Case No. D94/04

Profits tax – deduction of loan interest expenses and related expenditure borrowed for the purpose of producing chargeable profits under section 16(1)(a) – whether further conditions in subsection (2) were satisfied – whether the 'Ramsay principle' was applicable to section 16 of the Inland Revenue Ordinance ('IRO') – whether there was any artificial or fictitious transaction – whether the sole or dominant purpose was the obtaining of a tax benefit – onus of proving assessment excessive or incorrect was on the appellant – sections 16(1)(a) & (2)(d), 17(1)(b), 51(4)(a), 61, 61A & 68(4) of the IRO.

Panel: Colin Cohen (chairman), Mabel Lui Fung Mei Yee and Anthony So Chun Kung.

Dates of hearing: 15, 16, 17, 19, 22, 23, 25 and 26 November 2004.
Date of decision: 16 March 2005.

This appeal by Company A, heard together with that in D95/04, was against the determination of the Commissioner in respect of the profits tax assessments raised on the appellant company for the years of assessment from 1994/95 to 2000/01. By the said determination, the Commissioner reduced the profits tax assessments for the years of assessment 1994/95 and 1995/96, confirmed the profits tax assessments for the years of assessment 1996/97, 1997/98, 1998/99 and 1999/2000 and increased the profits tax assessment for the year of assessment 2000/01 raised on the appellant company.

Company A ('the appellant company') was incorporated in Hong Kong on 26 November 1991 with an authorized share capital of HK$1,000 divided into 100 ordinary shares of HK$10 each (two shares were issued and fully paid-up) and was a wholly-owned subsidiary of Company D Group, which was in turn part of the Company AW Group. Company D, a company incorporated in Hong Kong and listed on the Hong Kong Stock Exchange, also indirectly held all the equity in Company E (which owned a number of properties including the Property at Address AC), Company F and Company G. In its 1994/95 to 2000/01 profits tax returns, the principal activity of the appellant company was described as ' property investment' .

On September 1992, in the implementation of a process of Company D group reorganization by separating property holding activity from the other business operations, the board of directors of Company A resolved to acquire the Property from Company E for long term investment purpose (the Property was to be leased to Company AD for rental income), at a consideration of HK$1,060 million. Company A was first advanced the whole of the purchase price by Company F on an unsecured basis at an interest rate of 11% per annum, pending the ability

to replace the borrowing from Company F with a bank loan. On 28 October 1992, Company A refinanced the loan (from Company F) by entering into a Loan Agreement with Bank C which in turn entered into a Participation Agreement with Bank R as regards the loan of HK$1,060 million on the terms thereof. Under the Loan Agreement, Bank C was to lend a sum of HK$1,060 million to Company A, to be repaid in five years' time (the repayment date was extended for a further period of five years under an amendment agreement dated 18 November 1997), at an interest rate of 10% per annum; and subject to the execution of a guarantee by Company F in favour of Bank C (Company F was replaced by Company D as the guarantor of the bank loan, pursuant to an amendment agreement dated 1 August 1994). The fees payable under the loan from Bank C included an arrangement fee of HK$3,500,000, an annual management fee of HK$100,000, and the legal fees incurred by the solicitors of Bank C.

On 28 October 1992, Bank R also entered into a Sub-Participation Agreement with Company B, which was a special purpose company ('SPC') incorporated in Commonwealth Q on 20 October 1992, with an authorized capital of HK$1,060,000,002 divided into two ordinary shares of HK$1 each and 1,060,000,000 cumulative redeemable preference shares of HK$1 each. The object of the establishment of Company B was to enter into a sub-participation agreement with Bank R and to enable Company G (which was also incorporated in the Commonwealth Q and was a wholly-owned subsidiary of Company D Group) to subscribe all the cumulative redeemable preference shares of Company B. The two ordinary shares and the 1,060,000,000 cumulative redeemable preference shares of Company B were issued to Bank R and Company G respectively on 27 October 1992 with payment in cash of the par value to be made by Bank R and Company G to Company B on or before 2 November 1992. An option agreement dated 28 October 1992 was executed between Company G and Bank R under which both Company G and Bank R has the option to require the other party to sell/purchase the two ordinary shares of Company B.

By a letter dated 28 October 1992, Company A gave notice to Bank C to draw down the loan of HK$1,060 million for value on 2 November 1992 and credited the sum to the account it maintained with Bank C so as to enable Bank C to transfer the same sum to the account Company F maintained with Bank C. Pursuant to the Participation Agreement, Bank R made a payment of HK$1,060 million to Bank C which in turn paid the said sum to Company A under the Loan Agreement. Company A then paid the said sum to Company F which in turn paid the same to Company G as an unsecured inter-company loan; followed by the payment of the said sum by Company G to Company B as the subscription money for the allotment of 1,060,000,000 redeemable preference shares of Company B. All these transactions took place on 2 November 1992. On 3 November 1992, Company B paid the said sum to Bank R under the Sub-Participation Agreement, thereby completing the flow of funds. The said sum was placed by Company B on an overnight deposit with the Country W branch of Bank R.

On appeal, the appellant company objected to the profits tax assessments for years of assessment raised on it from 1994/95 to 2000/01 and contended that the interest expenses, bank

changes and legal fees incurred by it in respect of a loan of HK$1,060 million borrowed from Bank C should be allowed for deduction. On the other hand, the Commissioner sought to confirm the said assessments on the ground that the interest expenses and the related expenditure paid by Company A under the loan agreement should not be allowed, pursuant to sections 16, 17, 61 and/or 61(A) of the IRO.

In this appeal, there were three issues for the Board to determine, namely:

<u>under sections 16 & 17 of the IRO</u>

(a) Whether, upon the true construction of sections 16(1) & (1)(a) and 17(1)(b), there was any money 'borrowed' by the appellant company from Bank C; or 'outgoings' or 'expenses' or 'interest' paid or payable by the appellant company to Bank C under the Loan Agreement;

(b) whether, upon the true construction of sections 16(1) & (1)(a) and 17(1)(b), there was any money borrowed, or interest incurred or expended by the appellant company 'in the production of profits' in respect of which the appellant company was chargeable to tax or 'for the purpose of producing such profits';

(c) whether the conditions in sections 16(2)(d) were satisfied, that is, the repayment of the principal or interest by the appellant company to Bank C was not secured or guaranteed either in whole or in part, and whether directly or indirectly, by any instrument executed or any undertaking given by an associate of the appellant company against a deposit made with an overseas financial institution (Bank R) where any sums payable by way of interest on the deposit were not chargeable to tax under the IRO;

(d) whether or not the 'Ramsay principle' was applicable to section 16 of the IRO when there were other general anti-avoidance provisions in the IRO (sections 61A and 61);

<u>under section 61A</u>

(e) what is relevant 'transaction' for the purpose of section 61A;

(f) whether the identified transaction has, or would but for this section have had, the effect of conferring a 'tax benefit' on the relevant person, that is, the appellant company;

(g) whether, having regard to the seven factors referred to in section 61A(1), it would be concluded that the transaction was entered into for the 'sole or dominant purpose' of enabling the appellant company, either alone or in conjunction with other persons, to

obtain a tax benefit;

under section 61

(h) whether there was any transaction which reduced or would reduce the amount of tax payable by the appellant company;

(i) whether such transaction was 'artificial' or 'fictitious'; and

(j) what was the tax consequence of 'disregarding' such transaction for the appellant company.

In short, the key issues for the Board to consider was the circumstances surrounding and arising out of Company A' s acquisition of the Property from Company E at the price of HK$1,060 million and the subsequent financing arranged between Company A/Bank C, Bank C/Bank R, Bank R/Company B and Bank R/Company G.; and whether the assessments were incorrect of excessive, as asserted by the appellant company.

Held:

1. The Board is not bound by the strict rules of evidence under section 38 of the Evidence Ordinance. The various documents produced by the bankers of Bank C and accountants of Accounting Firm AJ (who were acting as tax advisers for the Company E/Company AW Group), pursuant to the Commissioner' s request to provide the same under section 51(4)(a) of the IRO, are admissible as evidence as to the contents of those documents. The documentary evidence provides a contemporaneous record of what indeed did take place, that is, the pre-planning of a financing scheme which was expressed to be a tax exercise or a tax scheme as illustrated by the various contemporaneous documents; and the Board is able to give full weight to those documents, without the necessity to calling the makers to prove the documents.

2. The evidence adduced by the two witnesses of the appellant company in respect of the Property can best be described as vague, there was uncertainty as to exactly what the status of the Property was at the time of tine of acquisition by Company D. The witnesses were not able to particularize or provide any written documentation, memoranda or agreements to illustrate the way in which its properties activities were to be hived off or dealt with in order to implement Company D' s policy. There was no tenancy agreement nor again was there any breakdown as to the way in which the Property being managed.

Issue 1 – sections 16 & 17 of the IRO

3. Having carefully examined and reviewed the flow of documentation, memoranda and letters passing between the relevant parties, the Board found *inter alia* that there was never any lending between Bank C and Company A (hence there was never any real exposure to bank C) and that there were participating in a carefully thought out scheme (in a circle of fund flow) and in the end of the day, Bank C only obtained management fees. Moreover, it is unequivocal and clear that the evidence shows that at the very beginning, the financing scheme was expressed to be a tax exercise or a tax scheme and the contemporaneous documentation that was disclosed by Bank C and Accounting Firm AJ gives full support to such a contention. The Board concluded that there was no evidence adduced to illustrate or support Company A's contention that the main commercial purpose was to achieve a group reorganization and to segregate property holding activity from the other business operations.

4. The Board rejected the appellant's arguments that the exclusion of the Bank C loan would have the result excluding the acquisition of the Property and therefore the rents; that the Commissioner was reconstructing the loan by Bank C to Company A as if it were a loan by Company B to Company A; and that the Commissioner had disregarded funding while leaving acquisition and rental income in the equation.

5. The Board found that the loan to Company A by Bank C was only a preordained transaction in a composite whole and therefore there was never any loan between Company A from Bank C in commercial reality. The financing scheme that was designed and implemented resulted in the creation of documents, accounting entries which gave an appearance of a loan being granted by Bank C to Company A on the 2 November 1992; but in fact, Bank C received the principal amount of the loan back on the same date and was fully paid by Bank R even before it paid out anything to Company A.

6. It is therefore clear that the money 'borrowed' by Company A from Bank C and the interest paid by Company A to Bank C under the loan agreement was not for the purpose of producing any profits. On the contrary, 'it was paid for exactly the opposite purpose, namely, to reduce the profits of [Company A]'. The Board accepted that the interest and related expenses paid or incurred by Company A pursuant to the Loan Agreement cannot be deducted as outgoings or expenses for the purpose of ascertaining Company A's chargeable profits.

7. Moreover, the appellant had not discharged the burden to prove that the interest paid to Bank C under the loan agreement falls under one of the conditions specified in subsection (2) under section 16 of the IRO (only condition (d) is of relevance to the present appeal). Subsection (2)(d) provides that interest is deductible if the loan is

borrowed from a financial institution or an overseas financial institution and the repayment of the loan or interest is not secured or guaranteed; in whole or in part; directly or indirectly; by an instrument executed or undertaking given by the borrower or its associate; against a deposit made with that or any other financial institution or overseas financial institution; where any sums payable by way of interest on that deposit is not chargeable to tax under the IRO. The Board found that each repayment of interest by Company A to Bank C was 'effectively, secured by an instrument or undertaking (in the form of a payment instruction) executed or given in advance by Company G (an associate of Company A) to Bank R to pay the deposit (derived from dividends received from Company B) in its bank account to Company F/Company D'. Hence, the interest paid by Company A to Bank C under the loan agreement is not deductible for the purpose of ascertaining Company A's chargeable profit (Wharf Properties Ltd v CIR 4 HKTC 310 distinguished on facts from the present case).

8. As to the applicability of the 'Ramsay principle' to section 16 of IRO, the Board was of the view that it is entitled to disregard for fiscal purposes self-cancelling intermediate steps and apply the legislative provisions instead to the scheme viewed as a composite whole; there can be no valid reason why the Ramsay principle cannot co-exist and operate side by side with the anti-avoidance provision contained within the Ordinance. The Board rejected the appellant's submission that the Ramsay principle is only relevant to section 61A. The Court of Final Appeal in Arrowtown held that the ultimate question was whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed realistically.

9. The Board rejected the contentions of the appellant that the Bank C loan, Bank R participation and Company B Subparticipation were normal banking businesses, instead they were transactions of a tax scheme designed to obtain a tax benefit (WT Ramsay Ltd v IRC [1982] AC 300, Shiu Wing Ltd v Commissioner of Estate Duty [2000] 3 HKCFAR 215, Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] 6 HKCFAR 517, Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)[2004] UKHL 51 considered and followed).

Issue 2 – section 61A of the IRO

10. When reviewing the provisions of section 61A, one of the first steps for the Board to determine is to identify the relevant 'transaction' which is widely defined under section 61A(3) as 'a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings'. The relevant transaction does not necessarily have to be a single transaction or contract; but it could be a 'scheme' or 'operation' with a number of constituent elements. The Board rejected the appellant's submission that the only

transaction relevant for its consideration would be the acquisition of the Property by Company A from Company E. Instead, the Board had no hesitation in finding that the transaction for the purpose of section 61A is the whole financing scheme including the temporary loan that originated from Company F to Company A followed by the financing proposal as described in the Accounting Firm AJ/Bank C documents involving the Loan Agreement, the Participation Agreement, the Sub-Participation Agreement, the issue of redeemable preference shares by Company B and the circular movement of funds on the drawdown date and on the subsequent interest/dividend payment dates.

