) HKLR 612
(16) D6/91, IRBRD, vol 5, 556
(17) D61/91, IRBRD, vol 6, 457

24. The Revenue produced the following authorities in support of its case:

(1) D54/98, IRBRD, vol 13, 314
(2) D83/99, IRBRD, vol 14, 566
(3) Turner v Last 42 TC 517

(4) Chinachem Investment Co Ltd v CIR 2 HKTC 261
(5) Extramoney v CIR 4 HKTC 394
(6) D127/98, IRBRD, vol 13, 598
(7) D145/98, IRBRD, vol 13, 682
(8) D21/01, IRBRD, vol 16, 206
(9) D11/02, IRBRD, vol 17, 443

The evidence

25. The parties produced their respective bundles of documents for the purpose of this appeal. The Taxpayer also called three witnesses to give evidence on its behalf. The witnesses are Mr V, Madam W and Mr X. Mr V was the only witness who could give us a direct account on the intention of the Taxpayer in the development of Plaza S. Both Madam W and Mr X did not have personal knowledge on the Taxpayer's intention or on the matters leading to the sale of the properties in question. Madam W only came to Hong Kong in October 1993 and Mr X was in Hong Kong working for the Taxpayer and Company B from November 1995 to July 2001.

26. Mr V produced a written statement which he confirmed as his evidence in chief. His written statement is summarized as below.

27. Mr V was a director of the Taxpayer between July 1992 and end of 1995. At the same time he was also a director of Company B. He was its director since 1991. During the relevant time, he was responsible for the administration and management of both companies. One major assignment of his was to complete Plaza S on time.

28. On the issue of the Taxpayer's intention, Mr V urged us to take note that at the time of acquisition of Address Q, these properties were intended to be redeveloped and be held as a long-term investment, partly as the flagship and headquarter of the Ministry K in Hong Kong and partly for letting purposes. He asserted that the sale of the Shop Premises was made upon the request of the other two joint-venture partners in order to meet the costs and repayment of the bank loans and also to resolve the management and interest-sharing problems of the Shop Premises and the sale of the Office Premises and car parks was also to meet the then financial predicaments. Those sales were not trading activities. Neither was there a change of intention. He told us that initially the Taxpayer intended to apply the rental income to repay the redevelopment costs and the bank borrowings and the Ministry K was expected to provide all the necessary financial support whenever necessary before the redevelopment costs and bank borrowings were met. However, as a result of AEP launched by the Country AF government since about the end of 1992, the Taxpayer was unable to obtain the necessary financial support from the Ministry K or Company C and instead, the Taxpayer and Company B were asked to reduce the investment in Plaza S and to remit HK$20,000,000 back to Company C. In about July and August 1993, on account of AEP the Ministry K directed and ordered that all non-approved investment projects of which Plaza S was one, were not to be financed by the Ministry. Thus, the Taxpayer's expected financial support

from the Ministry ceased. Notwithstanding this predicament, Company C remitted HK$80,000,000 to Company B at about the end of October 1993 to meet the bank repayment in October 1993 and also pledged a further sum of HK$50,000,000 to HK$100,000,000 before Company B and the Taxpayer would totally take over the financial responsibility. In view of the outstanding bank loan of HK$600,000,000, the Taxpayer reconsidered the idea of selling the Shop Premises and the Shop Disposal Proposal was reviewed by the vice-officer of the Ministry and the financial secretary. As a result, the Ministry gave approval to sell the Plaza S (including both the Shop and Office Premises) to meet the repayment obligations. After a meeting between Company I, Company F and the Taxpayer on about 1 November 1993, it was resolved that the Shop Premises were to be sold. It was anticipated that the sale proceeds of the Shop Premises would not be sufficient to cover the bank loans, Company Y was thus also instructed to prepare a proposal for sale and letting of the Office Premises on about 5 November 1993. By 18 November 1993, the Taxpayer was informed by Company C that no further fund would be forthcoming. On 19 November 1993, the Taxpayer signed the agency agreement, giving instructions to sell also the Office Premises. The response to the sale of the Office Premises was poor and no offer was received at the close of the tender of the Shop Premises. In about the middle of December 1993, an offer to purchase 10 upper floors of the Office Premises was received from Company Z. The Taxpayer made a counter-offer of selling of 6-8/F, 11-12/F, 16-19/F and 22/F. After negotiations, the Taxpayer agreed to sell those floors and 26 car parking spaces to Company Z, in order to meet the imminent bank repayments. The Shop Premises remained to be sold because the other joint-venture partners needed the proceeds to meet their expenses and also the sale would obviate the future management and interest-apportionment problems. Consequently, the Shop Premises were sold on about 17 January 1994. On about 23 February 1994, Company Y was appointed as the leasing agent for the remaining unsold offices save the 28th Floor which was used by Company I as its headquarter. Since then none of the remaining offices or car parks was sold.

