INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D82/89

Profits tax – letter B land entitlements – whether gain or sale liable to tax – whether capital assets or adventure in the nature of trade.

Panel: Henry Litton QC (chairman), Joseph E Hotung and Norman Ngai Wai Yiu.

Dates of hearing: 16, 17, 18, 19 and 25 October 1989.
Date of decision: 6 December 1989.

The taxpayer was a private limited company incorporated in Hong Kong. It acquired Letter B land entitlements in the New Territories at a time when the market was rising rapidly. Letter B entitlements were highly marketable assets. The taxpayer claimed that it intended to use the Letter B land entitlements to obtain land which it could convert into an income producing asset.

Held:

There was no evidence to indicate that the taxpayer did in fact intend to use the Letter B land entitlements to be converted into an income producing asset. The Board held that the intention of the taxpayer was to maximize the profit which it could obtain from the Letter B land entitlements which it acquired and that this was an adventure in the nature of trade.

Appeal dismissed.

Robert Andrews for the Commissioner of Inland Revenue.
John J Swaine instructed by Vivien Chan & Co for the taxpayer.

Decision:

Introduction

1. This is an appeal by the Taxpayer Company ('the company') against profits tax assessment for the years of assessment 1979/80 and 1980/81 arising from the sale by the company of Letter B entitlements. The details are as follows:

Date of Disposal	Area of Entitlements	Disposal

	(square feet)	
January 1980	10,018	sold to A Limited
July 1980	10,376	sold to B Limited
August 1980	68,553	sold to C Limited
September 1980	871	sold to Mr D
	13,391	sold to E Limited

2. The company's financial year ended on 31 March each year. The disposal in January 1980 of 10,018 square feet of Letters B was reflected in its financial statements for the year ending 31 March 1980 as a 'gain on disposal of investments in Letter B entitlements during the year' in the sum of $5,348,222. The remaining disposals were reflected in its financial statements for the year ending 31 March 1981 with a similar description, the 'gain on disposal of investments' amounting to $57,770,676.

3. The assessor did not accept the company's return and assessed the company on the basis that the gains amounted to trading profits. The Commissioner confirmed the assessments (except for a minor variation not relevant to this appeal), hence this appeal to the Board of Review.

Background Facts

4. The company was incorporated in 1972. Its authorised and issued capital has remained at $10,000. Its early history has no relevance to this appeal. In practical terms, it remained a 'shelf-company' until June 1978 when it was used as a vehicle to acquire Letters B from two related companies, F Limited and G Limited. F Limited and G Limited had acquired the Letters B through Crown resumptions of agricultural land owned by them in the New Territories over a considerable period of time. The details of the acquisitions are as follows:

Date	Vendor	Area (square feet)	Price $
June 1978	G Limited	84,144	12,621,600
June 1978	F Limited	20,583	3,087,450
			15,709,050
July 1979	F Limited	13,391	1,071,280
		118,118	16,780,330

5. The bulk of the 118,118 square feet of Letters B were of old vintage (over 100,000 square feet being acquired from the Government in 1971 or before 1971) and therefore carried a considerable premium under the Government tendering system for exchange of Letters B for building land in the New Territories.

6. F Limited was incorporated in Hong Kong in 1948 and G Limited was incorporated in Hong Kong in 1949; the founder of both companies was Mr H. Mr H died in 1977. At the time when the 118,118 square feet of Letters B were transferred to the company, the beneficial shareholders of F Limited and G Limited were as follows:

F Limited:

58.8%	Mr I, son of Mr H.
41.2%	Remaining shares held by members of Mr I's family and employees and associates of Mr H.

G Limited:

84.5%	Mr I.
5%	J Limited: a company registered in China before the Communist takeover in 1949.
10.5%	Remaining shares held by Mr I's family and old employees and associates of Mr H.

At the time of the acquisition of the Letters B the beneficial shareholders of the company were as follows:

50%	Mr I.
50%	Miss K, the sister of Mr I, and wife of Mr L.

7. The 13,391 square feet of Letters B referred to in paragraph 4 above were acquired by F Limited from the Government in 1978 and therefore did not fall within the arrangements for the sale of the Letters B to the company in June 1978.