11. The second step for the Board to determine is whether the 'transaction' has, or would, but for section 61A have, the effect of conferring a 'tax benefit' on Company A. Pursuant to section 61A(3), a tax benefit is defined as 'the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof'. The Board found that the appellant company did enter into a financing scheme for the sole or dominant purpose of avoiding its liability to pay profits tax on the rental income or reducing the amount of tax payable on such rental income. The Board accepted that the appellant company entered into a transaction (or financing scheme) which created a 'liability' to pay interest to Bank C which was then used to reduce its liability to pay profits tax as claiming to offset the rental income; hence satisfying the definition of a 'tax benefit' under section 61A of the IRO.

12. The Board rejected the appellant's contentions that before a 'tax benefit' could be said to have been conferred by a transaction, there must have been a 'liability past or future to which that person (the appellant company) could have been subjected but which has been avoided (postponed or reduced) by entering into the identified transaction'; and that 'the taxpayer must have some other source of income which is left to be taxed if the transaction is avoided or counteracted'; such contentions were held to be contrary to the Court of Appeal decision in Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773.

13. The Board also rejected the appellant's argument that for the purpose of section 61A, the relevant transaction must be one to which the appellant company was a party. A transaction is caught by section 61A if the transaction has, or would have had but for this section, the effect of conferring a tax benefit on the relevant person (the appellant company), and the person or one of the persons (not necessarily the relevant person) who entered into or carried out the transaction did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit. The Board accepted that the last sentence of section 61A makes it clear that the person or persons who entered into or carried out the transaction might not be the same person who obtained the tax benefit.

14. The third step for the Board to determine is whether, having regard to the seven factors referred to in section 61A(1), the transaction was entered into or carried out for the 'sole or dominant purpose' of enabling Company A to obtain a tax benefit. The Board found that all seven sectors – the manner in which the transaction was carried into or carried out; the form and substance of the transaction; the result in relation to the operation of the IRO that, but for section 61A, would have been achieved by the transaction; the transaction did not result in any real change in the financial position of the appellant company; the transaction did not result in any real change in the financial position of any other party who was connected with the appellant company; the various transactions which made up the financing scheme entered into between Company A/Bank C, Bank C/Bank R, Bank R/Company B, and Bank R/Company G were obviously non-commercial and would not normally have been entered into by parties dealing with each other at arm's length; and the transaction involved the channeling of funds to offshore companies, namely, Bank R, Company B and Company G – have been satisfied and came to the conclusion that the 'sole or dominant purpose' of the transaction was to obtain a 'tax benefit' for the appellant company.

15. There was no inconsistency between a finding that the purpose lay in the pursuit of commercial gain and in the course of carrying on a business and a finding that the sole or dominant purpose was to enable the relevant taxpayer to obtain a tax benefit; and attributing the sole and dominant purpose of tax avoidance held by a professional adviser such as Accounting Firm AJ or Bank C to a relevant person (the appellant person) within the meaning of section 61A is both acceptable and appropriate.

16. The Board rejected that the 'choice' principle is relevant to the interpretation of section 61A, since 'choice' of a taxpayer in conducting his fiscal affairs has been expressly circumscribed by section 61A (FCT v Consolidated Press Holdings Ltd (2001) 207 CLR 235, FCT v Sleight (2004) ALR 511, FCT v Spotless Services Ltd (1996) 186 CLR 404 and FCT v Hart (2004) 206 ALR 207 applied).

17. The Board found that the three conditions as set out under section 61A have been satisfied; the Commissioner was therefore empowered under section 61A(2) to assess the liability to tax of Company A by (i) disregarding the transaction or part of the transaction or (ii) such other manner as appropriate to counteract the tax benefit which otherwise would be obtained. The Board had no hesitation in accepting that the Commissioner was fully justified in disallowing deduction of the interest and related bank charges and legal fees from the rental income.

Issue 3 – section 61 of the IRO

18. The Board found that the Loan Agreement entered into between Company A and

Bank C (the transaction) resulted in a substantial interest being paid by the appellant company which reduced or would reduce the profits of the appellant company and hence the tax payable by the appellant company.

19. As to the issue of whether the transaction is 'fictitious' or 'artificial', the Board found that the transaction was indeed 'artificial' because it has no commercial reality. Looking at all the circumstances and the background of this case, the Loan Agreement was commercial unrealistic and artificial if not fictitious.

20. The Board also had no hesitation in concluding that the Commissioner was entitled to disregard the Loan Agreement, any interest and related bank charged and legal fees 'paid' by the appellant company to Bank C pursuant to that agreement, and assess the appellant company's liability to pay profits tax accordingly.

Appeal dismissed.

Cases referred to:

WT Ramsans Ltd v IRC [1982] AC 300
Collector of Stamp Revenue v Arrowtown Assets Ltd (2003) 6 HKCFAR 517
Shiu Wing Ltd v Commissioner of Estate Duty (2000) 3 HKCFAR 215
Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) (appellant) (Session 2004-0-5) 3rd report [2004] UKHL 51 (reported)
Wharf Properties Ltd v CIR 4 HKTC 310
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773
FCT v Consolidated Press Holdings Ltd (2001) 207 CLR 235
FCT v Sleight (2004) 206 ALR 511
FCT v Spotless Services Ltd (1996) 186 CLR 404
FCT v Hart (2004) 206 ALR 207

Gladys Li SC, Anderson Chow SC, Jin Pao and Simon Lau instructed by Department of Justice for the Commissioner of Inland Revenue.
John Gardiner QC, Rimsky Yuen SC and Kenny Lin instructed by Messrs Baker & McKenzie for the taxpayer.

Decision:

Introduction

1. This is an Appeal by Company A in respect of the determination of the Commissioner of Inland Revenue ('the Commissioner') dated 15 January 2004. In that determination, the Commissioner overruled the taxpayer's objection and confirmed the following:

> '(1) Profits tax assessment for the year of assessment 1994/95 under charge number 1-5057462-95-2, dated 30 March 2001, showing assessable profits of $106,684,272 with tax payable thereon of $17,602,904 is hereby reduced to assessable profits of $106,683,672 with tax payable thereon of $17,602,805.
>
> (2) Profits tax assessment for the year of assessment 1995/96 under charge number 1-3153477-96-3, dated 13 March 2002, showing assessable profits of $88,032,798 with tax payable thereon of $14,525,411 is hereby reduced to assessable profits of $88,032,498 with tax payable thereon of $14,525,362.
>
> (3) Profits tax assessment for the year of assessment 1996/97 under charge number 1-1154177-97-A, dated 19 July 2002, showing assessable profits of $88,191,218 with tax payable thereon of $14,551,550 is hereby confirmed.
>
> (4) Profits tax assessment for the year of assessment 1997/98 under charge number 1-2909292-98-1, dated 19 July 2002, showing assessable profits of $86,889,467 with tax payable thereon of $12,903,085 is hereby confirmed.
>
> (5) Profits tax assessment for the year of assessment 1998/99 under charge number 1-1119621-99-0, dated 19 July, 2002, showing assessable profits of $85,310,519 with tax payable thereon of $13,649,683 is hereby confirmed.
>
> (6) Profits tax assessment for the year of assessment 1999/2000 under charge number 1-1108248-00-2, dated 19 July 2002, showing assessable profits of $69,475,699 with tax payable thereon of $11,116,111 is hereby confirmed.
>
> (7) Profits tax assessment for the year of assessment 2000/01 under charge number 1-1099201-01-0, dated 19 July 2002, showing assessable profits of $69,966,325 with tax payable thereon of $11,194,612 is hereby increased to assessable profits of $72,064,262 with tax payable thereon of $11,530,281.'

2. We would also mention that an appeal B/R 22/04 in respect of Company B was also heard at the same time. However, the Commissioner indicated through Leading Counsel that they did not intend to oppose that appeal and we were invited to make an order allowing the Company B's appeal in B/R 22/04 which we have done by way of a separate decision (D95/04).

Agreed facts

3. The following facts as set out in the statement of agreed facts were agreed by the parties and we find them as facts:

(1) This is an appeal by Company A against a determination of the Commissioner of Inland Revenue ('the Commissioner') dated 15 January 2004. The notice of appeal was given on 13 February 2004. By the said determination the Commissioner reduced the profits tax assessments for the years of assessment 1994/95 and 1995/96, confirmed the profits tax assessments for the years of assessment 1996/97, 1997/98, 1998/99 and 1999/2000 and increased the profits tax assessment for the year of assessment 2000/01 raised on Company A.

(2) The Assistant Commissioner's notes to the assessments indicate that they are raised under section 16, section 17, section 61 and/or section 61A of the Inland Revenue Ordinance ('IRO'). The assessments seek to disallow the deduction of interest expenses, bank charges and legal fees incurred by Company A in respect of a loan of HK$1,060 million borrowed from Bank C.

(3) At all relevant times, Company D, a company incorporated in Hong Kong and listed on the Hong Kong Stock Exchange was the ultimate holding company of Company A and Company D indirectly held all the equity in the following companies:

	Interest in equity held by subsidiary
Company E	100%
Company F	100%
Company A	100%
Company G	100%

Two charts showing the corporate structure of the group of companies of which Company D was the ultimate holding company as at 30 September 1992 and 31 December 1994 are attached.

Company A

(4) Company A was incorporated in Hong Kong on 26 November 1991 with an authorized share capital of HK$1,000 divided into 100 ordinary shares of HK$10 each. Two shares were issued and fully paid-up.

(5) Company A makes up its accounts to 31 December each year. In its 1994/95 to 2000/01 profits tax returns, the principal activity of Company A was described as 'property investment'.

(6) From date of incorporation up to 31 December 2000, the following individuals were the directors of Company A:

(a)	Mr H	(Appointed on 24 March 1992 and resigned on 1 January 1994)
(b)	Mr I	(Appointed on 24 March 1992 and resigned on 2 August 1994)
(c)	Mr J	(Appointed on 24 March 1992 and resigned on 2 August 1994)
(d)	Mr K	(Appointed on 1 July 1993 and resigned on 2 August 1994)
(e)	Mr L	(Appointed on 1 January 1994 and resigned on 10 June 1994)
(f)	Mr M	(Appointed on 1 July 1994 and resigned on 2 August 1994)
(g)	Mr N	(Appointed on 2 August 1994)
(h)	Mr O	(Appointed on 2 August 1994)
(i)	Mr P	(Appointed on 2 August 1994)

Company B

(7) Company B was incorporated in Commonwealth Q on 20 October 1992 with an authorised capital of HK$1,060,000,002 divided into two ordinary shares of HK$1 each and 1,060,000,000 cumulative redeemable preference shares of HK$1 each. Throughout the relevant period under dispute, all the ordinary shares were issued to Bank R and all the cumulative redeemable preference shares were subscribed by Company G.

(8) Company B has not applied for a business registration in Hong Kong.

(9) Company B's directors throughout the period under dispute are as set out below:

(a)	Mr S	(Appointed on 20 October 1992 and resigned on 27 April 1993)
(b)	Ms T	(Appointed on 20 October 1992)
(c)	Mr U	(Appointed on 29 April 1993 and resigned on 5 March 1996)

(10) The object or purpose for which Company B was established, as laid down in its Memorandum of Association, was to enter into a sub-participation agreement with Bank R which was to be made on or about 26 October 1992. Clause 8 of Company B's Memorandum of Association and Articles 86 to 90 of Company B's Articles of Association also provided for the conditions upon which dividends were payable to Company B's shareholders.

(11) The Register of Officers and Directors filed at the Registrar General's Department, Commonwealth Q dated 5 February 2002 shows the retired directors were based in Commonwealth Q.

(12) Records exist of two bank accounts maintained by Company B since its incorporation. One is with Bank C – Region AV in the Kingdom V (formerly known as Bank R), which was located in Country W in the Commonwealth Q. The other is with the Country W Branch of Bank C.

(13) Throughout the relevant period, the two ordinary shares of Company B were held by Bank R.

Company G

(14) Company G was incorporated in the Commonwealth Q on 7 August 1992 with an authorised share capital of US$5,000 divided into 5,000 ordinary shares of US$1 each with one vote for each share. Company G is a wholly owned subsidiary of Company D.

(15) Company G has not applied for a business registration in Hong Kong.

(16) From date of incorporation to 31 December 2000, the following individuals were directors of Company G:

(a)	Mr H	(Appointed on 7-8-1992 and resigned on 1-1-1994)
(b)	Mr I	(Appointed on 7-8-1992 and resigned on 2-8-1994)
(c)	Mr J	(Appointed on 7-8-1992 and resigned on 2-8-1994)
(d)	Mr K	(Appointed on 1-11-1993 and resigned on 2-8-1994)
(e)	Mr L	(Appointed on 22-2-1994 and resigned on 10-6-1994)
(f)	Mr O	(Appointed on 2-8-1994)
(g)	Mr X	(Appointed on 2-8-1994)
(h)	Mr Y	(Appointed on 2-8-1994)
(i)	Mr Z	(Appointed on 2-8-1994)
(j)	Mr AA	(Appointed on 2-8-1994)

(17) In the minutes dated 29 September 1992 of a meeting of the directors of Company G, it was recorded that the directors resolved that a Hong Kong dollar current account in name of Company G would be opened with Bank R.

