

Case No. D46/09

Profits tax – trading stock or capital asset – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Ng Man Sang Alan and Yeung Eirene.

Date of hearing: 28 September 2009.

Date of decision: 12 January 2010.

The appellant acquired the only share of a shelf company ('SPV') which acquired a commercial property, funded mainly by a mortgage loan. After completion of the conveyancing transaction had been postponed a number of times at the request of the commercial property purchaser, the commercial property purchaser proposed 'to acquire the commercial property by transfer of SPV's shares instead of usual transaction'. The assessor raised profits tax assessment on the profit derived from the transfer of the subject share to which the appellant objected. The appellant contended that he had no intention to sell the subject share. If the appellant had intended to sell the subject share at the outset, SPV would not have entered into the sale and purchase agreement for the commercial property in the first place. The assessor considered that the sale of the subject share was only an alternative way to complete the trading of the commercial property by SPV.

Held:

Investment or trading is a common dispute in tax cases. It is plain that SPV was a special purpose vehicle acquired for the purpose of dealing with the commercial property. It is idle to speak of intention to acquire the subject share as a capital asset if SPV does not have a viable future or business. It is plain from evidence placed before the Board that SPV did not have the financial resources to pay off its mortgage loan and director's loan for the purpose of holding the commercial property on a long term basis. Upon a holistic consideration of the circumstances of this particular case, the Board concluded that the appellant carried on an adventure in the nature of trade and acquired the subject share as a trading stock.

Appeal dismissed.

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

Marson v Morton [1986] 1 WLR 1343

All Best Wishes Limited v CIR (1992) 3 HKTC 750

Lee Yee Shing v The Commissioner of Inland Revenue (2008) 11 HKFCAR 6

Real Estate Investments (NT) Limited v The Commissioner of Inland Revenue
(2008) 11 HKFCAR 433

Edmund Wong, Certified Public Accountant, of Reliance Tax Consultants Limited for the taxpayer.

Fung Chi Keung and Tam Tai Pang for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The following is a brief chronology of the relevant events:

<u>Date</u>	<u>Event</u>
15 October 2004	A shelf company ('SPV') was incorporated.
19 November 2004	Appellant was appointed a director of SPV.
22 November 2004	Appellant acquired the only issued share of SPV, a fully paid up subscriber share of \$1 ('the subject share').
23 November 2004	Date of provisional agreement by which SPV contracted to acquire a commercial property ('the commercial property') subject to existing tenancy. The name of the purchaser was amended from another company of which the appellant was a director to SPV and the purchase price was amended from \$10,300,000 to \$10,500,000.
2 March 2005	Date of the acquisition assignment. The acquisition was funded mainly by a mortgage loan.
26 May 2005	Date of provisional agreement by which SPV contracted to dispose of the commercial property at \$15,300,000.
6 September 2006	After completion of the conveyancing transaction had been postponed a number of times at the request of the commercial property purchaser, the controlling shareholder ('the subject share purchaser') of the commercial property purchaser proposed to acquire SPV in place of the acquisition of the commercial property by the commercial property purchaser.
27 September 2006	The conveyancing transaction was cancelled and

	the subject share was transferred by the appellant to the subject share purchaser for \$4,092,080.54.
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2. The assessor assessed the gain of \$4,092,080 from the sale of the subject share to profits tax. Having objected without success, the appellant appealed to the Board.
3. The appellant absented himself from the hearing of the appeal.
4. He was represented by Mr Edmund Wong, certified public accountant. Mr Edmund Wong called no witness to testify and cited no authority.
5. After Mr Edmund Wong had completed presenting his case, we told the parties that we were not calling on the Commissioner and that we would give our decision in writing which we now do.