8. Under the formal agreements in June 1978 (referred to in paragraph 4 above) the company acquired the Letters B, amounting to over 100,000 square feet, upon very favourable terms. The agreements provided for deferment of payment of the purchase price for four years, and payment thereafter by three equal instalments as follows: June 1982, June 1983 and June 1984 with interest thereon at 6% per annum. The purchase price was based on the sum of $150 per square foot which, on the evidence before us (in particular, an offer for sale made two months later for 10,018 square feet of the Letters B at $500 per square foot which the company rejected) it would appear that the purchase price in June

1978 was below market price. Obviously, F Limited and G Limited remained the registered owners of the Letters B pending completion of the purchase. The agreements in June 1978 contained a number of fetters on the company with regard to dealings with its beneficial interest in the Letters B under the two agreements: for example, clause 6 under which the company agreed not to assign or part with its interest under the agreements; clause 6 also provided that F Limited and G Limited were 'not required to grant a conveyance to any person or any corporation other than [the company]'.

9. On the face of the two agreements in June 1978, the parties contemplated that the company would make application to the New Territories Administration for the grant of building land upon the surrender of the Letters B, and made provisions for F Limited and G Limited, as the registered owners, to execute the formal documents necessary to give effect to such grants of land to the company. The agreements also contained an undertaking by the company (as provided in clause 9 of the agreements) to carry out the terms and conditions of grant of building land by the Government and to fully observe and perform such conditions. Invariably, such conditions would include building covenants to be fulfilled by the grantee. These provisions in the agreements have the effect of safeguarding the interests of F Limited and G Limited as creditors of the company in relation to the unpaid purchase price, in the event that F Limited and G Limited should, as registered owners, surrender any part of the Letters B to the Hong Kong Government in exchange for land granted to the company. Contemporaneously with the two agreements in June 1978 for the sale of the Letters B, Mr L executed guarantees, holding himself liable to F Limited and G Limited in respect of 75% of the purchase price payable by the company.

10. In relation to the balance of the Letters B amounting to 13,391 square feet, referred to in paragraph 4 above, the transaction was effected by a simple conveyance on sale, G Limited lending to the company the sum of $1,000,000 at 2% below prime lending rate for the purpose of discharging the liability for the purchase price to F Limited. The consideration for the 13,391 square feet of Letters B under the July 1979 conveyance was also based on the price of $150 per square foot: but this was, of course, for Letters B of much more recent vintage than the Letters B sold under the June 1978 agreements.

11. The legal documents for the sale of Letters B to the company in June 1978 were prepared by a firm of solicitors. The bill of costs rendered by that firm in August 1978 which suggests that much time and thought had been given to protect the interests of the parties (both vendors and purchaser) to the two agreements have been placed before us in evidence.

12. At the time of the June 1978 agreements, the directors of the company were as follows:

Mr L
Miss M (daughter of Mr L)
Mr I

13. Together with the formal documentation in relation to the acquisition of the Letters B by the company in June 1978, the solicitors also prepared minutes for a directors' meeting of the company recording the adoption of the transactions on behalf of the company and ratifying the appointment of the solicitors. These minutes purport to record a meeting at the registered office of the company on l6 June 1978, attended by the three directors, Mr L, Miss M and Mr I, with Mrs N (Mr L's secretary) in attendance. This was, in effect, a 'paper meeting': whilst the directors informally were in agreement with the contents of the minute, such a meeting was in fact never held. These minutes bear the signature of Miss M.

14. There has also been put in evidence a minute of a meeting purportedly held on 18 June 1978 at the same place, attended by the same directors which recorded as follows:

> ' It was confirmed that Letters B totalling 84,144 square feet and 20,583 square feet purchased from G Limited and F Limited respectively should be held by the company as long term investments with a view to exchange suitable land for the construction of building thereon for rental purpose.'
>
> This minute also bears the signature of Miss M, signing as chairman.

15. Pausing at this juncture in our recital of the facts, two sharp points emerge:

(i) On the face of the documents before us, and in particular the two agreements in June 1978, there is nothing to indicate that the company acquired the Letters B with a view to pursuing an adventure in the nature of trade in respect of the Letters B. The intention, insofar as such can be inferred from the documents, appears to have been to exchange the Letters B for building land.

(ii) And yet, within a period of just over two years, the company had sold all its Letters B (except for 14,909 square feet exchanged for building land), without in fact having developed any property whatever for rental income. The company from beginning to end has not derived a cent of income from the Letters B.

It is within the polarity of these two propositions that we examine the further facts, to see whether the company was at all times holding the Letters B (until sale) as capital assets, or whether it acquired the Letters B in pursuit of an adventure in the nature of trade.