29. On the project management fee, Mr V gave evidence that on 6 June 1992, the Taxpayer entered into a project management agreement with Company B to engage Company B as the project manager in the development of Plaza S whereby the Taxpayer would pay Company B a fee equal to 15% of the construction costs. The Taxpayer believed that it was reasonable for it to pay this fee because the Taxpayer was appointed the leader of the development project to oversee and manage the project and yet it was a newly-formed company and lacked the relevant knowledge and expertise, to do the job and thus it engaged Company B to provide the necessary services and pay a fee for such services. The management fee was not shared by the other two partners because the Taxpayer was compensated by a larger share of the interests in Plaza S.

30. As to the bank guarantee fee, Mr V explained that it represented a consideration from the Taxpayer to Company B for Company B to give a corporate guarantee for the bank loans granted to the Taxpayer and it was calculated at the rate of 1% of the loans granted. It was reasonable for the Taxpayer to pay the fee because Company B as a guarantor had to bear the risk and liability of the bank loans and further more on the Taxpayer's behalf it had given an indemnity to Company F and Company I for their use of their respective properties as a security for the

Taxpayer's bank loans. Had it not been for Company B's good standing and relationships with the banks, the Taxpayer being a newly-formed company would not have been able to obtain the necessary bank loans. For the same reason as above stated for the project management fee, on account of the Taxpayer's larger share of the interest in Plaza S the other two partners were not required to pay or share the guarantee fee.

31. In support of his aforesaid contentions, Mr V referred us to various documents produced for the purpose of this hearing.

32. Mr V was extensively cross-examined by counsel for the Revenue on the documents, which meant to lend weight to the Taxpayer's case. Mr V relied on documents such as a letter from Company B of 18 March 1991; a letter from Company C of 3 April 1991; a letter from Company J of 18 November 1991; a proposal from Company F, Company I and Company C of 27 January 1992; the Ministry K's approval for the development project of 15 April 1992; a newspapers cutting of 28 May 1992; minutes of 20 March 1992; a Budgetary Cash Flow Analysis; and a Rental Forecast Summary. Mr V asserted that the commitment and pledge of financial support from the Ministry or Company C could be found from these documents.

33. Mr V was also extensively cross-examined on the facility letters and the loan documents in respect of the loans extended by the banks on this development project and also on those documents which were meant to provide the necessary evidence on the alleged impact of AEP which caused the sale of the Shop Premises, the Office Premises and car parks in question.

34. Madam W was the second witness called for the Taxpayer. On the written statement produced by her prior to the hearing, other than the amendments made on the figures of the bank loans, she confirmed the contents of the same. Her written statement was of the following effects. She worked for Company B between October 1993 and December 1996. She was the senior manager in the finance department and later she became a general manager. She was also a director of Company B and also a director of the Taxpayer. She was responsible for the Taxpayer's taxation matters. She did not at the relevant time raise objection to the profits tax assessment for the year of assessment 1995/96 of the Taxpayer because she was not familiar with the Hong Kong tax law. She was at the relevant time advised by a Miss AA of the Representatives that profits from a long-term investment was taxable while appreciation of land costs was not. As to the footnote at the end of the profits and loss account explaining the change of intention from long-term investment to trading purpose, she said she could not remember clearly as to this footnote or explanation but all she remembered and understood at the time was that appreciation of land costs was not taxable but proceeds of sale was. In cross-examination, she denied that there was ever any change of intention on the part of the Taxpayer. She insisted that the advice to her at the time was that if the intention was for long-term investment they still had to pay tax on the profits from that part of the building which was sold but tax was not payable on the appreciation of the land costs. She learnt of the mistake that tax should not have been paid by the Taxpayer from someone of her office. She confirmed that Company B had paid tax on the project management fee of

$22,500,000 and the bank guarantee fee of $8,850,000. She was challenged and also cross-examined by counsel for the Revenue on the circumstances which led her to amend her own written statement. She denied that the amendments were made as a result of the evidence given prior to her attendance at the hearing.