The agreed facts

6. The parties have agreed the following facts and we find them as facts.
7. The appellant has objected to the profits tax assessment for the year of assessment 2006/07 raised on him. The appellant claims that the profit derived from the disposal of the subject share should not be chargeable to profits tax.
8. SPV was incorporated as a private company in Hong Kong on 15 October 2004. The appellant was appointed as director of SPV on 19 November 2004. At the material times, SPV's capital consisted of one issued and fully paid up share of \$1¹. On 22 November 2004, the subscriber of SPV transferred the subject share to the appellant.
9. By a provisional agreement for sale and purchase dated 23 November 2004, SPV purchased the commercial property at a price of \$10,500,000. The purchase was completed on 2 March 2005 when the commercial property was assigned to SPV. To finance the purchase of the commercial property, SPV obtained a mortgage loan from a bank.
10. By a provisional agreement for sale and purchase dated 26 May 2005, SPV [contracted to sell] the commercial property to the commercial property purchaser at a price of \$15,300,000. The transaction was contracted to be completed on or before 30 September 2005.
11. By a supplemental agreement for sale and purchase dated 27 September 2005, SPV and commercial property purchaser agreed to postpone the completion of the sale and purchase of the commercial property either to 31 March 2006 (on payment of a non-refundable fee of \$765,000 from the commercial property purchaser to SPV) or to 29

¹ That is to say, the subject share.

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

September 2006 (on payment of a further non-refundable fee of \$765,000 from the commercial property purchaser to SPV).

12. By a letter dated 6 September 2006, the solicitors acting for commercial property purchaser informed the solicitors acting for SPV that purchaser wished ‘to acquire the [commercial property] by transfer of [SPV’s] shares instead of usual transaction’.

13. By a cancellation agreement dated 27 September 2006, SPV and the commercial property purchaser agreed to cancel the sale and purchase of the commercial property. By an instrument of transfer dated 27 September 2006, the appellant transferred the subject share to the share purchaser at a consideration of \$4,092,080.54.

14. In response to the assessor’s enquiries, SPV supplied the following information:

- (a) The appellant, being the registered sole shareholder of SPV, sold the entire share capital (i.e. the subject share) of SPV to the share purchaser on 27 September 2006.
- (b) The amount of consideration paid for the transfer of the subject share was \$4,092,080.54, which was based on the net assets value of SPV per the balance sheet at 27 September 2006.

15. The assessor was of the view that the profit derived from the transfer of the subject share by the appellant should be chargeable to profits tax and thus raised on him the following profits tax assessment for the year of assessment 2006/07:

Assessable profits	<u>\$4,092,080</u>
Tax payable thereon	<u>\$654,732</u>

16. On behalf of the appellant, Reliance Tax Consultants Limited (‘Mr Edmund Wong’s company’) objected against the above profits tax assessment on the ground that the assessment was incorrect. Mr Edmund Wong’s company further asserted the following (written exactly as it stands in the original):

- ‘(a) The profits tax assessment was based on the sale value of the entire issued share capital of [SPV] received by the [appellant] from the disposal of the [subject share]. According to section 14(1) of the Inland Revenue Ordinance [Cap. 112 (“the Ordinance”)], any profits obtained from carrying on a trade should be charged to profits tax. However, the [appellant] never conducted the business of trading of private company’s share. Therefore, there should not be any profits derived from it.
- (b) The following points showed that the [appellant] was not carrying on a trade or business:

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (i) [SPV] was incorporated on 15 October 2004 and was acquired by the appellant on 22 November 2004 for permanent investment purpose. The [appellant] intended to use [SPV] as a vehicle to invest in land properties.
 - (ii) The proceeds from the disposal of the [subject share] should not be recurring in the future. Trade or business required frequent similar transactions.
 - (iii) The [appellant] had done nothing in the whole transaction. Trade or business required him to do a lot to make it.
 - (iv) The disposal was passive and reluctant from the view of the [appellant] and at all material times there was no motive to make the disposal.
 - (v) The [appellant's] proceeds from the disposal of the [subject share] were capital in nature and not chargeable to tax under section 14(1) of the [Ordinance].
- (c) The circumstances leading to the [appellant's] disposal of the subject share were as follows. Upon acquiring [SPV] in late 2004, the [appellant] looked for investment properties with high yield. In early 2005, [SPV] acquired the [commercial property] for long term investment purpose. This intention had been clearly indicated in the audited financial statements made up to 31 December 2005 and Profits Tax Returns 2005/06.
- (d) Upon all the procedures (the long term financing loan from a bank; the registration of assignment and leasing agreement) of acquiring the [commercial property] were completed, the [appellant] was approached by many property agents that there were potential purchasers offering to acquire the [commercial property]. [SPV] subsequently entered into a sale and purchase agreement with [the commercial property purchaser] to dispose of the [commercial property]. According to the agreement, the whole transaction should be completed by the end of September 2005. If the transaction could be completed, [SPV] could earn a gross capital profit of around \$4,800,000.
- (e) However, by the end of September 2005, [the commercial property purchaser] requested several times to extend the completion date until the end of September 2006. In early September 2006, almost one year delay from the original date of completion, [the commercial property purchaser's] controlling shareholder offered to the [appellant] to transfer the [subject share] to him rather than selling the [commercial property] to [the commercial property purchaser]. In order to complete

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

the transaction, the [appellant] was reluctant but with no other alternatives and nevertheless accepted his offer.

- (f) The [appellant] had no intention to make this deal. It was clear that at all material times, he had no intention to sell the [subject share]. If the [appellant] had intended to sell the [subject share] in the early beginning, [SPV] would not enter into the sale and purchase agreement in mid-June 2005. Secondly, the proceeds from the disposal of the [subject share] were around \$4,100,000 which was substantially lower than the capital gain of \$4,800,000 that would have been derived by [SPV].’

17. The assessor did not accept Mr Edmund Wong’s company’s contentions. The assessor considered that the sale of the subject share was only an alternative way to complete the trading of the commercial property by SPV. The sale did not represent the realisation of an investment but must be regarded as something done in the course of an operation of business, undertaken in pursuance of a profit making scheme. The profit realised was accordingly income and not capital in nature. The assessor invited the appellant to withdraw the objection.

18. In response, Mr Edmund Wong’s company contended the following on behalf of the appellant (written exactly as it stands in the original):

- ‘ (a) The [appellant] did not agree that the sale of the [subject share] was an alternative way to complete the disposal of the [commercial property] nor that he had done a lot to make the profit in the course of an operation of business.
- (b) Whether the profit from the disposal of the [commercial property] by [SPV] was capital or revenue in nature had not yet been determined.
- (c) The disposal of the [subject share] was the last resort, not an alternative way to complete the transaction after a year of delay by the [commercial property purchaser]. The disposal of the [commercial property] by [SPV] or by disposal of the [subject share] to the purchaser was quite different to the [appellant]. Not only did the sum received was significantly reduced from the disposal by the [subject share], but also [SPV] and the [appellant] should not be regarded as the same entity under the law of Hong Kong.
- (d) The intention was of paramount importance in determining whether there was a trade or not. From the early beginning of the disposal of the [commercial property] by [SPV], there was an offer from the [commercial property purchaser]; the final subsequent disposal of the [subject share] was requested by the purchaser. The [appellant] was in a passive position. He did nothing throughout the period concerned. His

intention on [SPV] and the [commercial property] was for long term investment.

- (e) There would be double taxation if both the [appellant's] disposal of the [subject share] and [SPV's] disposal of the [commercial property] were taxed.'

The notice of appeal

19. Investment or trading is a common dispute in tax cases. A properly formulated argument or ground of appeal should be clear, succinct and pertinent. What we are saddled with in this case are the arguments quoted in paragraphs 16 and 18 above and the grounds of appeal quoted in paragraph 20 below.