<u>The Company's Case</u>

16. The burden of satisfying us that the assessments as confirmed by the Commissioner is incorrect is, of course, upon the company. It is the company's case that the Letters B were, in the hands of F Limited and G Limited, capital assets and when the company acquired the Letters B in June 1978 the intention of the company was to exchange the Letters B for building land, to be developed for rental income purposes. The company says that its intentions are accurately reflected in the board minutes dated 18 June 1978, as

referred to in paragraph 14 above, and in minutes to which we will refer later on. The company further says that from the time of acquisition until about the middle of 1980, the company had made repeated efforts to fulfil the objective as set out in the board minutes of 18 June 1978 by tendering for building land when such was offered by the New Territories Administration from time to time: at first on its own, and later in joint venture with other large developers. The fact that most of these efforts came to nothing does not detract from the main aim: which was to turn the Letters B into long term assets for rental income. It is the company's case that the sales effected in January 1980 (10,018 square feet) and July 1980 (10,376 square feet) were consistent with this objective: these sales were effected in order to meet the company's commitments for funds in relation to capital projects. As regards the large disposal made in August 1980 (68,553 square feet) this came about in consequence of a change of intentions, when, through news obtained from the highest levels of the Chinese Government, the company's directors (Mr L and Miss M) realised that the termination of the New Territories lease in 1997 was likely to become a major political issue between the United Kingdom Government and the Chinese Government; the company therefore lost confidence in the prospects of long term investment in land in the New Territories and thereafter sought diversification. Accordingly, the 68,553 square feet were sold in August 1980. What then was left was the company's Letters B which were sold in the following month: the 871 square feet sold to Mr D were very old and valuable 1963 vintage Letters B, the balance of 13,391 sold to E Limited were the 1978 Letters B conveyed to the company by F Limited in July 1979.

The Oral Evidence

17. At the hearing before us, Counsel for the company called as its sole witness Miss M. After Miss M obtained a MBA degree in USA, she worked as an investment banker in New York for one year and returned to Hong Kong in 1977 shortly after her grandfather Mr H's death. She became a director of the company in April 1978 and has been in charge of the affairs of the company ever since then.

18. Miss M's father, Mr L was, in 1978, engaged in very large scale business. One of Mr L's companies (O Limited) was engaged in constructing three hotels in China. It is therefore Miss M's case that although the company had a very small issued capital (the sum of $10,000), there were considerable resources available to Mr L's family to fulfil the objectives set out in the minutes of 18 June 1978.

19. Miss M gave evidence to the effect that it was she herself who drew up the minutes of 18 June 1978: she did that after discussion with her uncle, Mr I, (who owned beneficially 50% of the company). Mr I was not active in business and was not in very good health. It was Mr I's wish, and that of Miss M's mother (who owned the other half-share in the company), to have a steady income derived from the company's assets. Accordingly, the 'mandate' given to her by the two beneficial owners of the company (her uncle Mr I and her mother) was to generate recurring income with the Letters B: this meant, in effect, to exchange the Letters B for building land and then to build upon such land to generate rental income. She said that the Letters B were, in effect, an inheritance passed down by her grandfather, and the only reason why F Limited and G Limited were not used as the vehicles

to achieve this objective was the fear that, because of the underlying shareholdings in F Limited and G Limited, there might be claims from the Chinese Government later on; her uncle Mr I therefore wanted to have the Letters B transferred to a 'clean' company so that the long term objectives (rental income from developed properties) could be achieved without such complications.

20. Obviously, if we accept in total the propositions as summarised in paragraph 19 above, this is almost conclusive in establishing the fact that the Letters B were, in the hands of the company, capital assets.

21. We pause here to say that we do not accept the proposition that the transfer to the company was, in effect, a technical matter. We say it for this reason: undoubtedly, there was a considerable change in the ultimate beneficial ownership of the Letters B consequent upon the transfer. For one thing, the interests of the 'outside' shareholders disappeared: they were not shareholders in the company. Moreover, the beneficial interest of Miss M's mother had considerably increased through her 50% shareholding in the company. This is no mere technical matter. However, this is a minor consideration in the case. What needs to be examined in detail is the proposition that the company had attempted repeatedly to fulfil the 'mandate' as mentioned in paragraph 19 above. To this we will now turn.

Town Lot No AA

22. This was a very large piece of land, approximately 1.96 hectares, offered for residential development by the Government (with ancillary recreational and community facilities) in about August 1978. Miss M said that she was interested in this development because she had the concept of good quality service apartments in mind, catering for bachelors and families who might be prepared to pay a premium over the market through the attraction of special facilities. The running of service apartments fell comfortably within that concept.

23. The company received tentative proposals from two separate developers to tender jointly for Town Lot No AA. She said that both proposals were rejected because these were developers who were more interested in development for resale rather than the construction of high quality buildings for rental income. In the event, no tender was put in for Town Lot No AA.