Sale and purchase of Property

(18) In the written resolutions dated 18 September 1992 passed by the board of directors of Company F, it was resolved that:

(a) Company F should procure Company E to transfer the property known as Building AB at Address AC ('the Property') to Company A. Any one director of Company F should be authorized on behalf of Company F to sign any documents to signify Company F's consent to the said transfer;

(b) the purchase consideration of $1,060 million should be provided to Company A by an inter-company unsecured loan from Company F. After referring to the prevailing interest rate charged on the unsecured advance of similar size with no fixed repayment terms; Company F should accept the recommendation to charge the aforesaid inter-company loan at the interest rate of 11 per cent per annum;

(c) the statutory declaration for claiming relief from the Collector of Stamp Revenue under section 45 of the Stamp Duty Ordinance as regards the assignment of the Property should be approved; and

(d) any one director of Company F should be authorized to make the aforesaid statutory declaration and to sign any other documents on behalf of Company F in connection therewith.

(19) In the written resolutions dated 19 September 1992 passed by the board of directors of Company A, it was recorded that the directors resolved:

(a) Company A should acquire the Property from Company E at a consideration of $1,060 million. The Property should be held as a long term investment for rentals and should continue to be leased to Company AD;

(b) the acquisition of the Property by Company A should be financed by an inter-company unsecured loan from Company F. After referring to the prevailing interest rate charged on the unsecured advance of similar size with no fixed repayment terms, Company A should accept the

recommendation of the interest rate of 11 per cent per annum regarding the proposed inter-company loan;

(c) the sale and purchase agreement to be entered into between Company E as the vendor and Company A as the purchaser ('the Agreement') should be approved. Any one director of Company A should be authorised for and on behalf of Company A to execute the same and to agree to such modifications or alterations to be made thereto as he may think fit;

(d) the assignment to be entered into between Company E as the assignor and Company A as the assignee in respect of assigning all the beneficial interests and title of the Property to Company A ('the Assignment') should be approved. Any two directors of Company A should be authorized for and on behalf of Company A to execute the same and to agree to such modifications or alternations to be made thereto as he may think fit and to affix the seal of Company A thereon in his presence;

(e) the statutory declaration for claiming relief from the Collector of Stamp Revenue under section 45 of the Stamp Duty Ordinance as regards the assignment of the Property by Company E to Company A ('the Statutory Declaration') should be approved. Any one director of Company A should be authorized for and on behalf of Company A to make the Statutory Declaration; and

(f) any one director of Company A should be authorised for and on behalf of Company A to sign any other documents in connection with the Agreement, the Assignment, and the Statutory Declaration, and to do such acts and things as may be necessary to give effect to the acquisition of the Property.

(20) By a sale and purchase agreement dated 21 September 1992, Company E agreed to sell the Property to Company A at $1,060 million.

(21) By a deed of assignment dated 21 September 1992, Company E assigned the Property to Company A.

(22) Company A recorded the below accounting entries in respect of the transfer of Property in its books on 21 September 1992:

Dr.	Leasehold land and building	1,060 million
Cr.	Current account with Company F	1,060 million

(23) On 23 September 1992, Mr J made a declaration for the purposes of section 45 of the Stamp Duty Ordinance.

Bank Loan from Bank C

(24) In the written resolutions dated 21 October 1992 passed by the board of directors of Company A, it was recorded that the directors resolved:

(a) Company A should accept the terms and conditions set out in a facility letter to be entered into between Company A and Bank C ('the Facility Letter') regarding the proposed loan, which includes the following:

- the loan should be repayable by Company A in one instalment on the repayment date as defined in the Facility Letter;

- the interest rate for the loan should be at 10% per annum; and

- Company F should execute a guarantee ('the Guarantee') in favour of Bank C under which Company F should guarantee to pay to Bank C on demand any of the following amounts as defined in the Guarantee as the Guaranteed Moneys which were defined as all moneys owing by Company A to Bank C at any time, interest on such moneys and all reasonable expenses of Bank C in enforcing the Guarantee.

(b) any one of the directors of Company A should be authorised to execute the Loan Agreement and any other documents in connection with the Loan Agreement.

(25) In a Loan Agreement dated 28 October 1992, Bank C confirmed that it would place at the disposal of Company A a loan of $1,060 million ('the Bank Loan') according to the terms and conditions set out in the Loan Agreement.

(26) By a guarantee dated 28 October 1992, Company F guaranteed to pay to Bank C on demand any of the Guaranteed Moneys as defined in the Guarantee which have fallen due by Company A and that have not been paid at the time such demand is made.

(27) By a letter dated 2 October 1992, Bank C confirmed with Company A that the fees payable under the Bank Loan included an arrangement fee of

$3,500,000, an annual management fee of $100,000, and the legal fees incurred by the solicitors of Bank C regarding the Bank Loan.

Loan participation and sub-participation

(28) By a participation agreement dated 28 October 1992, Bank R agreed with Bank C to participate in the loan of $1,060 million on the terms thereof.

(29) By a sub-participation agreement dated 28 October 1992, Company B agreed with Bank R to sub-participate in the loan of $1,060 million.

(30) Mr AE of Bank C signed the sub-participation agreement on 28 October 1992 pursuant to authority approved at a board resolution passed by the board of directors of Company B on 26 October 1992.

(31) (a) According to an internal fax from Mr AE to Bank C – Country W dated 26 October 1992, the sub-participation agreement would be signed on 28 October 1992 in City AF as per an action list attached to the said fax.

(b) There exists a copy of an agenda for, inter alia, the signing of the sub-participation agreement on 28 October 1992 in City AF together with copies of six sets of used return jetfoil tickets between Hong Kong and City AF for 28 October 1992 with departure times from Hong Kong to City AF and from City AF to Hong Kong coinciding with those set out in the agenda.

(c) According to an internal memo of Bank C dated 30 October 1992, Mr AE gave instruction to credit Bank C – City AF's HKD account with the sum of HK$15,000 being the signing fee for the sub-participation agreement.

(d) Company B's bank statements for the period from 1992 to 2001 are tab Q to the bundle of witness statements.

Subscriptions for preference shares in Company B by Company G

(32) In the written resolution dated 26 October 1992 passed by the board of directors and signed by Mr S and Ms T, it was recorded that the director resolved among other things that:

(a) two ordinary shares would be issued to Bank R on 27 October 1992 with payment in cash of the par value to be made by Bank R on or before 2 November 1992;

(b) 1,060,000,000 cumulative redeemable preference shares would be issued to Company G on 27 October 1992 with payment in cash of the par value by Company G on or before 2 November 1992;

(c) a sub-participation agreement entered into between Company B and Bank R would be approved and that Mr AE of Bank C would be authorised on behalf of Company B to execute the sub-participation agreement;

(d) that the amount received in respect of the cumulative redeemable preference shares was to be deposited by Company B with Bank C in Country W branch overnight on 2 November 1992 and, pursuant to Article 87, the one-day interest thereon would be declared dividend in favour of the holder of the cumulative redeemable preference shares;

(e) pursuant to Article 88, each amount received by Company B from time to time under the sub-participation agreement would constitute surplus and that payment of interim cumulative preference dividends to the holder of the cumulative redeemable preference shares from each such amount upon receipt be authorised; and

(f) that any one director, or any person authorized by the directors, should do such act and execute such documents as might be required or otherwise regarded by him as necessary or desirable in connection with the resolution, including to sign and deliver irrevocable payment instructions to Company B's bank to effect payments of the cumulative preference dividends.

(33) In the minutes of a meeting of the directors of Company G dated on 21 October 1992, it was recorded the directors resolved that Company G should subscribe at par for all the 1,060,000,000 cumulative redeemable preference shares of $1 each in the capital of Company B.

(34) In the minutes of a meeting of the directors of Company G dated 21 October 1992, it was recorded that:

(a) the two ordinary shares ('the Shares') and 1,060,000,000 cumulative redeemable preference shares in Company B were to be respectively held by Bank R and Company G;

(b) an option agreement should be executed between Company G and Bank R under which Company G should grant to Bank R an option to require Company G to purchase and Bank R should grant to Company G an option to require Bank R to sell the Shares; and

(c) the directors resolved that the option agreement should be approved and that any one director should be authorized to execute the option agreement.

(35) By an option agreement dated 28 October 1992, Company G granted to Bank R an option to require Company G to purchase the Shares in Company B and Bank R granted to Company G an option to require Bank R to sell the Shares in Company B on the terms set out therein. Neither option has been exercised in the periods covered by the assessment in this case. In the option agreement, Bank R gave the following undertakings:

(a) Clause 7.01

Bank R shall not vote in favour of any resolution to:

(i) amend or vary the memorandum or articles, or amend or waive any terms of the sub-participation agreement;
(ii) alter the share capital of Company B;
(iii) incur any indebtedness on the part of Company B; and
(iv) wind up Company B.

(b) Clause 7.02

Bank R agrees to procure and to pass such resolutions as may be necessary to ensure, that the profits of Company B in each of its financial year should be distributed in full semi-annually by way of cumulative preference dividends promptly upon receipt of such profits. Bank R acknowledges and agrees that any payment received by Company B pursuant to the terms of the sub-participation agreement shall constitute profits of Company B and would use reasonable endeavours to procure that such profits will be distributed in full.

The fund flow

(36) By a letter dated 9 October 1992, Company A instructed Bank C to transfer out of its account on the draw down date and the anniversaries thereof the fees referred to in paragraph (27) above.

(37) (a) By a letter dated 28 October 1992, Company A gave notice to Bank C to draw down the loan of $1,060 million for value on 2 November 1992 and credited the sum to the account it maintained with Bank C.

(b) By a letter dated 28 October 1992, Company A instructed Bank C to transfer out of its account $1,060 million for value on 2 November 1992 to the account Company F maintained with Bank C. The transfer was recorded in the bank statement of Company A.

(38) On 2 November 1992, Bank R paid the sum of $1,060 million to Bank C under the Participation Agreement.

(39) On 2 November 1992, Bank C paid the sum of $1,060 million to Company A under the Loan Agreement.

(40) On 2 November 1992, Company A paid the sum of $1,060 million to Company F.

(41) On 2 November 1992, Company F paid the sum of $1,060 million to Company G as an unsecured inter-company loan.

(42) On 2 November 1992, Company G paid the sum of $1,060 million to Company B as the subscription money for the allotment of 1,060,000,000 redeemable preference shares.

(43) On 3 November 1992, Company B paid the sum of $1,060 million to Bank R under the Sub-Participation Agreement, thereby completing the flow of funds. Accordingly, between 2 and 3 November 1992 the relevant funds were placed by Company B on an overnight deposit with the Country W branch of Bank R.

Interest/dividend payments

(44) With the exception of the 1st interest/dividend payment, the amount and date of the each interest payment under the Loan Agreement/Participation Agreement/Sub-Participation Agreement coincided with the amount and date of each dividend payment in respect of the redeemable preference shares in Company B. The 1st interest/dividend payment was exceptional because of the 1 day's interest payable to Company B by Bank C – Country W.

(45) For example, with respect to the interest/dividend payment which took place on 3 May 1993:

(a) On 28 April 1993, Company F gave an irrevocable instruction to Bank C to debit the amount of HK$52,807,186.17 from its account and pay the same to Company A's account on 3 May 1993 (in order to put Company A in funds to make the interest payment);

(b) On 28 April 1993, Company A gave an irrevocable instruction to Bank C to debit the amount of HK$52,807,186.17 from its account on 3 May 1993 to settle the 1st interest payment due to Bank C under the Loan Agreement;

(c) On 28 April 1993, Company G gave an irrevocable instruction to Bank R to debit the amount of HK$52,807,186.17 (representing the 1st dividend payment expected to receive from Company B) from its account and pay the same to Company F on 3 May 1993 (in order to cover the outflow of funds from Company F under (1) above);

(d) According to a document dated 30 April 1993, Bank C informed Bank R of the details of the payment of HK$52,807,186.17 (made up of HK$52,517,568.68 and HK$289,617.49, the latter being the overnight interest on the principal amount of HK$1,060,000,000 on 2 November 1992) to take place on 3 May 1993 amongst various accounts and the accounting entries which were required to be made.

(e) According to a document dated 30 April 1993, Mr AE gave instructions to the OIC loans section of Bank C in respect of the accounting entries to be made on 3 May 1993 in the accounts of Company F, Company A and Bank R.

(f) On 3 May 1993, the following fund flow in respect of the interest/dividend payment took place:

(i) Company F paid the sum of HK$52,807,186.17 to Company A;

(ii) Company A paid the sum of HK$52,807,186.17 to Bank C as the 1st interest payment;

(iii) Bank C paid the sum of HK$52,807,186.17 to Bank R pursuant to the Participation Agreement;

(iv) Bank R paid the sum of HK$52,517,568.68 to Company B pursuant to the Sub-Participation Agreement, and Bank C (Country W Branch) paid the sum HK$289,617.49 to Company B (being the overnight interest on the principal amount of HK$1,060 million on 2 November 1992);

(v) Company B paid the sum of HK$52,807,186.17 to Company G as the 1st dividend in respect of the redeemable preference shares;

(vi) Company G paid sum of HK$52,807,186.17 to Company F pursuant to the irrevocable instruction dated 28 April 1993.

(46) All subsequent interest/dividend payments were effected in manner similar to that of the 3 May 1993 payments.

Group re-organization and amendment of Guarantee

(47) In the minutes of a meeting of the board of directors of Company A dated 29 July 1994, it was recorded that Company D would substitute for Company F as the guarantor to the bank loan of $1,060 million provided by Bank C to Company A.