35. The last witness called by the Taxpayer was Mr X. Mr X confirmed the written statement produced by him prior to the hearing but made the amendments that the sum of $205,000,000 was a bridging loan, and the amount of the bank loans used was $410,000,000 instead of $691,600,000. In cross-examination, he told us that the Taxpayer learnt of the mistake that tax should not have been paid on the proceeds of sale at the time when there was a change in the personnel of the Representatives. He said that he was told by a Mr AB, a partner of the Representatives that a wrong basis of taxation was used. They had not made any formal complaint to the Representatives in this regard. Neither did they make a complaint in writing because they did not consider that the matter was important enough to justify a written complaint. They had not made any claim against the Representatives because the result of this appeal was not yet known.

The conclusion

36. The legal principles for determination of cases as to whether a property was acquired as a long-term investment or for trading purposes are well established. We will refer to them where necessary.

37. The subjective intention of a taxpayer is to be tested by objective facts and circumstances. As per J Mortimer (as he then was) in All Best Wishes Limited v CIR:

> *'The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the assets is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realizable, 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.'*

38. We have the following facts before us. On about 31 July 1996, the Taxpayer filed a tax return for the year of assessment 1995/96 comprising copies of the audited accounts and tax computation and stating the taxable profits as $194,635,372. The taxable profits included the sale

proceeds of the properties in question. On the basis of the tax return submitted and subject to queries raised, the assessor on 26 September 1996 raised on the Taxpayer net assessable profits of $193,654,839 and tax payable thereon of $31,953,048, for profits tax assessment for the year of assessment 1995/96. The Taxpayer did not lodge any objection against this assessment and the Taxpayer duly paid the first instalment of tax thereon. In the absence of any reply to the letter dated 23 September 1996 within the stipulated time, the assessor on 16 June 1997 raised on the Taxpayer additional net assessable profits of $126,626,095, which represented the amounts of project management fee of $22,500,000, bank guarantee fee of $8,850,000 and revaluation surplus of $95,276,095. The Taxpayer did not raise objection to the additional assessment within a reasonable time after receipt of the notice of assessment. Only on 15 July 1997 the Representatives on behalf of the Taxpayer objected against it. On 27 April 1998, the Representatives wrote to Mr X on behalf of the Taxpayer saying that in order to expedite the finalization of the objection, they proposed to reply to the Revenue that '1. to treat the portion of revaluation reserve attributable to the shops sold as taxable, on the ground that the company intended to sell the shops at the outset of the development project, 2. to capitalize the project management fee as part of the construction cost and 3. to capitalize the bank guarantee as interest expenses' so as to reduce the additional tax by about $3,000,000. By a letter dated 30 April 1998, the Representatives conceded on behalf of the Taxpayer to the assessable profits and additional assessment. On 20 April 1999, the Representatives wrote to Mr X on behalf of the Taxpayer that the application for revising the 1995/96 assessment was lodged with a view to expediting the finalization of a compromise settlement on the capital claim which should be regarded as a tactic to speed up the negotiation process but not aiming at obtaining a success in revising the 1995/96 assessment which was considered to be relatively difficult. Only on 27 April 1999, the Representatives applied on behalf of the Taxpayer to reopen the profits tax assessment for the year of assessment 1995/96 under section 70A of the IRO. The aforesaid facts differ from the picture painted by the witnesses.