24. We are not much impressed by the evidence concerning Town Lot No AA as a demonstration of the company's intentions. The site area was approximately 14,700 square metres and, at a plot ratio of 2.1 (which the conditions of tender allowed) the total gross floor area would have been 30,870 square metres. The development cost of such a project would have been very considerable. There was not an iota of evidence adduced as to how the company would have financed such a development; no calculations of any kind were put forward as to the feasibility of such a project.

25. The minutes of a meeting purportedly held on 18 August 1978 where the directors 'resolved' that they should 'prepare costings' for the proposed joint ventures with

the two developers with a view to the joint tender for Town Lot No AA were put before us. It is not clear from the evidence whether such costings were in fact ever prepared, and if so what figures were thrown up.

26. The next minutes put before us are dated 22 August 1978 which refers to the rejection of the proposals to jointly tender for Town Lot No AA and also the rejection of an offer made to purchase 10,018 square feet of the Letters B at $500 per square foot. The minute goes on to say:

> ‘ After lengthy discussions among the directors, it was unanimously resolved that the above offer be rejected and that the Letter B entitlements should be retained for the purpose of exchanging suitable land for the construction of buildings thereon for rental purpose as originally intended.’

27. The matter of tendering for Town Lot No AA was then dropped.

Town Lots Nos BB and CC

28. The papers in relation to the application for Town Lots Nos BB and CC, as adduced in evidence, are not complete. It appears that these ere also residential lots. Miss M said in evidence that she was interested in tendering for Town Lots Nos BB and CC for much the same reasons as for Town Lot No AA: young professionals would be attracted to live and work in the area because of the infrastructure which the Government was putting in place.

29. There is no doubt that the company did, in fact, tender for Town Lots Nos BB and CC and that the tender was unsuccessful. Miss M said in evidence that, in relation to Town Lots Nos BB and CC, she did ‘a lot of studies’ and talked to a lot of experienced people about the most efficient way of ‘running a rental collection project’. However, no concrete evidence was put before us in the form of feasibility studies or anything else and, at the end, we are left in the dark as to the basis upon which the tender was made. We have nothing but Miss M’s bare words that the intention was to run a ‘rental collection project’. How the project would have been financed if the tender was successful; what return on investment the company was hoping to make; how the company would discharge its liability for the construction and other cost in connection with a large project; how large was the project anyway; how the company was to repay both the development cost and the debt incurred to F Limited and G Limited; none of these questions were answered. We are left unimpressed by the tender for Town Lots Nos BB and CC as a demonstration of Miss M’s ‘mandate’.

Town Lot No DD

30. The company utilised a total of 38,793 square feet of Letters B of 1971 vintage and 9,699 square feet of Letters B of 1978 vintage for the tender of Town Lot No DD. This was in July 1979. The tender was successful. However, the company withdrew the tender and forfeited the deposit of $50,000: the reason, according to Miss M, being that her costing

was far too high and it was advantageous to the company to withdraw from the transaction and forfeit the deposit rather than to go ahead with the acquisition of Town Lot No DD. Town Lot No DD was, according to Miss M, within the area of the company's 'special interest', being in a low density area and therefore suitable for the kind of tenants she would want for long term rental income purposes.

31. Again, the feasibility studies for Town Lot No DD, if such ever were made, have not been produced. We are left in the dark as to the basis upon which the company tendered for Town Lot No DD and we do not know the extent to which the costing was far too high. At that time (September 1979) the market value of Letters B was rapidly escalating. Was this a case of a company genuinely interested in developing residential property for rental income, or was it a case where the directors thought that it would be more profitable to leave the Letters B in the company's hands as a 'commodity', rather than having them exchanged for land? The evidence adduced provides no answer.

Town Lot No EE

32. A joint tender was made in September 1979 with a developer P Limited for Town Lot No EE. This was not a residential development, and therefore outside the parameters of the previous three properties referred to above (Town Lots Nos AA, BB, CC and DD).

33. Miss M said that by this time (September 1979), the company had learnt that the Government was considering abolishing the system of giving priority to vintage Letters B and she was therefore anxious to utilise the company's Letters B: that was one of the reasons for tendering for Town Lot No EE jointly with a developer P Limited (a subsidiary of Q Limited), even though this represented a change of focus regarding her 'mandate'.

34. Miss M explained that she decided to go into joint venture with a real estate developer to tender for Town Lot No EE because the company's attempts to do it alone had previously been unsuccessful: it was difficult, she said, to tender at the appropriate price and, through inexperience, the company had been either under-bidding or (in the case of Town Lot No DD) 'over-shooting'. So she thought it better to join professionals who knew the market better.

35. Town Lot No EE was a composite commercial development: it comprised a car-park block (parking for not less than 350 motor vehicles), a petrol filling and service station and tower blocks for commercial purposes.