(48) In the written resolutions of Company D dated 29 July 1994, it was recorded that the ultimate holding company Company D should substitute Company F as the guarantor to the bank loan of $1,060 million provided by Bank C.

(49) By an amendment agreement dated 1 August 1994, Bank C agreed to release Company F from its obligations under the Guarantee, subject to the conditions, inter alia, that Company D should enter into a guarantee with Bank C substantially in the same form as the Guarantee.

(50) By a guarantee dated 1 August 1994, Company D guaranteed to pay to Bank C on demand any of the Guaranteed Moneys as defined in the guarantee which have fallen due by Company A and that have not been paid at the time such demand is made. Guaranteed Moneys were defined as all moneys owing by Company A to Bank C at any time, interest on such moneys and all reasonable expenses of Bank C in enforcing the guarantee.

(51) By a letter dated 28 July 1994, Bank C gave notice to Bank R of an amendment agreement relating to the Loan Agreement to be made between Bank C, Company A and Company F asking Bank R to confirm its agreement to the terms of the said agreement and changes in the participation agreement between Bank C and Bank R dated 28 October 1992 consequent upon the said amendment agreement which Bank R did by signing the letter.

(52) In the written resolutions of the board of directors of Company B dated 1 August 1994 in Commonwealth Q, it was recorded that the directors approved a letter agreement to be entered into between Bank R and Company B to approve the terms of an amendment agreement between Bank R and Bank C.

(53) By a letter dated 1 August 1994, Bank R gave notice to Company B of amendments to the participation agreement between Bank C and Bank R to reflect the amendments pursuant to the Amendment Agreement whereby Company F was to be released from its obligations under the Company F Guarantee to Bank C and Company D was to be substituted as guarantor asking Company B to confirm its agreement to consequential amendments to the sub-participation agreement between Bank R and Company B which Company B did by signing the letter.

(54) In the minutes of a meeting of the board of directors of Company G dated 25 July 1994, it was resolved that Company G should give consent to a letter agreement to approve the proposed change of guarantor to the loan as defined in the sub-participation agreement.

(55) By a letter agreement dated 25 July 1994, Company G gave consent to Bank R to the amendment to the sub-participation agreement pursuant to a letter agreement to be made between Bank R and Company B.

Extension of loan facility

(56) In the written resolutions of the board of directors of Company A dated 12 November 1997, it was recorded that the directors of Company A approved a draft amendment agreement relating to the loan facility of $1,060 million to be executed between Bank C and Company A under which the repayment date was extended for a period of five years.

(57) By an amendment agreement dated 18 November 1997, Bank C and Company A agreed to vary the terms in the loan agreement in order to extend the repayment date under the original agreement for a further period of five years and to increase the interest payable on the loan to the annual rate of 13 per cent per annum.

(58) By a letter agreement dated 18 November 1997, Company B confirmed its agreement to the amendments to the sub-participation agreement as a result of the amendment to the participation agreement between Bank C and Bank R caused by the changes.

(59) In the written resolution of the board of directors of Company B dated 18 November 1997, it was recorded that the sole director of Company B approved the letter agreement in the form of the attached draft be entered into between Bank R and Company B to approve the terms of the amendment agreement and other amendments to the sub-participation agreement.

(60) In the minutes of a meeting of the board of directors of Company G dated 17 November 1997, it was resolved that Company G should approve the letter agreement to be entered into by Company G and Bank R to approve the terms of the amendment agreement and certain amendments to the option agreement.

(61) By a letter dated on 18 November 1997 to Bank R, Company G gave consent to the amendment to the sub-participation agreement pursuant to a letter agreement to be made between Bank R and Company B.

The evidence

4. Mr John Gardiner, QC ('Mr Gardiner, QC') on behalf of Company A called two witnesses, Mr AG and Mr P.

5. Mr AG joined Company D in 1990 and is now the deputy Managing Director of

Company D. In 1991, he was Company D's Executive Director in charge of Business Development Department. He stated that the board of Company D had been considering for some time the idea of purchasing the Company E Group and his Department had gone through an evaluation process. As a consequence of that evaluation, Company D as part of a consortium acquired a 36% interest in the Company E Group in 1991.

6. It was at that time that he became an Executive Director of Company F. He also stated that he became its Chief Executive in 1995.

7. In 1992, Company D acquired the balance of 100% of the Company E Group and at that time, Mr J was assigned to the Company E Group from Company D as the Managing Director.

8. He stated that the Company E Group of companies ran their business operations in a very 'old-fashioned' way. He stated that the businesses were mainly in the field of selling motor vehicles, food and various other ancillary operations from a number of substantial premises.

9. He drew to our attention that the Company D Group had for many years proceeded on the basis of separating properties from the businesses and in turn, running them. He emphasized that in his view, it was an essential commercial requisite to ensure that properties were properly managed so that they can achieve their full economic potential .

10. In 1992, the board of Company F recognized that there should be delineation between property values and business undertakings and this was something which the Company E Group should adopt in the interest of maximizing its assets and business efficiency. At that time, the Company E Group owned a number of properties but the most important one was the Property at Address AC.

11. He stated that the Company E Group decided to implement a process of reorganization of separating properties from businesses and did so initially with the Property.

12. Mr AG in his evidence emphasized time and time again that he felt it was an essential part of the commercial purposes of the reorganization that the Property should be acquired at its full value and that the separation of the properties from the businesses enabled them to better exploit or manage those properties so as to obtain a greater yield from them.

13. He stated that these were deliberate decisions taken to try and improve the management of properties and the performance of the businesses by separating the properties from the trading activities.

14. Therefore, it was for this reason that they decided to implement a process of reorganization of separating properties from businesses and to do so initially with the Property.

15. He stated that on the 18 September 1992, they decided to procure the sale by Company E of the Property to Company A at a price of HK$1,060 million which was based on a valuation dated December 1991. He emphasized that it was an essential part of the commercial purpose of the reorganization that the Property should be acquired at full value and Company A should pay for it out of its own funds or those borrowed for that purpose.

16. He stated that the purchase had to be financed either from outside or inside the Group. Again, he repeated that the separation of properties from the businesses enabled them to better exploit or manage those properties and again to obtain a greater yield from them.

17. He stated that Company A purchased the property from Company E for a consideration of HK$1,060 million pursuant to a purchase and sale agreement dated the 21 September 1992. It had been intended that this transaction would be financed by bank borrowing but he stated that they were led to believe that there was a problem in obtaining the relevant stamp duty exemption for group transfers if they took such borrowing out at that time since it might render the relief unavailable.

18. Therefore, Company A was advanced the whole of the purchase price by Company F on an unsecured basis at an interest rate of 11% pending the ability to replace the borrowing with a borrowing from a bank.

19. He stated that they had considered the market rates of interest and borrowing cost of the Group and thought the 11% was an appropriate rate of interest for such a borrowing.

20. On 28 October 1992, Company A refinanced the Company F loan by taking out a five-year loan from Bank C. However, he emphasized that he himself was never involved in respect of the arrangements that led to the Bank C loan and stated that although the decision had been taken in principle that the property should be sold to Company A, he did not concern himself with the financing aspects since these matters were within the province of Mr J (who also sat on the Board of Company A).

21. During the course of his evidence, Mr AG emphasized what he felt was the commercial activities and rationale, that is, the separation between the properties and the business being an important aspect. He indicated that they were always concerned about the prevailing value and that they should always account for the most reasonable market rental in order to justify 'that kind of profit centre monitoring'.

22. However, during the course of cross-examination, it was quite clear that Mr AG was not able to draw to our attention any rental agreements in respect of the Property nor any memoranda or analysis of the type of return one would expect. Indeed, from his evidence, it can be seen that at no time during the course of his evidence, did he ever exhibit any rental agreement

between Company A and Company AD or any other entity. No evidence was adduced showing that they have assessed the ability to fund future interest payments.

23. Mr P gave evidence and stated that he joined Company D as an Executive Director on the 1 April 1992 and remained in that position until 2000. He stated that he was responsible for managing the Properties and Infrastructure Section of Company D. He stated that when he joined Company D in 1992, his main role was to regroup the properties within the Company D Group including the properties in the Company E Group. He stated that this was a pressing matter for the Company D Group because Company D had just acquired a 30% interest in Company E which had substantial property holdings and the Company E Group did not segregate its properties from business which the Company D Group had regarded of paramount importance.

24. Mr P stated again that the Company D Group had a philosophy of ensuring that properties were to be kept separate from business or undertakings that operate from them. He emphasized that it was essential to keep the separation so as to enhance the overall management control of the Company D Group. Again, he stated that the true value and profits of the operation within the Company D Group were properly and fully recognized and exploited and that businesses were run and awarded for their true worth.

25. He stated that the concept was that all entities within the Company D Group should be dealt with at an arm' s length basis and subsidiaries should be required to pay market rent for the property that they lease from the parent company. This was intended to ensure that the true profitability of business was made clear.

26. He stated that in his view, the main reason for Company D to acquire the Company E Group was to unlock substantial profit potential from the under-utilized properties previously owned by the Company E Group. He stated that when he joined Company D as an Executive Director, Mr J was already with Company E. However, during the course of his cross-examination, he was asked by Miss Li, SC whether or not there were any lease or rental agreements between Company E and the motor service company, he was not able to draw to our attention nor show us any lease agreements or lease arrangements. In response to cross-examination, he was not able to provide any justification for the level of rent to be paid and indeed when the rent was increased to HK$13 per square foot, no sensible or plausible explanation was given to the Board. He also drew to our attention that it was quite clear that if any of the companies had difficulties in paying rent, then steps could be taken by the parent company to assist.

27. However, Mr P was not employed by Company D at the time when Company A acquired the Property and was not involved in the financial and other arrangements which are subject matter of this Appeal.

28. It was Mr Gardiner, QC' s intention on behalf of Company A to call Mr J to give evidence. Mr J is currently resident in Country AH. However, he was undergoing medical

treatment and initially arrangements were being made for his evidence to be taken by way of a video link. However, during the course of the appeal, it became clear that Mr J was unwell and was having a brain scan. He was suffering from continuous headaches. Therefore, Mr Gardiner, QC decided that he was not able to call him. Two doctor's reports were made available. We did however invite Mr Gardiner, QC to consider whether or not he wished to apply for an adjournment to enable him to be able to call Mr J some time in the future to give evidence before us. However, Mr Gardiner, QC indicated that he did not wish to do so. It was suggested that we attach what weight we think fit to an affirmation which Mr J affirmed dated the 10 November 2004 in Country AH.

29. We are of the view that since Mr J was not able to give evidence nor could he attend to be cross-examined, we are not able to attribute any weight to his affirmation.

30. Miss Li, SC on behalf of the Commissioner called two witnesses, Ms AI (a partner at Accounting Firm AJ) and Mr AK, the Relationship Manager of Conglomerates and Public Sector Entities of Bank C. The objective of calling these witnesses was to adduce the originals of various documents that were provided to the Commissioner pursuant to a request to provide documents by virtue of section 51(4)(a) of the IRO. Pursuant to this request, both Bank C and Accounting Firm AJ provided the relevant documents. Both these witnesses brought along their files which contained either originals or copies of the relevant documents. For ease of reference, we shall call these the Accounting Firm AJ and Bank C Documents respectively. Miss Li, SC drew our attention to the following documents:

(1) Accounting Firm AJ's letter to Mr J of Company E dated 28 November 1991;
(2) Mr AE (of Bank C)'s internal note (by Mr AE) dated 31 December 1991;
(3) Mr J's letter to Accounting Firm AJ dated 9 January 1992;
(4) Accounting Firm AJ's financing proposal dated 9 January 1992;
(5) Mr AE (of Bank C)'s internal memo dated 14 January 1992;
(6) Handwritten note of Mr AL (of Bank C), undated;
(7) Mr AM (of Bank C, Assistant Group Tax Adviser)'s internal memo dated 16 January 1992;
(8) Mr AN (of Bank C, Senior Group Financial Accountant GHO FIN)'s internal memo dated 20 January 1992;
(9) Form B dated 3 February 1992;
(10) Bank C (Hong Kong)'s cable draft to its Country W Offshore Banking Unit dated 7 February 1992;
(11) Note of conversation between Mr AO and Ms AP dated 12 February 1992;
(12) Handwritten note by 'JS' dated 12 February 1992;
(13) Memo dated 27 February 1992 from Accounting Firm AJ (Hong Kong) to its London Office and copied it to Bank C;