39. In order to ascertain the true intention of the Taxpayer at the time of the acquisitions of Address Q. We need to consider the whole of the surrounding circumstances including things said and done at the time, before and after. The Taxpayer's case of intention to hold the properties as long term investment and of financial support from the Ministry and Company C lies mainly on the evidence given by Mr V and the documents produced by him. He claimed that Plaza S was initially intended to be the flagship and headquarter of the Ministry K in Hong Kong; there was no intention of sale; the building was intended partly for self-use and partly for letting; the Ministry K had committed to giving all the financial support which would be needed for the project; and had it not been for the AEP launched by the government of Country AF at the relevant time, the Taxpayer needed not sell the properties in question to meet the repayments of bank loans. He claimed that the Ministry's commitment or pledge of financial support was clearly shown from the documents such as the minutes between the three joint-venture partners, the feasibility report of the three partners, the approval of the Ministry K, the budgetary cash flow analysis and the rental forecast Summary. However, having read through those documents carefully, we are unable to find any record or hint of the Ministry's commitment or pledge of financial support to the development

project. Those documents simply recorded the proposal of the development project, the agreement on the proposal between the three joint-venture partners and the Ministry's approval on the proposal of the development project. More significantly, they recorded the agreement between the three joint-venture partners that finance for the project was to be obtained through bank loans on the security of the parties' respective properties at relevant addresses and that Company B would be responsible for raising any insufficient fund. They only recorded the Ministry's approval of the agreement between the parties and not its financial pledge or commitment. Also, we have here a feasibility report of 27 January 1992, containing two proposals. Both proposals suggested the use of bank loans, one included a rental income forecast while the other included a sales forecast of $680,000,000 and a 13.3% profit yield. In this regard, Mr V under cross-examination confirmed that the proposal with a sales forecast was however adopted. In addition, also under cross-examination, Mr V finally agreed that the support which the Ministry gave in respect of the development project was only a moral one. He also told us that if any commitment was to be made by the Ministry, the Ministry would only make direct commitment to Company C. No evidence was adduced to show direct commitment made by the Ministry to Company C nor Company C to the Taxpayer or Company B. Consequently, on the basis of the aforesaid evidence we have not been able to find the financial support or commitment allegedly given by the Ministry from the documents produced or from Mr V's oral evidence. Apart from a mere assertion of financial support from the Ministry or Company C, no evidence was produced to support this allegation of financial support nor evidence produced to show the Ministry's or Company C's own financial ability to make this alleged commitment of financial support viable.

40. On the facility letters and loan documents produced by Mr V in respect of the bank loans obtained for this development project. It is our observation that in the facility letter of 3 September 1992 in respect of the HK$110,000,000 Term Loan facility, inter alia, there are the following terms:

> 'Prepayment : The loan may be prepaid, in multiples of HK$1 million on interest payment dates, from sale or rental proceeds, without penalty. Prepayment from other sources are subject to a fee of 1/4 % flat on amounts prepaid.'
>
> 'Partial Reassignment : Partial reassignment of individual units will be made against payment of 100% sale proceeds of the units sold after full repayment of the Construction Loan Facility.'

In the other facility letter of 3rd September 1992 in respect of the HK$510,000,000 2.5 year (construction) Loan Facility, similar prepayment and partial reassignment conditions applied. Furthermore, it also contains the following repayment condition:

'Repayment : In one lump sum upon loan maturity, subject to the following conditions:-

Unless cumulative presale of 25% and 45% of the G.F.A. of the property are achieved on or before 31st October 1993 and 30th April 1994 respectively, mandatory repayment of HK$80 million each are to be made on the respective dates. Such repayments are ….'

In addition, in respect of the figure '45%' of the G.F.A. in this facility letter produced, the figure '45%' was originally written as '50%' which was however crossed out and amended in hand-writing to '45%' with the signature 'Mr AC' next to the amendment. This facility letter was addressed to Company B and marked for the attention of 'Mr AD'. Presumably, this amendment was made with the consent of Mr AD who put his signature next to the amendment. The aforesaid conditions for prepayment, partial reassignment and repayment are strong indicators of an intention to sell. We are not convinced by Mr V's evidence that these conditions were imposed upon the Taxpayer by the bank although they had no intention whatsoever to sell. Further, if indeed sale was not contemplated, why would there be an amendment to the condition on repayment since whether 45% or 50% of the GFA was to be sold would be of no consequence and the amendment would have been superfluous. The aforesaid terms in the facility letters strongly indicate that as from the beginning, sale of Plaza S was contemplated. This intention to sell was further strengthened by the amendment made to the percentage of the GFA to be sold in that unless the intention to sell was in mind, the amendment would not have been made.