36. There is no suggestion in the evidence that the joint venture partner, P Limited, was proposing to develop Town Lot No EE for investment purposes. Miss M was extremely vague as to how the shares in the development might eventually be carved up: she claimed that she had associates who had experience of running car-parks as a business; alternatively, the company might opt to retain some of the commercial development in Town Lot No EE for rental income.

37. There has been placed before us in evidence a letter dated 18 September 1979 written by Miss M to Q Limited ('Q Properties') setting out the Letters B which the company was putting forward as its contribution to the joint venture. These amounted to 38,793 square feet of agricultural land (which, of course, would be surrendered on a 5:2 basis). The site area of Town Lot No EE was 32,702 square feet. The letter of 18 September 1979 proposed that in the event that the tender was successful, each party's share of the development would be based on the market value of the Letters B and cash contributed. The letter went on to say:

> 'Details of the arrangement will be reduced in writing in the form of a joint venture agreement to be signed at a later date.'

38. This was as far as matters went between the company and its joint venture partner in relation to Town Lot No EE. The impression left in our minds at the end of the day is that there was no commitment of any kind for retention of any part of the development for long term investment: of course, the discussions with Q Properties were at an early stage and ultimately the tender was unsuccessful. But we would have expected to see at least some feasibility studies made if the company had any real commitment to a long term project.

Town Lot No FF

39. Town Lot No FF was a very large piece of land in a town centre. A number of large developers were interested in tendering for this property including the R Group of companies headed by Mr S. Mr S was a good friend of Mr L.

40. In about September 1979 R Group of companies was putting together a syndicate to tender for Town Lot No FF through a joint venture company called T Limited. The company was invited to join in, and did so. Accordingly, 65,943 square feet of the company's Letters B were assigned to T Limited as its contribution to the joint venture. This amounted to approximately a 7% interest in the joint venture development.

41. Miss M said in evidence that she spoke to Mr S and told him that she was interested in running 'part of the commercial complex or a restaurant' and Mr S agreed to the proposal. Miss M said that she did not ask for any written commitment: Mr S's word was good enough.

42. As things transpired, T Limited's tender for Town Lot No FF was unsuccessful and, following this, the 65,943 square feet of Letters B were re-assigned back to the company.

Town Lots Nos GG, HH, II and JJ

43. These were four lots of residential sites for low density development, in the same vicinity as Town Lot No DD (for which the Company had tendered successfully and then had withdrawn its tender by forfeiting the deposit).

44. In about November 1979 the company jointly tendered with Q Properties for these four lots. They were successful in relation to three: Town Lots Nos GG, II and JJ. Eventually, Town Lots Nos II and JJ became incorporated into one lot, renumbered as Town Lot No KK. The company's commitment of Letters B was 14,909 square feet (see paragraph 15(ii) above). Low-rise residential blocks were constructed on the two sites: Town Lot No GG (the smaller site) became known as LL Block and the larger site Town Lot No KK became known as MM Block. LL Block and MM Block were separated by a road ending in a cul-de-sac. There were sixteen residential units in LL Block and forty-eight residential units in MM Block. Within the site of MM Block was a swimming pool.

45. There is before us minutes of a directors' meeting purportedly held on 8 January 1980 where the successful tender for Town Lots Nos GG, II and JJ was noted. The minutes then went on to say:

> ' It was resolved to enter into a joint development agreement with [Q Limited] to construct a commercial residential complex on the above sites. It was further resolved that the units in the complex to be distributed equivalent to [the company's] share in the joint project be retained for rental income purpose.'

46. In June 1980 the company entered into a formal agreement with Q Properties' subsidiary, P Limited, in relation to these town lots development ('the Town Lots Nos GG and KK project'). P Limited's share was 77.09% and the company's share was 22.91%. P Limited was appointed the project manager. The parties agreed, for the purposes of financing the project, to first seek financing from banks and other financial institutions by means of a building mortgage and, if such was not acceptable to the parties, to finance the project out of their own resources in proportion to their interest in the property.

47. By clause 8 of the agreement, P Limited was entrusted, after building contracts for the construction of the superstructures of all buildings had been let, with the task of determining the value of all units in the project. The company was then given the right of first choice in the selection of units and entitled to take units having a total value equivalent to 22.91%. Clause 9 of the agreement provided for a deed of partition of the property. Clause 10 of the agreement made arrangements for P Limited selling its entitlement of the units in the development and clause 10(b) went on to say:

> ' (b) In so far as [the company] has expressed its intention to retain its entitlement of the units, [the company] will nevertheless sign the said approved agreements for sale and purchase within seven days after the same have been delivered to it by the solicitors in charge of the sale of [P Limited's] units in order to facilitate the sale of [P Limited's] units and no more.'