20. By letter dated 23 April 2009, Mr Edmund Wong's company gave notice of appeal on behalf of the appellant which was described as the 'petitioner' stating that (written exactly as it stands in the original):

'Referring to Inland Revenue Department's ("IRD") notice of assessment to our client dated 23 December 2008, our subsequent objection and finally leading to the Commissioner's determination ("the Determination") dated 2 April 2009, we are lodging formal appeal to your board on the ground that IRD's assessment to our client is unreasonable and incorrect.

A copy of full text of the Determination which included commissioner's reasons for such decision; the written determination; and the statement of facts were enclosed for you. The determination included our grounds for making such objection. However we wish to reiterate the following points:

- (1) The disposal of share shall be capital in nature because our client never intends to sell (resulting in a profit, now taxed by IRD) from the first acquisition on 22 November 2004 until the final disposal on 27 September 2006. It is a long term investment. The circumstances leading to the subsequent disposal can be found in the statement of facts under the Determination. We wish to stress that if our client intends to sell the share, he should make it at the early beginning. IRD shall not assume [SPV] "the Company" 's change its intention to dispose the investment property would imply our client also change his intention for his disposal of the Company's share. To our knowledge, in most of the cases, individual's profits from trading of list companies' share are not subject to tax. Furthermore, private company's shares are not marketable and non trading assets.
- (2) We do believe that our client's investment in private company share and the Company's investment in land property shall be separated as they are different entities under the law of Hong Kong. The results for such

disposal are different in both the amount to be taxed and profits tax rate applied. It is the case that our client is the sole director and shareholder of the Company. Please consider what happen if the Company has many shareholders. IRD shall not assess our client for the appreciation of share after the agreement for the Company's disposal of its investment property was cancelled.

- (3) Regarding the claims by IRD on the unrealistic for \$1 company to be permanent investment purpose, we do not agree as most of HK companies are \$1 companies. The objective fact is that the Company was able to obtain the bank loan required for financing the acquisition of the land property. The finance background of the shareholders and directors shall be the paramount importance.
- (4) IRD also claims the Company's short period of ownership of land property constituted an adventure in the nature of trade. Our view is that length of ownership is not the conclusive factor to determine whether it is trade nor not. We believe that even the Company change the intention for disposal of land property does not automatically imply our client's change his intention for holding of the Company's share. The objective fact appears to us is that our client's disposal of his share was only made after nearly 1 and half year being the first agreement entered by the Company for the disposal of Company's investment property. Our client is reluctant but no other alternative. We do not agree with the assertion by IRD that our client has alternative and open to him how to dispose the property to make the trading profit.

For the reasons stated above, the disposal of share by our client is capital in nature and shall not be subjected to tax.'

The hearing

21. The parties also agreed the matters set out in a document called 'Companies of which [the appellant] was a director and which purchased and/or sold properties during the period between 1 January 2004 and 31 December 2006'. We note the agreement but do not wish to burden our decision with further irrelevant matters introduced by Mr Edmund Wong. What we are concerned with in this case is the subject share. That is the subject property.

22. Mr Edmund Wong told us that he understood that there should be no assumption that the written declarations by the appellant and the estate agent were admissible. Nevertheless, he chose to adduce no oral evidence and made available neither the appellant nor the estate agent for cross-examination. The crucial issue is a factual one. Yet, the appellant chose to absent himself from the hearing. The Revenue simply had no opportunity to cross-examine the appellant to test the veracity of his assertions. We attach no weight to his and the estate agent's respective written declarations.

Authorities on capital or trading/business issue

23. Section 2 of the Inland Revenue Ordinance, Chapter 112 ('the Ordinance'), defines 'business' as including 'agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government' and 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'.

24. Section 14 is the charging provision on profits tax. Sub-section (1) provides that:

'Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment ... on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'

Onus of proof

25. Section 68(4) provides that the 'onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'. See also paragraphs 26 and 33 below.