41. Also produced was the minutes of 9 August 1992 which recorded inter alia the following: 'each party's shared properties are not to be sold externally (save the shop premises). If any of the three joint-venture parties because of its business development requires to sell its shared properties to recover part of its investment, it must sell internally according to the existing economical regulations.' This document shows that external sale of the Shop Premises was permitted, although Mr V in cross-examination asserted that this part of the minutes was a mistake, and that even the Shop Premises were not permitted to be sold externally. From both the oral and documentary evidence, it is accepted that the three joint-venture partners were all under one and the same control and authority of the Ministry K, but it is also clear that among themselves they were actually separate legal entities, having their own operations assets and liabilities which were meant to be dealt with and were dealt with at arm's length between them. Thus whether the properties in question were permitted to be sold externally to the public or internally to the entities under the control of the Ministry, the intention to sell whether internally or externally was present and cannot be ignored. Besides, there was no evidence to support the claim that it was a mistake in the minutes when it recorded that 'each party's shared properties are not to be sold externally (save the shop premises)'.

42. 'Intention' connotes an ability to carry it into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented. It is the Taxpayer's claim that Plaza S was intended partly for self-use and partly for letting purpose; the Ministry K or Company C had agreed to finance the project; and had it not been for AEP exercised by the government of Country AF, sale of the properties in question would not have taken place. Notwithstanding the claim that the Ministry or Company C would finance the project, as aforesaid there is no evidence to substantiate this claim. On the other hand the facts are that the entire development costs including the land costs was secured by bank loans; the Ministry gave its approval and support which as admitted by Mr V was only a moral one to this project; and the three joint-venture partners were jointly responsible for the funding of the project with Company B appointed to arrange the necessary bank loans. Thus the evidence before us is that unless the properties in question were sold the Taxpayer would not have had the ability on its own account to repay the bank loans. It is idle for Mr V to claim that the Shop Premises were initially not intended nor permitted to be sold externally. In this connection, we are also not convinced by Mr V's claim that a mistake was made in the minutes of 9 August 1992 whereby it was wrongly recorded that 'save the Shop Premises all other units were to be sold internally'. Mr V claimed that Mr AE of the Ministry did actually complain about the mistake. However, as is shown on the minutes produced, this minutes was signed by three persons and yet if indeed a mistake was made, could it have been overlooked by all of them, especially when the mistake was on a matter of such importance. Mr V also gave evidence and confirmed that the sales forecast in the feasibility report of 27 January 1992, was adopted instead of the rental forecast. This chosen option also supports an intention to sell. Further, although evidence was given that Plaza S was initially intended to be sold internally, there was however no evidence to show that any attempts to sell internally were ever made before approval from the Ministry was sought to sell externally.

43. The Taxpayer's claim of no intention to sell was also negated by the fact that notwithstanding the sale proceeds of the Office Premises and car parks in question were sufficient to repay the bank loans, the Shop Premises were similarly sold. In this connection, we are aware of the Taxpayer's claim that the Shop Premises were sold because the other two partners required fund to meet their financial obligations and also the sale served to resolve the future management and interests sharing problem arising out of the joint ownership of the Shop Premises among the partners. However, this is only an assertion on the part of the Taxpayer. No evidence was adduced to show the financial needs of the other two partners. The claim that sale of the Shop Premises would resolve the management and interest sharing problem which was another reason for sale is also not convincing, because if indeed the matters of management and interest sharing did pose a problem, this problem would have existed right from the beginning. Thus the claim that it was another reason for the sale of the Shop Premises, is not reliable.