48. Counsel for the company relies relies heavily upon the agreement in June 1980 as evidence of the company's intentions to carry out the 'mandate' for development for

rental income purposes. The question for us is the weight we attach to this agreement as evidence of such intention in the light of all the evidence viewed as a whole.

49. What in fact transpired as regards these town lots development was this. By 1982, when the construction was still at a relatively early stage, there was a down-turn in the market and P Limited decided to slow down the development to await a revival in the business cycle. In the event, no partition of the property between the joint venture partners ever took place. Eventually, all the units in LL and MM Blocks were sold, between August 1984 and January 1985.

50. Despite what has been recorded on paper, as summarised in paragraphs 46 and 47 above, we are left in considerable doubt as regards the company's intentions concerning LL and MM Blocks. The evidence is that P Limited was, from the outset, intending to redevelop for sale. This would have made for a very uncomfortable joint venture partner for the company if the company's firm intention all along was to retain part of the development for rental income. For example, a feature of the development, which would have been attractive to the class of tenants Miss M claims to have had in mind, was the swimming pool: this was located within the site of Town Lot No KK. The company's share of the development was 22.91%. Assume that the company took the whole of LL and MM Blocks (as was suggested in the course of the hearing) this meant in effect that what the company retained would have been without the swimming pool.

51. Furthermore, we are left in considerable doubt with regard to the proposals for financing the development. Assuming that bank finance was obtained for the construction cost, as the agreement of June 1980 envisaged, how was the company's share of the liability to be discharged out of eventual rental income?

Town Lot No NN

52. In about November 1979, after the tender for Town Lot No FF was unsuccessful, R Group of companies offered the company a 10% share in a development project in relation to Town Lot No NN. This did not involve in any way the surrender of the company's Letters B to the Government: the owner of Town Lot No NN was U Limited. And a R Group of companies subsidiary called V Limited had an agreement to purchase from U Limited Town Lot No NN for the purposes of development. At that time, Town Lot No NN was zoned 'light industrial' and there was a proposal before the Town Planning Board to change the zoning to either residential or residential and commercial purposes.

53. The company's investment in this project took the form of shareholding in V Limited: $500,000, being 10% of the issued capital. The initial outlay totalled $1,913,010 being made up of capital ($500,000) and the balance by way of shareholders' advance to V Limited.

54. Miss M's evidence concerning the reasons for taking part in this joint venture were these: Mr S said to her (after the disappointment regarding Town Lot No FF), 'You can be flexible. If the ultimate purpose is to have income-generating property, you do not

have to just go for Letters B tenders. You can sell your Letters B and invest the cash in a project'. This, according to her, led to the investment in V Limited.

55. As regards her 'mandate', she said R Group of companies were confident that, despite the 'light industrial' zoning, the site would be converted to commercial/residential use. There would be a commercial podium and, Miss M said, one possibility might be for the company to run a restaurant on the site. There was also the possibility of residential development: the apartments would have good sea views and this would be suitable for attracting good tenants. Miss M claims in evidence that she discussed these possibilities with Mr S whose response was positive. She said that Mr S welcomed the company's proposals to retain part of the commercial space for rental income and 'encouraged us to run a business there'. None of this was in writing but Mr S's word, she said, was her bond.

56. Eventually, V Limited's sale and purchase agreement with U Limited was cancelled upon the payment by U Limited of a sum of $25,000,000 by way of compensation. An interim dividend of $18,500,000 was declared by V Limited, 10% being paid to the company to reflect its shareholding in V Limited.

Town Lot Nos PP, QQ, RR, SS, TT and UU

57. These were all joint tenders with P Limited (the wholly owned subsidiary of Q Properties). The arrangement with Q Properties, according to Miss M, was very much the same as on previous occasions: the company would retain part of the development for rental income whilst Q Properties would sell their share.

None of these tenders were successful.

Sale of Letters B

58. In January 1980 the company accepted an offer and sold 10,018 square feet of Letters B at $700 per square foot. There is in evidence the minutes of a meeting purportedly held on 3 January 1980 which records Miss M as having been 'elected' as chairman of the meeting and, in relation to the offer made by A Limited to purchase 10,018 square feet of Letters B at $700 per square foot, states as follows:

> ' The chairman pointed out to the meeting that [the company] is in need of funds in its investment in a commercial residential development at [Town Lot No NN]. [The company's] share of investment in the above project is 10%, being approximately $11,000,000.
>
> In view of the forthcoming investment in the [Town Lot No NN] project, it was resolved that the above offer by [A Limited] should be accepted.'