(14) Further wire message from Bank C (Hong Kong) to its Country W's office dated 1 March 1992;
(15) Letter dated 3 March 1992 from Accounting Firm AJ to Bank C;
(16) Bank C's letter of 6 March 1992 to Mr AQ of Accounting Firm AJ;
(17) Form B dated 6 March 1992;
(18) Handwritten memo dated 12 March 1992 disclosed by Bank C;
(19) Bank C's letter of 16 March 1992 to Mr AQ of Accounting Firm AJ;
(20) Fax dated 20 March 1992 from Bank C to Company E;
(21) Fax dated 30 March 1992 from Bank C to Company E;
(22) Fax dated 2 April 1992 from Bank C to Company E;
(23) Accounting Firm AJ's letter to Legal Firm AR dated 14 April 1992;
(24) Cable message dated 15 April 1992 from Bank C (Hong Kong) to Bank C (Country W);
(25) Accounting Firm AJ's letter to Company E dated 16 April 1992;
(26) Further wire message dated 22 April 1992 from Bank C (Hong Kong) to Bank C (Country W);
(27) Fax dated on 5 May 1992 from Bank C to Company E;
(28) Note of meeting between Bank C and Mr K of Company E on 26 June 1992;
(29) Accounting Firm AJ's letter to Mr K of Company E dated 30 June 1992;
(30) Mr AS (of Bank C)'s letter to Accounting Firm AJ dated 6 July 1992;
(31) Revised Form B dated 9 July 1992;
(32) Bank C's fax to Accounting Firm AJ dated 6 August 1992;
(33) Memo from Bank C (Hong Kong) to Bank R dated 7 August 1992;
(34) Accounting Firm AJ's letter to Mr K of Company E dated 7 September 1992;
(35) Accounting Firm AJ's letter to Bank C dated 1 October 1992;
(36) Internal memo of Bank C, from Senior Credit Manager (Hongs Division) to Senior Group Financial Accountant, dated 6 October 1992;
(37) Letter dated 6 October 1992 from Bank C (Hong Kong) to Bank R;
(38) Fax dated 26 October 1992 from Bank C (Hong Kong) to its Country W office;
(39) Mr AT (of Bank C)'s internal note dated 30 October 1992 to Ms AU of the Loans Department;
(40) Mr AE (of Bank C)'s internal memo dated 23 November 1992;
(41) Fax dated 2 February 1993 from Bank C Country W to Bank C Hong Kong;
(42) Note dated 5 January 1994 from Bank C Country W to Bank C Hong Kong;
(43) Internal memo of Bank C dated 17 October 1997;
(44) Facility Interim Adjustment Form dated 22 October 1997;
(45) Further Facility Interim Adjustment Form dated 29 October 1997;
(46) Internal memo of Bank C dated 5 January 2001;
(47) Internal memo of Bank C dated 1 November 2002;
(48) Internal memo of Bank C dated 10 December 2002;
(49) Internal memo of Bank C dated 7 February 2003;

(50) Internal memo of Bank C dated 8 March 2003;
(51) Internal memo of Bank C dated 13 March 2003;
(52) Internal memo of Bank C dated 29 April 2003;
(53) Letter dated 24 June 2003 from Bank R to Company B;
(54) Bank C' s internal e-mail dated 7 May 2004;
(55) Notice of exercise of put option by Bank C – Region AV (formerly Bank R) to Company G dated 11 May 2004;
(56) Transfer of shares and resignation of directors of Company B dated 18 May 2004.

31. Miss Li, SC submitted that these contemporaneous documents disclosed by Bank C and Accounting Firm AJ clearly show that the financing scheme was expressed to be a tax exercise or a tax scheme as illustrated by the various contemporaneous documents. She also submitted that there can be no doubt that the Bank C and Accounting Firm AJ Documents are admissible as evidence as to the contents of those documents. She submitted that as far as the Board of Review is concerned, it regularly receives documentary evidence which the Commissioner obtains under her statutory powers of obtaining information from third parties without the necessity of calling the makers to prove the documents. It was her submission that we should give full weight to the Bank C and Accounting Firm AJ Documents in the present case for the following reasons:

(1) The nature and purpose of the scheme, as evidenced by those documents, are clearly and unambiguously set out. There is no possibility of mistake, misunderstanding or mis-interpretation.

(2) The documents were made <u>contemporaneously</u> by reputable bankers and accountants, whose professional callings required them to state facts and matters with clarity and precision. These documents are very different in nature from the affirmation of Mr J, which was recently created for the purpose of the present appeal.

(3) Mr Gardiner, QC submitted that the makers of the documents should be called to give evidence so that they could be cross examined, in particular with respect to the instructions which were given to Accounting Firm AJ and Bank C. Miss Li, SC stated that it is important to note, however, that:

(a) The persons who gave instructions to Accounting Firm AJ were Mr J and Mr K. Mr J was at the material time a director of Company E and the Group Deputy Chief Executive of the Company E Group, whereas Mr K was the Group Financial Controller. Further, Mr J was a director of Company A from 24 March 1992 to 2 August 1994, while Mr K was a director of Company A from 1 July 1993 to 2 August 1994. Many of the

documents contained were sent by or to, or copied to, Mr J and/or Mr K.

It is for the Appellant, who bears the burden of proof in this appeal, to call its former officers to explain those documents.

(b) A distinction should be drawn between documents and correspondence passing between Mr J and Mr K (who were entrusted with the task of appointing tax advisers and structuring the scheme) and Accounting Firm AJ (who were acting as tax advisers for the Company E/Company AW Group), and the internal bank documents which Mr J/Mr K and Accounting Firm AJ would not have seen. In respect of the former category of documents, there is absolutely nothing in the point of unfairness at all. If those documents did not reflect the true understanding at the time of the purpose of the scheme, it could and would have been instantly corrected.

(c) If it is suggested that Accounting Firm AJ or Bank C might have misunderstood the instructions given to them by Mr J or Mr K, obviously it is for the taxpayer to call its former officers to tell the Board of Review what their instructions were. The same goes for Mr AQ and Miss AX of Accounting Firm AJ, who were Company E Group's tax advisers. She submitted that it makes no sense whatsoever to suggest that the Commissioner should call the taxpayer's witnesses for them to be cross examined by the taxpayer. She also submitted that it was also extraordinary that none of the taxpayer's witnesses (including Mr J) made any mention of the scheme in their evidence or witness statements/affirmation.

32. Mr Gardiner, QC responded that what the Commissioner attempted to do here is to invite the Board to look at the documents they produced and nothing else and to portray a picture that the Commissioner wishes the Board to see on the basis of those document alone. The weight to be attached to documentary evidence must depend not only on its inherent probability but also on the other evidence in the case. The fact that a statement appeared in a document is not, without more, proof of its truth. No witnesses have been called to speak to the contents of the documents, he suggests that they could have been. Nor have the contents of the documents relied on been properly put to the witnesses called by the taxpayer. He submitted that that is the way in which the documents should have been used. He suggested that it is the evidence of those witnesses that the Board must assess using the contents of the documents as appropriate. The witnesses called by the Respondent from Bank C and Accounting Firm AJ can at best testify as to the compilation or authenticity of documents and nothing else.

33. However, having considered matters carefully, we are of the view that Miss Li, SC's submissions that the Board is not bound by the strict rules of evidence under section 38 of the Evidence Ordinance are correct. The documentary evidence provides a contemporaneous record of what indeed did take place and we are able to give full weight to those documents.

Our review of the evidence and finding of facts

34. The key issue for us to consider is the circumstances surrounding and arising out of Company A's acquisition of the Property from Company E at the price of HK$1,060 million and the subsequent financing arranged between Bank C and Company A. Bank C as lender agreed to advance the five-year term loan of HK$1,060 million to Company A at the interest rate of 10% per annum. The issue in respect of this case is the attempt by Company A to deduct the interest and the related banking charges and legal fees paid by Company A pursuant to the loan agreement and the assessment by the Assistant Commissioner which disallowed the deduction of the interest and the related bank charges and legal fees that were paid by Company A under the loan agreement pursuant to section 16, section 17, section 61 and/or section 61(A) of the IRO.

35. Therefore, we are entitled to look at all circumstances arising out of the Bank C loan which Company A asserts was used to refinance the acquisition of the property. Mr AG and Mr P time and time again repeated to us that it was Company D's policy of separating property ownership from the business operations and the company acquiring the property should acquire at full value and should pay for it out of its own funds although borrowed for that purpose.

36. However, our attention was drawn to the fact that within the Company AW Group, there were 29 properties of which 19 were held which were owned and occupied by the Group and the balance were held for investment for future development or disposal. Although Mr AG and Mr P repeated the overall philosophy of the Company D Group, at no time were they able to particularize or provide us with any written documentation, memoranda or plans as to the way in which the properties were to be hived off or dealt with in order to implement Company D's policy.

37. The evidence adduced in respect of the Property can best be described as vague, there was uncertainty as to exactly what the status of the Property was at the time of acquisition by Company D; there was no tenancy agreement nor again was there any breakdown as to the way in which the Property being managed.

38. We also find that Mr AG never knew nor was involved in the various steps that were in reality taken by Mr J and Mr K. Therefore, although Mr AG may very well have been able to give us some general evidence as to the overall philosophy and intention of Company D, we find that he was not involved nor was he aware of the various steps that were being factually carried out at the time with regard to the financing of the Property.

39. We also find that although Mr P time and time again tried to assert to us that full rent

would be charged and that agreements were reached between the relevant entities, no leases, memoranda or agreements were ever put before us to illustrate that this indeed was the case. Indeed, we find as a matter of fact that there was great flexibility between the Company D and its various subsidiaries as to how income was to be derived in respect of their relevant properties. Therefore, in our view, although there was stated to us the intention to hive off the properties into separate profit earning centres, no evidence was adduced or shown to us to illustrate that this was indeed effected and carried out.

40. Having carefully examined and reviewed the Bank C and Accounting Firm AJ Documents, we find the following:

(1) On 19 November 1991, Accounting Firm AJ introduced to Mr J a written 'tax planning memorandum' which eventually was acted on in November 1992. That memorandum stated:

'1.1 The main objective of this memorandum is to reduce the [Company AW Group] and [Company E Group] Hong Kong Profits Tax liabilities in a tax efficient and effective manner.'

As can be seen from the memorandum, three different tax planning schemes were outlined in the relevant appendices. However, the tax planning memorandum stated inter alia that:

'2.3 All proposed schemes will involve the sale of properties by the existing property holding subsidiaries (Company AAA) to new subsidiaries (Company BBB) at current market value. Company BBB will incur borrowings to finance the property acquisition and on the other hand lease the properties to the respective user companies at market rental, so that such rental income will be offset against interest costs for both accounting and taxation purposes.

2.4 Another important feature of these arrangements is that the funds borrowed by Company BBB for financing the acquisition of property may not appear in the consolidated accounts of [Company AW Group] but will be reflected in Company BBB's own financial statements, if the documentation is properly prepared and structured.'

(2) On the 30 December 1991, a meeting took place between Mr AO, Mr J and Miss AX of Accounting Firm AJ with Mr AE, the Senior Credit Manager of the Hong Kong Division of Bank C. During the course of that meeting, the Accounting Firm AJ representatives outlined the structure of a tax exercise which they were planning for Company E and invited Bank C to participate.

During the course of that meeting, Mr AE made a note whereby he stated as follows:

'The proposed structure seeks to strip the two major properties of [Company E] (their motor service centres) out of the holding company and into two wholly owned subsidiaries who would raise the funds to pay for the properties through bank loans. Funds would flow around in a circle such that the transaction would be self-funding and we would take a margin in the middle.'

(3) It is of interest to note that attached to his note were two charts which detailed the fund flows in respect of the loan and the subsequent interest/dividend payments which were set out.

(4) On the 3 January 1992, Mr AO sent to Mr J a further note entitled 'Financing Proposal – Loan Sub-participation' for presentation to Bank C and asked for his agreement to the contents of the draft before it was dispatched. By a letter dated the 9 January 1992, Mr J authorized Accounting Firm AJ to dispatch the draft document to Bank C which they did so on the same day. Having considered this Financing Proposal, we accept and find that this document put into effect a scheme that was:

'… The structure is designed to provide the [Company AW Group] with substantial tax benefits, such that borrowing costs incurred by A1 and A2 would be deductible whilst tax exempt income would be earned by the Offshore Investment Company which is also a wholly-owned subsidiary of [Company AW]'.

(5) We also rely on a memorandum dated the 14 January 1992 from Mr AE addressed to the Assistant Group Tax Adviser of Bank C headquarters where he stated as follows:

'I refer to our recent discussions and attach herewith an explanatory note prepared by [Tax Company AJ] on the proposed financing arrangement for [Company E].

I would be grateful if you would confirm that, were we to arrange finance along the proposed lines, [xxxx] would not be construed as having acted in any way as a party to an illegal or improper taxation reduction exercise, and that any such arrangement would not affect the Bank's relationship with the Inland Revenue Department.'

(6) We have reviewed a document entitled 'Form B' dated the 3 February 1992. This was a form that was presented to the Chief Executive of Bank C requiring approval of large facilities. The intended financing approval was approved by the Chief Executive expressly 'on the basis that the funds concerned will always be under our control'. At that time, the amount of the loan facility was subject to an upper limit of 80% of the value of the properties. There was a subsequent Form B dated the 6 March 1992 which increased the loan facility to 100% of the value of the properties and on the 9 July 1992, there was a further Form B which was recommended by the General Manager on the basis that 'this is an overnight exposure, unsecured tangibly but it must be inconceivable that [Company D] would let us down'.

(7) The Chairman of Bank C, Mr AY approved the intended financing.

(8) We also refer to the Form B that was approved by the Chief Executive of Bank C on the 3 February 1992. Again, it is important to note that in his approval, he stated 'on the basis that the funds concerned will always be under our control'. Subsequent to that, there were further financing proposals which were further developed by a memorandum dated the 16 January 1992 of Mr AE. Again, he took the view that they had 'no objection, as a matter of principle, to [Bank C's] entering into the proposed financial arrangement' and suggested … 'As a preliminary observation, I consider that it might be advisable for a non-Hong Kong branch of [Bank C] (or [Bank R] for that matter), preferably located in a tax haven country to be interposed between the SPC and [Bank C]'.