Simmons

26. Lord Wilberforce stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 that the relevant question is whether the stated intention existed at the time of the acquisition of the asset – was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? His Lordship recognised that intention may be changed (at page 1199) and that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention (at page 1202):

'One must ask, first, what the commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock - and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax: see

Sharkey v. Wernher [1956] A.C. 58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status - neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review.’ (at page 1196)

‘Finally as to the decision of the Court of Appeal, the judgment, delivered by Orr L.J., contains a clear account of the facts, and, in my respectful opinion, a generally correct statement of the law. In particular, it is rightly recognised that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention.’ (at page 1202)

In the Court of Appeal, Orr L J accepted that it was clearly established that on appeal to the Commissioners² the burden is on the taxpayer to displace the assessment and in the circumstances the burden was clearly on the taxpayers to establish that the sales in question gave rise to a surplus on capital account and not to a trading profit. His Lordship stated the general principles in these terms:

‘It is also clearly established that on appeal to the Commissioners the burden is on the taxpayer to displace the assessment, and in these circumstances the burden in the present case was clearly on the taxpayers to establish that the sales in question gave rise to a surplus on capital account and not to a trading profit (Norman v Golder 26 TC 293, at page 297, and Shadford v H Fairweather & Co Ltd 43 TC 291, at page 300). On the other hand it is also clear that if an asset is acquired in the first instance as an investment the fact that it is later sold does not take it out of the category of investment or render its disposal a sale in the course of trade unless there has been a change of intention on the part of the owner between the dates of acquisition and disposal (Eames v Stepnell Properties Ltd 43 TC 678). The question, moreover, whether an item is held as capital or as stock-in-trade is not concluded by the way in which it has been treated in the owner’s books of account (CIR v Scottish Automobile and General Insurance Co Ltd 16 TC 381, at page 390) or by the Revenue in past years (Rellim Ltd v Vise 32 TC 254).’ [1980] 53 TC 461 at pages 488 & 489.

Marson v Morton

27. In Marson v Morton [1986] 1 WLR 1343 at pages 1347 –1349, Sir Nicholas Browne-Wilkinson VC thought that the only point which was as a matter of law clear was that a single, one-off transaction can be an adventure in the nature of trade and the question

² In Hong Kong, the appeal is to the Board.

is whether the taxpayer was investing the money or was he doing a deal. His Lordship stated that:

- Only one point is as a matter of law clear, namely that a single, one-off transaction can be an adventure in the nature of trade.
- The purpose of authority is to find principle, not to seek analogies on the facts.
- The question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case.
- The most that his Lordship had been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another and that the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate. The matters which are apparently treated as a badge of trading are as follows:

- ‘ (i) *The transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.*
- (ii) *Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.*
- (iii) *The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the chairman of the commissioners quoted from Inland Revenue Commissioners v. Reinhold, 1953 S.C. 49. For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.*
- (iv) *In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?*

- (v) *What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.*
 - (vi) *Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.*
 - (vii) *Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.*
 - (viii) *What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.*
 - (ix) *Did the item purchased either provide enjoyment for the purchaser, for example a picture, or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment.'*
- In order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?

All Best Wishes

28. Mortimer J (as he then was) pointed out in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771 that – ‘was this an adventure and concern in the nature of trade’ is a decision of fact and the fact to be decided is defined by the Statute.

‘Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.’ (at page 770)

‘The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.

I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute - was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person’s intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.’ (at page 771)

Lee Yee Shing

29. Lee Yee Shing v The Commissioner of Inland Revenue (2008) 11 HKFCAR 6 is a case on share dealing activities.

30. Bokhary PJ and Chan PJ emphasised at paragraph 38 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree

to be answered by the fact-finding body upon a consideration of all the circumstances. McHugh NPJ thought that ultimately, the issue is one of fact and degree³.