59. When Miss M was asked in cross-examination whether the sale of Letters B for cash represented a change of intention on the part of the company, Miss M said yes. She said that when the company started off, it was on the basis of 'set specific authority' but

when they found that they could not achieve the purpose of generating income, the 'over-all strategy' had to change: they had to 'broaden that scope' with regard to the choice of investment and selling Letters B to invest in the Town Lot No NN project did represent a departure from the 'original mandate'. When pressed further in cross-examination with regard to the reasons for selling the Letters B in early 1980, Miss M said that 'from day one' the idea was to generate recurrent income; but up to the point when they started selling Letters B, they did not have much luck in achieving that objective, that is, constructing buildings and collecting rent. She said that there were many different ways to achieve the same purpose; she had not damaged the 'ultimate purpose' but had only changed the 'specific mechanism' employed.

60. In July 1980, the second sale of Letters B took place. It was 10,376 square feet also at $700 per square foot. In relation to this sale, there is put in evidence minutes of a meeting purportedly held on 15 July 1980 which, after referring to the offer to purchase 10,376 square feet of letters B at $700 per square foot, states as follows:

> ' The chairman proposed that the above offer should be accepted so as to enable [the company] to set up a reserve of funds to meet its commitment in the joint development project with [W Limited] at [Town Lot No NN]. It was pointed out to the meeting that there was a likely possibility that the original budget for investment for the whole project might have to be revised due to the current inflationary trend in the economy.
>
> The chairman also pointed out that [the company] had recently signed a joint building agreement with [Q Limited] in the building project of [Town Lots Nos GG, II and JJ]. [The company's] share of investment is estimated to be $6,000,000.'

61. Miss M accepted in evidence that the reference in the minutes to the possibility of the Town Lot NN project being 'revised due to the current inflationary trend in the economy' was a mistake: what she had in mind, she claimed, was a clause in the agreement with U Limited which foreshadowed the payment of additional premium to the Government in the event of commercial development being allowed. This would have made the project more expensive. As regards the need to 'set up a reserve of funds' to meet the company's commitment in the development of Town Lot No NN, Miss M was unable to give any indication as to when such commitment to further funds might have eventuated. In fact, in January 1982, the agreement with U Limited was cancelled, and the company was never called upon to contribute any further funds to the joint venture company V Limited beyond the initial investment of $1,913,010.

62. As regards the second reason for sale of the letters B in July 1980: namely, '[the company's] share of investment' in the Town Lots Nos GG and KK project being estimated to be $6,000,000, Miss M said that at that time the joint venture partner was proposing to get credit facilities from an associated company, X Finance, whose terms were very onerous. They were therefore proposing to finance the project with shareholders' loans. Later on, Miss M said, as a result of a telephone call made by Mr L to the chairman

of Q Properites, credit facilities on more favourable terms were provided by X Finance: but this was not until much later on; in the meanwhile, cash was required for the development in Town Lots Nos GG and KK. However, we have not been provided with any cash flow figures for this project; all we know is that the occupation permit for LL Block was not issued until September 1984 and the occupation permit for MM Block was only issued in August 1985: what expenditure was anticipated in 1980/81 is not something we can evaluate. The estimated requirement of $6,000,000 referred to in the minutes remains a bare assertion.

Adventure in the Nature of Trade or Investment

63. What we have set out in paragraphs 22 to 62 above is a brief summary of the testimony given by Miss M (supplemented by documents) over a period of about three full hearing days. The main issues for us to determine are:

(i) whether the evidence establishes Miss M's 'mandate' as she claims she was given at the inception, and

(ii) when she departed from the 'original mandate' (to turn the Letters B into income-producing real estate) as she admits she did (see paragraph 59 above) whether this destroys her fundamental premise that from beginning to end the Letters B were capital assets in the company's hands.

64. In our view, Counsel for the Commissioner summarised the position accurately when he said that when Miss M returned to Hong Kong in 1977 and took charge of the affairs of the company in 1978, she was 'bubbling with business ideas'. In the course of her testimony she spoke of operating service apartments, running a commercial car-park, opening restaurants and bowling alleys: all in the context of generating income from developed property. Where precisely the company fitted into these various proposals was not clear. In the context of the developments with which we are concerned in this case (the Town Lots Nos AA, BB, CC etc) a great deal of capital would plainly have been required. And no less by way of professional expertise, business structure etc. Miss M spoke of wide circles of acquaintances expert in the real estate field: but there is not a scrap of evidence that such expertise was ever engaged on behalf of the company. Further, if the June 1978 agreements could be treated as commercial documents (as the company contends they should), then the company had the obligation, as from June 1982, of paying to F Limited and G Limited the instalments of the purchase price for the Letters B. We find it difficult to see how the 'mandate' of generating income from developed property could be achieved without, at least, the sale of a substantial portion of the Letters B. On the company's own admission, the company's first two sales of Letters B (in January and July 1980) were made in order to meet the company's commitment of funds in, first, the Town Lot No NN project and then, in relation to both the Town Lot No NN project and the Town Lots Nos GG and KK project. We are therefore driven to the conclusion that, from the beginning, the company's intention was to sell at least part of the Letters B when the price was right.