(9) We have also reviewed a further internal memorandum of Bank C dated 26 June 1992 which again we find of relevance and importance. It states as follows:

> ' I had a meeting with [Mr K] from [Company E] this afternoon (26th June, 1992). He had just been advised by [Accounting Firm AJ] that the IRD had, within the past few days, disallowed an internal refinancing scheme identical to the one in which we are currently involved for [Company E].
>
> Apparently, the completion of internal funding arrangements all in one day (which from our point of view will involve a number of book entries here and in NAB), is too transparent for the Revenue. …'.

(10) We also refer to a letter dated the 30 June 1992 addressed from Accounting Firm AJ to Mr K where it states as follows:

'As discussed with you, the funds flow movement is an essential factor which requires particular attention in order to ensure the tax effectiveness of the financing arrangement. …'.

(11) We have also reviewed a letter from Bank C to Accounting Firm AJ dated the 6 July 1992 which again stated as follows:

'In order to consider this proposed new arrangement, we will need your confirmation that:

1. this new structure does not change your conviction that the loan sub-participation will not need to be consolidated by [Bank C] Ltd. or [Bank C] (Holdings) PLC;

2. the subsequent bi-annual dividend flow does not change;

3. from your point of view, the issue by [Company E] of irrevocable payment instructions to the Bank supporting the new funds flow movements will not defeat the object of the modified proposal.'

(12) It is therefore clear and incontrovertible having reviewed the flow of documentation, the memoranda and letters passing between the relevant parties that the lending by Bank C can never in our view be described as a true arm's length advance of funds. In short, there was never any real exposure to Bank C and that they were participating in a circle of fund flow and in the end of the day, Bank C only obtained management fees.

(13) Indeed the concern that Bank C (as stated in their Internal Form B dated 9 July 1992) had was as follows:

'[Accounting Firm AJ] have confirmed that subject to there being no default events which could alter the position and the appropriate documentation (we have instructed [Legal Firm AR] to prepare the documentation such that [Accounting Firm AJ] can sign-off without these caveats before the funding begins), and following the overnight consolidated exposure at the [Bank C] (Holdings) plc level, the SPC will not need to be consolidated into the accounts of either [Bank C] or [Bank C] (Holdings) plc, nor will it have any effect on the Capital Adequacy Ratio of either of the above entities.'.

(14) We also refer to an internal memorandum dated 12 February 1992 which stated as follows:

'(1) …

(2) To answer your questions:

(i) The SPC is for the sub-participation arrangement previously reviewed by RS. It is for our client, [Company E] (or now owned by the [Company AW] Group).

Funding of the loan (provided by the client in [Company AW] Group) has to be channeled back to an overseas entity which is to sub-part in the loan granted by [Bank C]. This overseas entity is best if it is not an associated company of the [Company AW] Group. Otherwise, the circulation of funds may be too transparent. Therefore, the SPC is best set up by [Bank C] in a tax haven e.g. in [Country W].

SPC will receive the funding (provided by [Company AW] Group) as subscription to its non-voting preference shares. The fund will then be used by SPC to sub-part in the loan earning interest. Such interest, through arrangement will be distributed to [Company AW] Group as a non-HK sourced income therefore not subject to HK tax.

(ii) Since mentioned previously, SPC has to be an overseas entity, preferably in a tax haven, we have no objection to it being held by NAS.'

(15) It is clear in our view that there was never any lending between Bank C and Company A and that the true nature of this matter was that Bank C was participating in a carefully thought out scheme. However, it is indeed of interest to note that the Bank by way of a memorandum dated the 12 March 1992 stated their views as follows:

'It seems to me that in any case such as the attached there are two issues from the Bank's perspective:

(i) our involvement in the arrangement vis-à-vis anti-avoidance and any ensuing penalties and/or sullying of our name;

(ii) the ability of the customer to pay interest and principal.

> Provided the Bank is not actively engaged in promoting such schemes of arrangement but merely acts as a banker to its customers. I personally do not have any problem with such arrangements or the Bank' s involvement therein.
>
> The provisions of S16(2) may or may not result in the customer being able to obtain a tax deduction for interest paid. This however is only of consequence to the Bank if the absence of tax deduction impacts upon the cash flow projections of the customer and therefore consequently impacts upon his ability to service the debt.
>
> On intra day deals such as the attached the second problem does not arise and we need only concern ourselves with the first.'

41. Our attention was drawn to a series of draft board resolutions that were circulated between the professional advisers in respect of this matter. It was suggested that again the numerous drafts that were prepared were clearly an attempt to ensure that the documentation that was being drawn up was finalized in such a way as to ensure that the intended scheme as first put forward by Accounting Firm AJ was supported. Again, we find the letter dated the 7 September 1992 to Mr K of assistance. There, it can be seen that Accounting Firm AJ had reviewed the final draft of the documents relating to the proposed loan sub-participation financing arrangement which was produced for identification purpose. In that letter, attention was drawn to the following:

> '5. ANTI-AVOIDANCE LEGISLATION
>
> (a) The enclosed draft documents have been considered in conjunction with the specific provisions in the Inland Revenue Ordinance ("IRO") which limit interest deductibility, for Profits Tax purposes. The draft documents have been prepared to ensure better arguments in favour of obtaining the required tax relief. However, it must be recognised that, to a certain extent, the financing arrangement adopted depends on the interpretation of those provisions and in such circumstances, it must be accepted that the IRD may adopt a different interpretation.
>
> (b) As you appreciate, any tax planning arrangement may be subject to the scrutiny of and attack by the IRD under the general anti-avoidance provisions contained in Section 61A of the IRO, under which any arrangement may be set aside if its sole and dominant motive is the avoidance of taxation.
>
> However, it is not anticipated that the general anti-avoidance provisions would be applied where a scheme is supported by a genuine commercial motive, even though tax planning is a major feature in the way in which the

> re-organisation is carried out. Accordingly, there always exists the risk of having to contend that the commercial motive is the dominant factor for entering into the arrangement thereby negating the contention that the anti-avoidance provisions apply. In this context it could be argued that the entire arrangement forms a part of the [Company AW] Group reorganization, following the acquisition of the [Company AW] Group by [Company D]. The reorganization has commercial substance of decentralisation of the property investment business of [Company E] for better/efficient management, further development of the core business of [Company E] etc.'.

42. As previously found by us, the evidence of Mr AG and Mr P set out some very general vague terms of the overall philosophy and intentions of the Company D Group to hive off its property activities. There was no memoranda as previously indicated there was no evidence before us to suggest any commercial planning with regard to the disposal and hiving off of the property at Address AC. Indeed, it is incontrovertible and clear that on 28 November 1991, Accounting Firm AJ had sent to Mr J a tax planning proposal in respect of a property. Hence, in our view, it is unequivocal and clear that the evidence shows that at the very beginning, the financing scheme was also expressed to be a tax exercise or a tax scheme and the contemporaneous documentation that was disclosed by Bank C and Accounting Firm AJ gives full support to such a contention. The tax scheme was put up for Company A by Mr J (as director of Company A) and Mr K.

43. As we have stated above, there was never any true lending or loan arrangements between Bank C and Company A. We also find as a matter of fact that there was a circle of fund flow and this is clearly supported by documentary evidence in respect of this matter, the flow of funds took place as follows:

(1) On 2 November 1992, Bank R paid the sum of HK$1,060 million to Bank C under the Participation Agreement.;

(2) On 2 November 1992, Bank C paid the sum of HK$1,060 million to Company A as the Loan under the Loan Agreement;

(3) On 2 November 1992, Company A paid the sum of HK$1,060 million to Company F;

(4) On 2 November 1992, Company F paid the sum of HK$1,060 million to Company G as an unsecured inter-company loan;

(5) On 2 November 1992, Company G paid the sum of HK$1,060 million to Company B as the subscription money for the allotment of 1,060,000,000 redeemable preference shares;

(6) On 3 November 1992, Company B paid the sum of HK$1,060 million to Bank R under the Sub-Participation Agreement, hence, completing the circle of funds.

44. We find therefore that as a consequence of delaying the payment of HK$1,060 million by Company B to Bank R under the Sub-Participation Agreement by one day was that in the books of Bank R, there was an outstanding loan of a very substantial amount (HK$1,060 million) overnight. In order to ensure that Bank R would not be subject to any commercial risk of default, it was arranged that Company B, when it received the fund of HK$1,060 million, which originated from Bank R and had passed through the accounts of Bank C, Company A, Company F and Company G, on 2 November 1992, would place the fund on deposit with the Country W branch of Bank C for one night, and the deposit would be uplifted on 3 November 1992 and transferred back to Company B's Bank R account and then paid to Bank R under the Sub-Participation Agreement. That circular movement of funds took place on 2 and 3 November 1992. We find that the various accounting entries to be made to give effect to the financing scheme was carefully thought out, well in advance of the actual dates of movement of funds in the circle. The professional's (Accounting Firm AJ and Bank C) planning could only be at the instructions of their principal Company A.

45. We conclude that there was no evidence adduced before us to illustrate or support Company A's submission that the main commercial purpose was to achieve a group reorganization and to segregate property holding activity from the other business operations. We reject such a contention.

Issues

46. As agreed by both parties before us, the ultimate question which we need to consider is whether the assessments are incorrect or excessive. We remind ourselves that the onus of proof was on the shoulders of Company A and we refer to section 68(4) of IRO whereby the following is stated:

'(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'

47. Miss Li, SC very helpfully set out and summarized the various issues that arise for determination by us in respect of this Appeal. Mr Gardiner, QC confirmed that these issues were correctly identified. The issues are as follows:

'(1) under ss.16 & 17

(a) whether, upon the true construction of ss.16(1) & (1)(a) and 17(1)(b), there was any money "borrowed" by [Company A] from [Bank C], or "outgoings" or "expenses" or "interest" paid or payable by [Company A] to [Bank C] under the Loan Agreement;

(b) whether, upon the true construction of ss.16(1) & (1)(a) and 17(1)(b), there was any money borrowed, or interest incurred or expended, by [Company A] "in the production of profits" in respect of which [Company A] is chargeable to tax or "for the purpose of producing such profits";

(c) whether the conditions in ss.16(2)(d) are satisfied, i.e. the repayment of the principal or interest by [Company A] to [Bank C] is not secured or guaranteed either in whole or in part, and whether directly or indirectly, by any instrument executed or any undertaking given by an associate of [Company A] ([Company G]) against a deposit made with an overseas financial institution ([Bank R]) where any sums payable by way of interest on the deposit are not chargeable to tax under the IRO;

(2) <u>under s.61A</u>

(a) what is relevant "transaction" for the purpose of s.61A;

(b) whether the identified transaction has, or would but for this section have had, the effect of conferring a "tax benefit" on [Company A]; and

(c) whether, having regard to the seven factors referred to in s.61A(1), it would be concluded that the transaction was entered into for the "sole or dominant purpose" of enabling [Company A], either alone or in conjunction with other persons, to obtain a tax benefit;

[NB: In the event that the Board of Review decides that the conditions of s.61A(1) are satisfied in the present case, the Appellant has not argued that the Assistant Commissioner's exercise of his powers under s.61A(2) to disallow the deduction of the interest expenses and related bank charges and legal fees was incorrect.]

(3) <u>under s.61</u>

(a) whether there was any transaction which reduces or would reduce the amount of tax payable by [Company A];

(b) whether such transaction is "artificial" or "fictitious"; and

(c) what is the tax consequence of "disregarding" such transaction for [Company A].'

Issue 1 – section 16 and section 17 of the IRO

48. As agreed by both parties, the amendments made to section 16 by the Inland Revenue (Amendment) Ordinance 2004 are irrelevant and therefore in this decision, references to section 16 are references to the pre-2004 version of that Section.

49. The relevant provisions of section 16 are as follows:

'*16. Ascertainment of chargeable profits*

(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including –

(a) where the conditions set out in subsection (2) are satisfied, sums payable by such person by way of interest upon any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing; (Replaced 2 of 1971 s.11. Amended 36 of 1984 s.4)

…

(c) tax of substantially the same nature as tax imposed under this Ordinance, proved to the satisfaction of the Commissioner to have been paid elsewhere, whether by deduction or otherwise, by any corporation or by a person other than a corporation who carries on a trade, profession or business in Hong Kong, during the basis period for the year of assessment in respect of profits chargeable to tax by virtue of section 15(1)(f), (g), (i), (j), (k) or (l): (Amended 7 of 1986 s.12; 19 of 1986 s.3; 63 of 1997 s.2(a))

> *(2) The conditions referred to in subsection (1)(a) are that –*
>
> *(a) …*
>
> *(b) …*
>
> *(c) the money has been borrowed from a person other than a financial institution or an overseas financial institution and the sums payable by way of interest are chargeable to tax under this Ordinance;*
>
> *(d) the money has been borrowed from a financial institution or an overseas financial institution and the repayment of the principal or interest is not secured or guaranteed either in whole or in part, and whether directly or indirectly, by any instrument executed or any undertaking given by or on behalf of the borrower or an associate of the borrower against a deposit made with that or any other financial institution or overseas financial institution where any sums payable by way of interest on the deposit are not chargeable to tax under this Ordinance (Amended 7 of 1986 s.4; 63 of 1997 s.2).'*

50. We also refer to section 17(1)(b) of the IRO which provides that no deduction shall be allowed in respect of any disbursements or expense 'not being money expended for the purpose of producing such profits'.