31. On the question of ‘trade’, McHugh NPJ pointed out that the intention to trade referred to by Lord Wilberforce in Simmons was not subjective, but objective, to be inferred from all the circumstances of the case. His Lordship stated that:

- (a) *‘No principle of law defines trade. Its application requires the tribunal of fact to make a value judgment after examining all the circumstances involved in the activities claimed to be a trade’. (at paragraph 56)*
- (b) *‘The intention to trade to which Lord Wilberforce referred in Simmons is not subjective but objective: Iswera v. Commissioner of Inland Revenue [1965] 1 WLR 663 at 668. It is inferred from all the circumstances of the case, as Mortimer J pointed out in All Best Wishes Ltd v. Commissioner of Inland Revenue (1992) 3 HKTC 750 at 771. A distinction has to be drawn between the case where the taxpayer concedes that he or she had the intention to resell for profit when the asset or commodity was acquired and the case where the taxpayer asserts that no such intention existed. If the taxpayer concedes the intention in a case where the taxing authority claims that a profit is assessable to tax, the concession is generally but not always decisive of intention: Inland Revenue Commissioners v. Reinhold (1953) 34 TC 389. However, in cases where the taxpayer is claiming that a loss is an allowable deduction because he or she had an intention to resell for profit or where the taxpayer has made a profit but denies an intention to resell at the date of acquisition, the tribunal of fact determines the intention issue objectively by examining all the circumstances of the case. It examines the circumstances to see whether the “badges of trade” are or are not present. In substance, it is “the badges of trade” that are the criteria for determining what Lord Wilberforce called “an operation of trade”’. (at paragraph 59)*
- (c) *‘What then are the “badges of trade” that indicate an intention to trade or, perhaps more correctly, the carrying on of a trade? An examination of the many cases on the subject indicates that, for most cases, they are whether the taxpayer:*
 - 1. *has frequently engaged in similar transactions?*
 - 2. *has held the asset or commodity for a lengthy period?*
 - 3. *has acquired an asset or commodity that is normally the subject of trading rather than investment?*

³ See paragraph 32(c) below.

4. *has bought large quantities or numbers of the commodity or asset?*
5. *has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?*
6. *has sought to add re-sale value to the asset by additions or repair?*
7. *has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?*
8. *has conceded an actual intention to resell at a profit when the asset or commodity was acquired?*
9. *has purchased the asset or commodity for personal use or pleasure or for income?’ (at paragraph 60)*

(d) *‘In some cases, the source of finance for the purchase may also be a badge of trade, particularly where the asset or commodity is sold shortly after purchase. But borrowing to acquire an asset or commodity is usually a neutral factor.’ (at paragraph 61)*

32. On the question of ‘business’, it has long been recognised that business is a wider concept than trade, per Bokhary PJ and Chan PJ at paragraph 17. McHugh NPJ is of the same view, stating in paragraph 68 that business is a wider term than trade. McHugh NPJ went on to state that:

(a) *‘What then is the definition or ordinary meaning of “business”? The answer is that there is no definition or ordinary meaning that can be universally applied. Nevertheless, ever since Smith v. Anderson (1880) 15 Ch D 247, common law courts have never doubted that the expression “carrying on” implies a repetition of acts and that, in the expression “carrying on a business”, the series of acts must be such that they constitute a business: Smith v. Anderson (1880) 15 Ch D 247 at 277 – 278 per Brett LJ. Much assistance in this context is also gained from the statement of Richardson J in Calkin v. Commissioner of Inland Revenue [1984] 1 NZLR 440 at 446 where he said “that underlying ... the term ‘business’ itself when used in the context of a taxation statute, is the fundamental notion of the exercise of an activity in an organised and coherent way and one which is directed to an end result”. In Rangatira Ltd v. Commissioner of Inland Revenue [1997] STC 47, the Judicial Committee said that it found these words of Richardson J “of assistance”’. (at paragraph 69).*