65. Was there then any real intention to retain the rest, and turn them into rental-income-producing properties? The only instance to which the company can point of having exchanged Letters B for land is in respect of the project (Town Lots Nos GG and KK). In this instance, 14,909 square feet were surrendered. But as a demonstration of Miss M's 'mandate' the project is full of question marks: as we have attempted to enumerate in paragraphs 50, 51 and 62 above. Ultimately, of course, not one unit in this development was retained.

66. When the company transferred 65,943 square feet of Letters B to T Limited, in September 1979, it was simply taking a position as a minority shareholder in a private company. There were other joint venture partners besides R Group of companies, but Miss M did not know who they were. This seems to us a very considerable departure from the 'original mandate' and casts doubt on whether such ever existed.

67. As regards the minutes of directors meetings, (and in particular those referred to in paragraphs 26, 45, 58 and 60 above) these are far from satisfactory as contemporaneous records of the company's intentions. At one point in her testimony, Miss M said that when professional secretaries were appointed (sometime in the course of 1979) the minutes were drafted by them upon her oral instructions. But when the format of the minutes was pointed out to her (these never seemed to have changed even up to the end of 1981), Miss M's testimony shifted. She said that, generally speaking, she would give instructions regarding the minutes to her father's secretary Mrs N who would then 'transcribe' her instructions: Mrs N would instruct the staff to prepare the minutes. Later on, Miss M would then be asked by a junior secretary to sign the minutes and she would do so from time to time. Where exactly the professional secretaries came into the picture, if they came into the picture at all, we do not know. (No one from the professional secretaries gave evidence).

68. The function of the minutes, Miss M said, was to enable a 'paper-flow of communication' to pass to her uncle Mr I. She simply gave instructions regarding the text of the minutes, and then signed them from time to time: the format was not her concern.

69. The stark fact of the matter in our view is this: whilst the minutes solemnly purported to record meetings of the directors having taken place at specific times and places, purportedly attended by the directors recorded as being 'present', the reality lies elsewhere. There were no meetings. In many instances, there was no prior discussion between the directors. Whilst the minutes purport to record the company's intentions, they in reality are nothing more than Miss M's own bare assertions. The minutes have a considerable flavour of contrivance. For example, the minutes dated 10 August 1983 purport to record the company's resolution 'to change original intention ... to develop [Town Lots Nos GG and KK] for resale'. And yet, on Miss M's evidence, the intention must have been formed three years before when, following Mr L's visit to China the company had decided to 'diversify' out of the New Territories.

70. In these circumstances, we attach little evidential weight to the minutes. As regards the formal legal documents (there were a number we have not set out specifically in

this decision), these do not in fact meet the reality on the ground. Whilst the company on the one hand and F Limited and G Limited on the other were contracting on formal legal terms, in fact the decision makers were at liberty to vary the formal agreements at will. The only decision makers were Miss M, her father Mr L and her uncle Mr I. They had total control of the companies. These formal legal documents carry little weight.

71. The main reason advanced for the sale of the bulk of the Letters B (68,553 square feet in August 1980) was that the company was seeking diversification of its investments as a result of loss of confidence in the New Territories. However, only the vaguest evidence was given as to what 'investments' the company thereafter made. Miss M gave some passing reference to some shipping business, and restaurant business in USA, nothing more.

Conclusion

72. The stark reality is that when the company acquired the Letters B in June 1978, these were highly marketable assets and the market value was rising rapidly. It took no steps to establish an operation whereby the Letters B could be converted into an income-producing asset. We cannot speculate as to what the company might have done if, for example, it had been successful in its tender for Town Lots Nos BB and CC (made in February 1979). Nothing that we have seen in the evidence convinces us that, if the company had been successful, it would have developed the site of Town Lots Nos BB and CC into an income-producing property. When the company was successful in its tender in relation to another site (Town Lot No DD) it withdrew the tender and forfeited its deposit. The aim, from the beginning, in our view, was to maximise the profit the company hoped to reap from the Letters B. In our view, the company embarked upon an adventure in the nature of trade when it acquired the Letters B in June 1978.

73. This appeal must therefore be dismissed.