51. It was submitted to us by Miss Li, SC that when considering section 16(1)(a) and section 17(1)(b), we should adopt what she suggested is a 'purposive interpretation of the statutory provisions to those facts viewed realistically'. In short, she drew our attention to what is widely known as the Ramsay principle and guide as set out and defined in the House of Lords in WT Ramsay Ltd v IRC [1982] AC 300. Our attention was also draw to the Court of Final Appeal Judgment in Collector of Stamp Revenue v Arrowtown Assets Ltd (2003) 6 HKCFAR 517 as well as Court of Appeal Decision in Shiu Wing Ltd v Commissioner of Estate Duty (2000) 3 HKCFAR 215. Miss Li, SC' s fundamental submission is that we are entitled to disregard for fiscal purposes self-cancelling intermediate steps and apply the legislative provisions instead to the scheme viewed as a composite whole. She drew our attention to the judgment of Riberio PJ in Arrowtown at paragraph 16:

> *'16. Another way of describing the House of Lords' approach to statutory interpretation in Ramsay is to say that, applying a purposive interpretation, their Lordships disregarded for fiscal purposes the*

self-cancelling intermediate steps and applied the legislative provisions instead to the scheme viewed as a composite whole.

17. This was effectively Lord Diplock's approach in IRC v. Burmah Oil Co Ltd [1982] STC 30, a case also involving a planned series of self-cancelling transactions, this time aimed at converting a non-allowable loss into a loss that would be deductible for capital gains purposes. Lord Diplock stated:

It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that Ramsay's case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transaction (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. ….. [T]he approach to tax avoidance schemes of this character sanctioned by Ramsay entitles your Lordships to ignore the intermediate circular book entries and to look at the end result. …..' (at pages 32-33)

52. In Arrowtown, Riberio PJ also stated the following:

'35. Accordingly, the driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically. Where schemes involve intermediate transactions having no commercial purpose inserted for the sole purpose of tax-avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always, MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd [2003] 1 AC 311 is a good example of a case where a purposive interpretation of the statute and its application to the facts did not dictate excluding the taxpayer's payment of interest from the statutory provision treating such payments as deductible charges on income. On the true construction of the statute (for the reasons stated by Lord Nicholls at paras.14-17), it mattered not that there had been a circular movement of money between the debtor and the tax exempt creditor to fund the relevant interest payment having no

> *commercial purpose other than to avail themselves of an allowable tax loss.'*

53. We note that Riberio PJ's dicta was followed by the House of Lords in the recent Decision of Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) (appellant) (Session 2004-0-5) 3rd report [2004] UKHL 51 (reported). There, the House of Lords approved Riberio PJ's sentiments and judgment and stated the following:

> *'36. In the course of argument, it was suggested by Lord Goodhart QC, appearing for the Collector, that in MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd [2003] 1 AC 311, Lord Hoffmann had re-interpreted the Ramsay principle in a way which should not be followed in this jurisdiction. Lord Hoffmann was said to have introduced a dichotomy between statutory concepts which may be characterised as "commercial" and those which are purely "legal" to be used as a filter to determine which statutory provisions are and are not susceptible to the Ramsay approach. This was said to be inconsistent with authority and, in any event, to involve an unworkable exercise in legal taxonomy, some of the difficulties of which had been noted by the English Court of Appeal in Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2002] EWCA Civ 1853.'*

The question we need to consider is whether or not the 'Ramsay principle' is applicable to section 16 of IRO when there is already a provision contained in the IRO that already contains a general anti-avoidance provision, section 61A and section 61. We accept the submissions of Miss Li, SC, that there can be no valid reason why the Ramsay principle cannot co-exist and operate side by side with the anti-avoidance provision contained within the Ordinance. We reject Mr Gardiner, QC's submission that the Ramsay principle is only relevant to section 61A since, in our view, the Court of Final Appeal in Arrowtown held that the ultimate question was whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed realistically. Indeed, in our view, it is quite clear that we are entitled to look at such an approach in the interpretation in the IRO and of tax statutes generally.

54. Mr Gardiner QC argued that the Bank C loan and Bank R participation and Company B subparticipation were normal banking businesses. However, the Bank C and Accounting Firm AJ documents show that the loan and the participation and the subparticipation were in fact transactions of a tax scheme designed to obtain tax benefit.

55. We reject Mr Gardiner QC's argument that the payment instruction, for example, by Company G to Bank R, is a simple transient movement involving only the 'bitting' of amounts into designated accounts. Such payment instruction was purposefully organized to ensure that the loan amount would safely flow back to Bank C. As a step designed of the whole fiscal arrangement, the

payment instruction, in essence was commercially an effective and sufficient undertaking safeguarding Bank C against any risk of non-repayment. The payment instruction is not only an undertaking, it in fact was an authorization given to Bank C to exclude all other parties from laying hand on the loan fund.

56. Mr Gardiner, QC argued that the exclusion of the Bank C loan would have the result excluding the acquisition of the Property and therefore the rents. Such an argument seems to suggest that unless the Commissioner could first find that the Property to Company A was a gift or it was acquired with cost-free finance, the Commissioner should not exclude the Bank C loan. We reject such an argument. We find that the issue before the Commissioner and indeed this Board still is whether the Taxpayer has successfully proved that the Bank C loan should be excluded and interest paid thereon disallowed for deduction according to those provisions prescribed under section 16 and section 17 of the IRO.

57. We also reject Mr Gardiner QC's argument that the Commissioner was reconstructing the loan by Bank C to Company A as if it were a loan by Company B to Company A. The evidence before us illustrates and shows that the loan to Company A by Bank C was only a preordained transaction in a composite whole and therefore we conclude that there was no loan at all.

58. Mr Gardiner QC argued that acquisition and financing was inextricably linked and accordingly criticized the Commissioner for disregarding funding while leaving acquisition and rental income in the equation. Such criticism is not fair. The Commissioner had not separated financing from acquisition. Instead, the Commissioner pulled together all relevant transactions in unveiling the whole composite scheme together with the tax consideration underlying thereof which scheme involves various financing and acquisition steps including, inter alia, the Bank C loan.

59. The Commissioner was not disregarding anything, in fact, the Commissioner invited us to consider the Bank C's loan to Company A by looking into each and every step in the round-robin flow of fund in order to expose the real purpose underling the Bank C's loan.

60. We have focussed, as suggested by Mr Gardiner QC, on the loan transaction between Company A and Bank C only, but still we were not convinced that the loan transaction was bona fide. The loan was constructed to be repaid soonest upon its issuance. Company A could not be said to be indebted and Bank C could not be said to be beneficially entitled to the proceeds of the loan. This is the commercial reality of the loan transaction.

61. As we have previously stated, there was, in our view, never any loan between Company A from Bank C in commercial reality. Therefore, we repeat again that the financing scheme that was designed and implemented resulted, in our view, in the creation of documents, accounting entries which gave an appearance of a loan being granted by Bank C to Company A on the 2 November 1992. As we have previously found, it is clear that Bank C received the principal

amount of the loan back on the same date. We accept the submissions put forward by Miss Li, SC that the accounting and book entries were structured in such a way that at least on the face of the records, Bank C was fully paid by Bank R even before it paid out anything to Company A. Again, we rely on the unequivocal facts that the funds moved around in a circle back to Bank R on the 3 November 1992. The same was applicable in respect of the subsequent bi-annual interest payments.

62. Again, as Miss Li, SC submitted to us another important aspect of section 16(1)(a) and section 17(1)(b) is that money borrowed or interest payments made must have been for the purpose of producing profits. It is clear that the purpose of these provisions is that only expenses which are generally incurred for producing a profit can be deducted. In our view, it is clear that the money borrowed by Company A from Bank C and the interest paid by Company A to Bank C under the loan agreement was not for the purpose of producing any profits. We accept Miss Li, SC's submission that 'it was paid for exactly the opposite purpose, namely, to reduce the profits of [Company A]'. Therefore, we accept that the interest and related expenses paid or incurred by Company A pursuant to the Loan Agreement cannot be deducted as outgoings or expenses for the purpose of ascertaining Company A's chargeable profits.

63. Mr Gardiner, QC submitted to us that section 16(2)(d) could very well be satisfied.

64. Section 16(1)(a) of the IRO sets out conditions in subsection (2) whereby sums payable by a person by way of interest upon any money borrowed for the purpose of producing profits can be deducted in ascertaining his chargeable profits. Clearly, the burden is on Company A to prove that the interest is paid to Bank C under the loan agreement falls under one of the conditions specified in subsection (2). We accept that Conditions (a), (b), (c), (e) and (f) of subsection (2) plainly have no application to the present Appeal. The only possible condition which Company A can rely is subsection (d) which provides that in respect of a loan which has been borrowed from a financial institution or an overseas financial institution, the interest is deductible only if the repayment of the principal or interest is not:

(1) secured or guaranteed;

(2) in whole or in part;

(3) directly or indirectly;

(4) by any instrument executed or undertaking given by the borrower or its associate;

(5) against a deposit made with that or any other financial institution or overseas financial institution;

(6) where any sums payable by way of interest on that deposit is not chargeable to tax under the IRO.

65. However, as previously indicated in our decision and having regard to our findings of fact each repayment of interest by Company A to Bank C was as Miss Li, SC submitted 'effectively, secured by an instrument or undertaking (in the form of a payment instruction) executed or given in advance by [Company G] (an associate of [Company A]) to [Bank R] to pay the deposit (derived from dividends received from [Company B]) in its bank account to [Company F/Company D]'. Further, we accept Miss Li, SC' s submission that 'any sums payable by way on interest on such deposit by [Company G] with [Bank R] (an offshore bank) would not be chargeable to tax under the IRO.'

66. Therefore, accordingly, condition (d) cannot be satisfied and the interest paid by Company A to Bank C under the loan agreement is not deductible for the purpose of ascertaining Company A' s chargeable profit. Again, we emphasize that the burden of proof is on Company A to show that the interest payment is satisfied the conditions of section 16(2) and in particular section 16(2)(d) which Company A relies on. However, the issue that we have already dealt with is that whether section 16 and section 17 upon their true construction can apply to the findings of fact that we have already found in respect of this matter. Mr Gardiner, QC relied on Wharf Properties Ltd v CIR 4 HKTC 310. However, we accept the submissions put to us by Miss Li, SC that that case does not decide whether the Ramsay principle has or has no application to the construction of section 16. In the Wharf case, it is quite clear that this was a case on whether certain interest payments are capital or revenue in nature. The facts on the Wharf case are far removed from the facts that we have found in respect of the present case.

Issue 2 – section 61A of the IRO

67. We, again, have no hesitation in accepting the submissions put forward to us by Miss Li, SC. In short, Miss Li, SC contended as follows:

'54. S.61A applies when 3 conditions are satisfied:-

(1) a transaction has been entered into or effected;

(2) the transaction has, or would but for this section have had, the effect of conferring a tax benefit on a person ("the relevant person"); and

(3) having regard to the seven factors referred to in ss.(1), it would be concluded that the transaction was entered into for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.

55. If these 3 conditions are satisfied, the Assistant Commissioner may, under s.61A(2), assess the liability to tax of the relevant person –

(a) as if the transaction or any part thereof had not been entered into or carried out; or

(b) in such other manner as the Assistant Commissioner considers appropriate to counteract the tax benefit which would otherwise be obtained.'

We accept this is the correct approach to be taken and we also accept that the relevant person is Company A.

68. When reviewing the provisions of section 61A, one of the first steps we need to do is identify the transaction. Again, we accept that section 61A(3) *'….. a transaction, operation or scheme whether or not such transaction, operation or scheme is enforceable, or intended to be enforceable, by legal proceedings'* is widely defined. It is unequivocal and clear that the word *'transaction'* for the purpose of dealing with and interpreting in section 61A does not necessarily have to be a single transaction or contract; it could be in our view a *'scheme'* or *'operation'* with a number of constituent elements. Mr Gardiner, QC again emphasized to us that in his submission the only transaction relevant for our consideration would be the acquisition of the Property by Company A from Company E. We reject this submission. In our view, it is clear and unequivocal that what we are concerned with here is the financing that was made available to Company A for the acquisition of the Property. We have no hesitation in finding that the transaction can be considered in its widest form, that is, the whole financing scheme including the temporary loan that originated from Company F to Company A followed by the financing proposal as described in the Accounting Firm AJ/Bank C documents involving the Loan Agreement, the Participation Agreement, the Sub-Participation Agreement, the issue of redeemable preference shares by Company B and the circular movement of funds on the drawdown date and on the subsequent interest/dividend payment dates. In our view, this is the only common sense and sensible approach which could be taken with regard to this matter. Again, we accept that the transaction for the purpose of section 61A is considered to be the acquisition of the Property and the financing for the acquisition of the Property. These are two distinct and separate matters.

69. The second step that we need to decide is whether the *'transaction'* has, or would but for section 61A have, the effect of conferring a *'tax benefit'* on Company A. Section 61A(3) defines a tax benefit as *'the avoidance or postponement of the liability to pay tax or the reduction in the amount thereof'*. We have already taken the view that the *'transaction'* is identified in its widest form, it is clear that, but for the interest payments (and other related bank charges and legal fees) created by the financing scheme, Company A would be under a liability to pay profits tax on the stream of rental income which it derived from the Property.