- (b) *‘Ordinarily, a series of acts will not constitute a business unless they are continuous and repetitive and done for the purpose of making a gain or profit: Hope v. Bathurst City Council (1980) 144 CLR 1 at 8 – 9 per Mason J; Ferguson v. Federal Commissioner of Taxation (1979) 79 ATC 4261 at 4264. However, as Lord Diplock pointed out in American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia) [1979] AC 676 at 684 “depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between”. Exceptionally, a business may exist although the shareholders or members cannot obtain any gain or profit from the activities of the business: Inland Revenue Commissioners v. Incorporated Council of Law Reporting (1888) 22 QBD 279 (law reporting body prohibited by its constitution from dividing profits among members). It may exist even though the object of the activities is to make a loss: c.f. Griffiths v. JP Harrison (Watford) Ltd [1963] AC 1 (dividend stripping operation). And a corporation, firm or business may carry on business in a particular country even though its profits are earned in another country: South India Shipping Corp Ltd v. Export-Import Bank of Korea [1985] 2 All ER 219.’ (at paragraph 70)*
- (c) *‘While engaging in activities with a view to profit making is an important indicator, and in some cases an essential characteristic, of a business, a profit making purpose does not conclude the question whether the activities constitute a business. Whether or not they do depends on a careful analysis of all the circumstances surrounding the activities. Some may indicate the existence of a business; some may indicate that no business exists. Ultimately, the issue is one of fact and degree. But, as Edwards v. Bairstow [1956] AC 14, Hope v. Bathurst City Council (1980) 144 CLR 1 and Lewis Emanuel & Son Ltd v. White (1965) 42 TC 369 show, the issue becomes one of law and not fact where the only reasonable conclusion to be drawn from the facts found or admitted is that the activities in question did or did not constitute the carrying on of a business. In such a case, an appellate court, although debarred from finding facts, may reverse the finding of the tribunal of fact and hold that a business was or was not being carried on.’ (at paragraph 71)*

Real Estate Investments

33. In Real Estate Investments (NT) Limited v The Commissioner of Inland Revenue (2008) 11 HKFCAR 433, Bokhary PJ and Chan PJ stated that, given section 68(4), it is possible although rare for such an appeal to end – and be disposed of – on the basis of burden of proof and that the onus cannot be shifted:

‘It is natural and appropriate to strive to decide on something more satisfying than the onus of proof. And it should generally be possible to do so. But tax appeals do begin on the basis that, as s.68(4) of the Inland Revenue Ordinance

provides, “[t]he onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant”. And it is possible although rare for such an appeal to end – and be disposed of – on that basis’, at paragraph 32.

‘As for the notion of a shifting onus, such a notion is seldom if ever helpful. Certainly it cannot shift the onus of proof from where s.68(4) of the Inland Revenue Ordinance places it, namely on a taxpayer who appeals against an assessment to show that it is excessive or incorrect’, at paragraph 35.

34. Their Lordships went on to state that:

- the badges of trade are no less helpful here than in the United Kingdom;
- they do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention; and
- the question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.

‘It is clear that question (ii)(b) uses the expression “badges of trade” to mean the circumstances that shed light on the issue of intention. Those circumstances simply do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention’, at paragraph 40.

‘Suppose a tax assessment is made on the footing that the position is X and the taxpayer appeals against the assessment by contending that the position is Y. The taxpayer will have to prove his contention. So his appeal to the Board of Review would fail if the Board positively determines that, contrary to his contention, the position is X. And it would likewise fail if the Board merely determines that he has not proved his contention that the position is Y. Either way, no appeal by the taxpayer against the Board’s decision could succeed on the “true and only reasonable conclusion” basis unless the court is of the view that the true and only reasonable conclusion is that the position is Y’, at paragraph 47.

‘... the list offered in Marson v. Morton is no less helpful in Hong Kong than it is in the United Kingdom. As the Privy Council observed in Beautiland Co. Ltd v. CIR [1991] 2 HKLR 511 at p.515G, there is no material difference between the Hong Kong and United Kingdom definitions of trade for tax purposes. Both include every adventure in the nature of trade’ at paragraph 53.