44. Pursuant to section 68(4) of the IRO, the onus lies on the Taxpayer to prove its case. On the basis of the aforesaid evidence and findings, we find that the Taxpayer has failed to discharge the burden rested upon it to prove that Address Q, was acquired by it for investment

purpose. We have reached the aforesaid conclusion notwithstanding that the newspapers reported that Plaza S was intended to be the flagship and headquarter of the Ministry. We find that the intention to use Plaza S as the Ministry's headquarter in Hong Kong and the subsequent use of the 28/F by Company I as office and the letting of the carparks and 21/F and 23/F allocated to the Taxpayer did not assist the Taxpayer's case since these factors did not necessarily preclude an intention to sell which we find had existed since the outset. The Taxpayer has failed to satisfy us on its claim of financial support from the Ministry or from Company C or on its own financial means to see through the development project or to make repayment of the bank loans, without sale of units in Plaza S. On the other hand, there is cogent evidence showing the intention to sell existed from the beginning. For these reasons, we must and hereby dismiss the Taxpayer's appeal.

45. In view of our aforesaid findings that the Taxpayer's intention was to hold its properties for trading purposes, we need not consider the issue on section 70A of the IRO as to whether or not to re-open the 1995/96 assessment on the ground that a mistake was made on the admission of trading stock. Had it been necessary for us to do so, we are of the view that it is not open for us to do the same for the following reasons. Where a taxpayer has deliberately and conscientiously made a decision to submit items of profits for assessment in its tax return, but subsequently changes his or her mind, that cannot be a correctable 'error' within the meaning of section 70A of the IRO. This was the view taken by the High Court in Extramoney Limited v CIR (1997). In the present case, the Taxpayer submitted its audited accounts which included the proceeds of sales as assessment profits. These accounts were signed by Madam W for and on behalf of the Taxpayer. Also when Madam W gave oral evidence, she did not deny that the proceeds of sale were knowingly offered for assessment albeit she claimed that it was offered for assessment by reason of the wrong advice given by the Representatives. In this connection the Taxpayer has failed to adduce satisfactory evidence or indeed any evidence to substantiate the claim of wrong advice given by the Representatives. Rather, Mr X gave evidence under cross-examination that upon discovery of the wrong advice allegedly given by the Representatives, the Taxpayer did not think the matter was important enough for it to make a complaint to the Representatives. Furthermore, for the purpose of this hearing, the Taxpayer did not see fit to call the Representatives to give evidence on its behalf, on the alleged wrong advice or at the very least to produce a letter from them to explain how the mistake made by the Taxpayer came about. Thus, all we have here is an assertion on the part of the Taxpayer that the offer of the sale proceeds for assessment was an error because it had been advised wrongly by its Representatives. The approach and attitude adopted by the Taxpayer in this regard do not lend credance to the Taxpayer's claim of having received wrong advice from the Representatives by reason of which the sale proceeds were mistakenly offered for assessment, thus the attribution of profits was an 'error' within the meaning of section 70A.

46. A general deduction is allowed for outgoings and expenses incurred in the production of profits which are chargeable to tax. An outgoing or expense is 'incurred' when it is paid out or when the liability to pay arises. On the claim of deduction of the project management fee and the bank guarantee fee, the Taxpayer produced the project management agreement of 6 June 1992

and the minutes in respect of the bank guarantee fee in support of its claim of deduction. Apart from these documents and the oral confirmation of Madam W of the said payments, there was no other evidence to prove that these two sums were actually incurred and paid out by the Taxpayer. The aforesaid documents only confirmed the Taxpayer's agreement in respect of the project management fee and its intention in respect of the bank guarantee fee to make such payments but they are not sufficient to prove that these sums were indeed incurred and paid out by the Taxpayer. In agreeing or intending to make such payments, the Taxpayer had not incurred the liability to make the payments, it had simply faced the possibility that such payments might be incurred. The amounts involved were substantial. It is the Taxpayer's case that these sums had been settled by the Taxpayer, and yet the Taxpayer was unable to produce receipts, bank statements, or confirmation from the recipients or any other relevant third parties to substantiate the actual payments of the same. Further, as to the explanation and reason why the other two joint-venture partners were exempted from similar payments, no evidence was adduced nor explanation given on the arrangements whereby the Taxpayer's alleged payments were compensated or offset by its larger share of the interests in Plaza S. Thus, all we have here is an allegation of payments. In the absence of satisfactory evidence to prove that these sums had actually been incurred or paid out by the Taxpayer, we are not in the position to allow the Taxpayer's claim of deduction of them. The appeal in this respect must also be dismissed.