70. In short, Company A in fact did enter into a financing scheme for the sole or dominant purpose of avoiding its liability to pay profits tax on the rental income or reducing the amount of tax payable on such rental income. It is unequivocal and again we accept Miss Li, SC' s submissions that the fact of this matter is that once Company A acquired the Property, it stood to receive a stream of rental income chargeable to profits tax under the IRO. We accept that the fact remains that Company A entered into a transaction (or financing scheme) which created a 'liability' to pay interest to Bank C which was then used to reduce its liability to pay profits tax as claiming to offset the rental income. This, in our view, is a *'tax benefit'* within the meaning of section 61A.

71. The real issue to consider was the way how transactions were structured, the transfer of the Property to Company A would generate unto Company A a stream of rental income and liability to pay profits tax, whereas the Bank C loan was structured into Company A (as part of the tax scheme) to reduce Company A' s liability to pay profit tax.

72. We have already commented on the fact that Company A' s witnesses were extremely vague on the existence of any lease (formal or informal) with respect to the Property. We have no hesitation again in accepting the submission that it followed that upon acquisition of the Property, Company A stood to receive rental income which would be chargeable to profits tax. In short, it is this anticipated liability to pay profits tax which Company A could have been subjected to but was to be avoided or reduced by entering into the transaction. We would mention that Mr Gardiner, QC drew our attention to various authorities in Australia and drew our attention to the provisions of section 260 of the Income Tax Assessment Act Australia and section 106 of the Land and Income Tax 1954 (New Zealand). However, we take the view that the authorities he drew to our attention as well as these particular taxing statutes in our view have limited relevance since section 61A of our Ordinance has a specific definition of *'tax benefit'*.

73. We refer to the Hong Kong Court of Appeal Decision in Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773. We rely on the judgment of the Court of Appeal and in particular, Woo JA when he states as follows:

> *'30. Anyhow, we are unable to see how the point raised by ground 1a can have any significant bearing on the case for the taxpayer. The appeal to the Board was against the determination of the Acting Deputy Commissioner who relied on s.61 although that determination arose out of the assessment made by the Assistant Commissioner who relied on s.61A. What seems to us to be the contention is that since s.61 had been applied, whereby the transaction in question had been treated as void, s.61A cannot have any further application to a void transaction. This is one of the most unattractive arguments we have ever come across. The disregarding provision in s.61 does not mean that the transaction is void: it is simply to be disregarded when the conditions in s.61 are satisfied. The provision in s.61A(2)(a) also gives similar power to*

> *disregard the transaction. There is no indication in the two sections, both aiming at tax-avoidance schemes, or indeed in other provisions of the Ordinance that the application of the two sections is mutually exclusive.'*

74. Mr Gardiner, QC also argued that a *'tax benefit'* could be said to have been conferred by a transaction, there must have been 'a liability past or future to which that person ([Company A]) could have been subjected but which has been avoided (postponed or reduced) by entering into the identified transaction' and 'the taxpayer must have some other source of income which is left to be taxed if the transaction is avoided or counteracted'. However we are of the view that these submissions have not been made out and indeed, are contrary to the Court of Appeal decision in Cheung Wah Keung v Commissioner of Inland Revenue and in particular, we refer to Woo JA:

> *'47. Ground 2b alleges that the Judge erred in determining that there was a tax benefit when the definition of tax benefit in s.61A(3) predicates that there must either be (i) some pre-existing liability to tax which is being avoided, or (ii) some pre-existing circumstances which would give rise to, or might be expected to give rise to, a liability to pay tax, when neither of such circumstances were present.*
>
> *48. The argued "pre-existing" liability to tax or circumstances do not appear in s.61A(3) or anywhere else in the Ordinance having any bearing on the meaning of the "transaction" referred to in that section. We do not think it is necessary to deal with this ground except to say that it has no substance whatsoever.'*

75. We again accept the submissions of Miss Li, SC where she said the submissions of Mr Gardiner, QC are 'contrary to the obvious purpose of s.61A, which was enacted to counteract transactions or schemes entered into for the "sole or dominant purpose" of avoiding tax liability which would otherwise arise under the IRO'.

76. Mr Gardiner, QC also submitted strongly to us that for the purpose of section 61A the relevant transaction must be one to which Company A was a party. Miss Li, SC submitted that this particular approach is incorrect. She submits that a transaction is caught by section 61A if the transaction has, or would have had but for this section, the effect of conferring a tax benefit on the relevant person (Company A), and the person or one of the persons (not necessarily the 'relevant person') who entered into or carried out the transaction did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit. Again, we accept that the last sentence of section 61A makes it clear that the person or persons who entered into or carried out the transaction might not be the same person who obtained the tax benefit.

77. The third step that we need to consider is whether the transaction was entered into or carried out for the 'sole or dominant purpose' of enabling Company A to obtain a tax benefit. We again accept that the tests set out in section 61A have to be applied 'objectively'. In our view, we accept again that there is no inconsistency between a finding that the purpose lay in the pursuit of commercial gain and in the course of carrying on a business and a finding that the sole or dominant purpose was to enable the relevant taxpayer to obtain a tax benefit. We also accept that attributing the sole and dominant purpose of tax avoidance held by a professional adviser such as Accounting Firm AJ or Bank C to a 'relevant person' such as Company A within the meaning of section 61A is both acceptable and appropriate.

78. Mr Gardiner, QC submitted that the 'choice' principle is relevant to the interpretation of section 61A. However, we do rely on FCT v Consolidated Press Holdings Ltd (2001) 207 CLR 235, FCT v Sleight (2004) 206 ALR 511, FCT v Spotless Services Ltd (1996) 186 CLR 404 and FCT v Hart (2004) 206 ALR 207 and accept Miss Li, SC's submission that 'choice' of a taxpayer in conducting his fiscal affairs has been expressly circumscribed by section 61A. We accept that the taxpayer is not entitled to 'choose' to enter into a transaction which has a sole or dominant purpose of enabling him to obtain a tax benefit.

79. We have found that the sole or dominant purpose was to enable Company A to obtain a 'tax benefit'. In our view, it is unequivocal that the financing scheme was expressed to be a tax exercise or a tax scheme.

80. Section 61A(1) sets out seven factors for us to consider as to whether or not we can reach the conclusion that the 'sole or dominant purpose' of the transaction was to obtain a 'tax benefit' for Company A. The seven factors are as follows:

(1) the manner in which the transaction was entered into or carried out;

(2) the form and substance of the transaction;

(3) the result in relation to the operation of the IRO that, but for section 61A, would have been achieved by the transaction;

(4) the transaction did not result in any real change in the financial position of Company A;

(5) the transaction did not result in any real change in the financial position of any other party who was connected with Company A;

(6) the various transactions which made up the financing scheme entered into between Company A/Bank C, Bank C/Bank R, Bank R/Company B, and

Bank R/Company G were obviously non-commercial and would not normally have been entered into by parties dealing with each other at arm's length; and

(7) the transaction involved the channelling of funds to offshore companies, namely, Bank R, Company B and Company G.

81. We are of the view that having looked carefully at each of the seven factors as set out in section 61A(1), the conclusion is irresistible, that is, the 'sole or dominant purpose' of the transaction was to obtain a 'tax benefit' for Company A. Miss Li, SC in her written submissions dealt with each of the seven factors:

'(1) In respect of (a), the manner in which the transaction was entered into or carried out, it is relevant to note that –

(a) the Loan Agreement, the Participation Agreement and Sub-Participation Agreement were all entered into on the same date, i.e. 28 October 1992;

(b) the drawdown of the Loans, the payments under the Participation Agreement and Sub-Participation Agreement, and the payment for the redeemable preference shares were all pre-planned to take place on 2nd or 3rd November 1992;

(c) each of the subsequent bi-annual payments of interest or dividends was pre-planned or pre-ordained to take place on the same day;

(d) the extreme care exercised by [Accounting Firm AJ] and the Appellant to ensure that the flow of funds would follow a pre-planned order;

(e) the careful drafting of the relevant board resolutions to make reference to a purported commercial purpose;

(f) the intentional inclusion of a one-day delay in the initial fund flow so that that the funding arrangement would not appear "too transparent for the Revenue";

(g) [Company B] was incorporated on 20 October 1992, being merely 8 days before the date of the Loan Agreement, the Participation Agreement and Sub-Participation Agreement, and was specially created for the purpose of the tax avoidance scheme. It was referred to as the "SPC" (Special Purpose Company) in the contemporaneous documents, see for example;

(h) both the Participation Agreement and the Sub-Participation Agreement contained substantially similar clauses and were drafted in a similar format.

(2) In respect of (b), the form and substance of the transaction, it is of note that:

(a) although [Bank C] was supposed to be the "lender" under the Loan Agreement, [Bank C] did not derive any income or benefit from "lending" a substantial sum to [Company A] other than the initial and annual bank charges;

(b) [Bank C] did not, effectively, have to put up any funding for the loan to [Company A] or bear any commercial risk of default on the repayment of the loan by [Company A];

(c) equally, [Bank R] did not have to put up any funding for participating in the Loan Agreement;

(d) [Bank R] had no right of recourse against [Bank C], save to the extent of the sum actually received by [Bank C] from [Company A] under the Loan Agreement;

(e) equally, [Company B] had no right of recourse against [Bank R], save to the extent of the sum actually received by [Bank R] from [Bank C] under the Participation Agreement.

(3) In respect of (c), the result in relation to the operation of the IRO, but for s.61A and subject to the Respondent's other arguments under ss.16, 17 and 61, was that the whole or virtually the whole of [Company A's] rental income for the years of assessment from 1994/95 to 2000/01, which would otherwise have been chargeable to profits tax, was wiped out by the "interest" paid to [Bank C] under the Loan Agreement.

(4) In respect of (d), the transaction did not result in any real change in the financial position of Company A Instead of being indebted to its indirect holding company ([Company F]), it became indebted to [Bank C], but the ultimate creditor was always recognised to be [Company D]. From [Bank C/Bank R's] point of view, the transaction was always regarded as being "zero-weighted, non-funded".

(5) In respect of (e), the transaction did not result in any real change in the financial position of any other party who was connected with [Company A]. In

particular, the financing scheme was designed by [Accounting Firm AJ] to ensure that it would result in "a nil payment of funds by the [Company AW Group]". Both the principal amount of the Loan and subsequent interest payments were designed to move in a circle, without any net change in the financial position of the [Company D] group of companies.

(6) In respect of (f), the various transactions which made up the financing scheme entered into between [Company A]/[Bank C], [Bank C]/[Bank R], [Bank R]/[Company B], and [Bank R]/[Company G] were obviously non-commercial and would not normally have been entered into by parties dealing with each other at arm's length. The matters mentioned in sub-paragraph (2) above is repeated. In addition, the following matters are relevant:-

(a) [Bank C] apparently granted a very substantial loan (which required the personal approval of the Chief Executive or Chairman of the bank) of an amount equivalent to 100% of the value of the Property without obtaining any mortgage or charge over the Property and without any analysis of [Company A's] ability to service the interest payments;

(b) when the original term of the Loan came to be renewed in 1997, it was [Company D] which requested that the interest rate be increased from 10% to 13% p.a.;

(c) after the extended term of the loan under the Loan Agreement had expired in November 2002 and after [Company A] had failed to repay the principal amount of the Loan on the due date, [Bank C], instead of demanding for repayment, extended the repayment date and reduced the interest rate from 13% p.a. to 3% p.a.;

(d) the mutual grant of call/put options in respect of the 2 ordinary shares of [Company B] by [Bank R] and [Company G];

(e) [Company D] undertook to indemnify [Bank C] of whatever losses that might arise from [Company B's] ongoing objections to IRD's tax assessment.

(7) Finally, in respect of (g), the transaction involved the channelling of funds to offshore companies, namely, [Bank R], [Company B] and [Company G].'

82. We have no hesitation in accepting Miss Li, SC's submissions in respect of this matter.

83. We conclude that all the Conditions as set out under section 61A have been satisfied and therefore we accept that the Commissioner was empowered under section 61A(2) to assess the liability to tax of Company A by (i) disregarding the transaction or part of the transaction or (ii) such other manner as appropriate to counteract the tax benefit which otherwise would be obtained. We have no hesitation in accepting that the Commissioner was fully justified in disallowing deduction of the interest and related bank charges and legal fees from the rental income.

Issue 3 – section 61 of the IRO

84. We now turn to consider section 61 of the IRO. It is clear that section 61 applies where two conditions are satisfied:

(1) Where there was any transaction which reduces or would reduce the amount of tax payable by any person; and

(2) such transaction is artificial or fictitious.

85. We have already reviewed and examined the evidence in respect of this matter and again, we have found that it is quite clear that the Loan Agreement entered into between Company A and Bank C is the transaction. We have found that the loan agreement resulted in a substantial interest being paid by Company A which reduced or would reduce the profits of Company A and hence the tax payable by Company A.

86. The issue which we need to consider is whether the transaction is 'fictitious' or 'artificial'. As we have found that the transaction has no commercial reality and indeed, the conclusion we have reached is that the transaction was indeed 'artificial'. We are able to look at all circumstances and the background in respect of this matter and we have come to the conclusion that the reasoning that we have already set out that the Loan Agreement was commercially unrealistic and artificial if not fictitious. Therefore, we have no hesitation in concluding that the Commissioner was entitled to disregard the Loan Agreement, and any interest and related bank charges and legal fees 'paid' by Company A to Bank C pursuant to that agreement, and assess Company A' s liability to pay profits tax accordingly.

Conclusion

87. In conclusion, therefore, we dismiss Company A' s Appeal. Finally, we wish to thank the parties and their representatives for the assistance they have given us in dealing with this matter.