‘In regard to one of the badges of trade which he listed in Marson v. Morton, the Vice-Chancellor said this (at p.1348 F-G):

“What was the source of finance of the transaction? If money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.”

That is as far as it goes, which is not very far when taken on its own. At p.1349 C-D the Vice-Chancellor emphasised that his list is not comprehensive, that no single item is in any way decisive and that it is always necessary to look at the whole picture.

The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case’ at paragraphs 54 – 55.

Subject share – trading stock or capital asset

35. It is plain that SPV was a special purpose vehicle acquired for the purpose of dealing with the commercial property.

36. The subject share was acquired on 22 November 2004 and disposed of on 27 September 2006.

37. The salaries tax returns by the appellant show the following:

Year of assessment	Total reported income \$	Deductions claimed \$
2004/05	500,000 + quarters	41,559 as interest
		Allowance for 2 children
2005/06	740,000 + quarters	Allowance for 2 children
2006/07	600,000 + quarters	Allowance for 2 children

38. The financial statements of SPV were audited by Mr Edmund Wong & Co. They show the following:

Period	Turnover & other revenue \$	Net current liabilities \$	Non current liabilities \$	Net asset value (liabilities) \$
15 October 2004 – 31 December 2005	251,423.81	(4,412,991.54)	(6,729,610.45)	(124,736.99)
1 January 2006 – 27 September 2006	316,129.67	(11,207,919.46)	-	4,092,080.54

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

39. In a letter dated 24 August 2005 to the Commissioner signed by the appellant on behalf of SPV, SPV stated that its monthly income of \$26,000 was insufficient to pay the monthly mortgage loan repayment of \$51,449.37 and undertook to pay profits tax on time upon successful sale of the commercial property.

40. It is idle to speak of intention to acquire the subject share as a capital asset if SPV does not have a viable future or business. SPV started off as a shelf company with no business activity. It is clear from SPV's audited financial statements and the letter dated 24 August 2005 that SPV was unable to make ends meet. The appellant's salary income was by no means sufficient to fund SPV's acquisition of the commercial property on a long term basis. It is plain from evidence placed before the Board that SPV did not have the financial resources to pay off its mortgage loan and director's loan for the purpose of holding the commercial property on a long term basis.

41. We turn now to the badges of trade summarised by McHugh NPJ in Lee Yee Shing.

- (1) Whether the appellant has frequently engaged in similar transactions: No.
- (2) Whether the appellant has held the asset or commodity for a lengthy period: 1 year and 10 months.
- (3) Whether the appellant has acquired an asset or commodity that is normally the subject of trading rather than investment: Sale and purchase of a special purpose vehicle is not uncommon.
- (4) Whether the appellant has bought large quantities or numbers of the commodity or asset: One share, being the entire issued capital of SPV.
- (5) Whether the appellant has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition: No. The appellant had to sell SPV in order to pay off SPV's liability to himself and SPV's liability under the mortgage loan.
- (6) Whether the appellant has sought to add re-sale value to the asset by additions or repair: No.
- (7) Whether the appellant has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class: No.
- (8) Whether the appellant has conceded an actual intention to resell at a profit when the asset or commodity was acquired: No.

(2009-10) VOLUME 24 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (9) Whether the appellant has purchased the asset or commodity for personal use or pleasure or for income: No. There is no question of pleasure in holding the shares of SPV since SPV was unable to pay its debts unless it sold the commercial property. There is no question of income from the subject share since SPV has not made any profit.
- (10) Source of finance: The appellant funded the acquisition of the subject share himself. However, SPV's acquisition of the commercial property was funded by a mortgage loan.

42. Upon a holistic consideration of the circumstances of this particular case and bearing in mind paragraphs 35 to 40 above, we conclude that the appellant carried on an adventure in the nature of trade and acquired the subject share as a trading stock.

43. The appeal fails and falls to be dismissed.

Disposition

44. We confirm the assessment appealed against and dismiss the appeal.