CACV 15/2006

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL

CIVIL APPEAL NO. 15 OF 2006
(ON APPEAL FROM HCIA NO. 8 OF 2005)

BETWEEN

REAL ESTATE INVESTMENTS (N.T.) LIMITED Appellant

and

COMMISSIONER OF INLAND REVENUE Respondent

Before: Hon Cheung JA, Tang JA and A. Cheung J in Court
Dates of Hearing: 19 and 20 October 2006
Date of Judgment: 10 November 2006

J U D G M E N T

Hon Cheung JA:

1. The appellant was the owner of a high-rise building (' the new building') situated at No. 49 Conduit Road, Hong Kong (' the property'). It disposed of the flats in the new building in 1996.

The Commissioner of Inland Revenue ('the Commissioner') assessed the profits arising from the disposal of the flats to be subject to profits tax under section 14(1) of the *Inland Revenue Ordinance* ('the *Ordinance*').

2. The appellant appealed to the Board of Review ('the Board') which confirmed the decision of the Commissioner. The appellant then appealed to Deputy High Court Judge Carlson by way of Case Stated. The appeal was likewise dismissed by the judge. The appellant now appeals to this court.

The facts

3. The undisputed evidence showed that the appellant is a member of the Chinachem Group of companies ('Chinachem Group'). It bought the property on 2 December 1979. At the time of the acquisition the property consisted of a seven-storey residential building over one storey of car park ('the old building'). The old building was built before 1920.

4. On 31 December 1979 there was an expansion of the share capital of the appellant. It is sufficient to note for the purpose of the appeal that eventually 60% of the shares were held by a company in the control of the Chinachem Group while the remaining shares were held by companies under the control of a well-known securities company called Sun Hung Kai Securities Ltd ('SHKSL'). It was common ground that the old building was bought as an investment under the joint venture between the Chinachem Group and SHKSL. The acquisition costs of about $49.4 million was financed by advances from the appellant's shareholders.

5. It was also common ground that the property was acquired for the purpose of redevelopment. However the government imposed a building moratorium on the locality in May 1979 as a result of the landslide that took place in 1972. The moratorium was only lifted in 1982. Shortly after the lifting of the moratorium the appellant submitted a building plan to the Building Authority on 28 September 1982. The application was unsuccessful and eventually it was only on 9 September 1985 that the Building Authority approved the application by the appellant to build a 24-storey domestic building at the site. The redevelopment plan did not provide for parking facilities.

6. On 23 September 1983 Sun Hung Kai & Co. Limited ('Sun Hung Kai'), a Hong Kong listed company, acquired SHKSL.

7. On 30 October 1987 the appellant entered into a loan agreement with a bank to obtain building loan facilities of up to $32 million. The entire loan had to be repaid on or before 31 December 1991.

8. The demolition of the old building commenced in 1988. By November 1994 the building works of the new building had been completed. On 5 June 1995 the occupation permit for the new building was issued.

9. Between July 1995 and June 1996 various interior decoration works as well as the installation of a lift was carried out at the new building.

10. In May 1996 the appellant offered the units in the new building for sale.

11. On 1 June 1996 there was a public announcement concerning a change in substantial shareholder in Sun Hung Kai the holding company of SHKSL.

12. The property was described in the appellant's balance sheet for the financial years 1980 to 1995 as fixed asset. No rebuilding allowance was ever claimed in respect of the property. In the appellant's accounts for the year ended the 30 June 1996 the property was reclassified as current asset.

Section 14(1)

13. Section 14(1) of the *Ordinance* provides that:

> 'Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate 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

14. The onus of proving that the assessment appealed against is incorrect is on the appellant : section 68(4) of the *Ordinance*.

The issue

15. A land property can be in the nature of a trading stock or a capital asset. A person may buy and sell the property (either in its existing form or after development) by way of trading. In which case the property is in the nature of a trading stock. On the other hand he may keep it as an investment i.e. as an capital asset. Any profits arising from the sale of the capital are not subject to profits tax.

16. The issue that had been identified by the Board was whether the property was acquired as a capital asset.

The approach of the Board

17. The principle that the Board adopted was that the nature of an asset (whether trading stock or capital asset) is to be ascertained from the intention of the acquirer at the time of acquisition of the asset. This intention is to be ascertained from all the surrounding circumstances. The stated intention of the taxpayer is not conclusive. It has to be scrutinised against the surrounding circumstances to see if it was genuinely held and realistic.

The decision of the Board

18. The Board heard evidence and the hearing lasted for eight days. Rather unusually the conclusion reached by the Board was that it was unable to come to a finding on the requisite intention. As a result, since the appellant carried the burden of proof, the Board held that it had failed to discharge its burden and dismissed its appeal.

The questions of law

19. The questions of law certified by the Board for the consideration of the judge were as follows:

> ' (1) Whether, as a matter of law and on the facts found, and having held that we were unable to come to a positive finding as to the Relevant Intention, we were right to conclude that the Appellant had not discharged its burden of proof in the appeal and consequently to dismiss the appeal and confirm the Determination.
>
> (2) (a) Whether we were right in directing ourselves in effect that the nature of an asset, whether trading stock or capital assets, was to be ascertained only from the intention of the acquirer at the time of the acquisition of the asset ("the Relevant Intention");
>
> (b) Whether, if the answer to (a) above is in the negative, we ought, having been unable to come to a positive finding as to the Relevant Intention, to have considered the badges of trade as matters separate from the ascertainment of the Relevant Intention, in order to decide on the nature of the asset in question;
>
> (c) Whether, if the answer to (b) above is in the affirmative, upon the facts found by us, the only true and reasonable conclusion at which we could properly have arrived was that the profits of the Appellant, the subject matter of the appeal, were profits arising from the sale of capital assets

> within the meaning of Section 14 of the Inland Revenue Ordinance and therefore exempt from tax.'

20. The answers given by the judge to questions 1 and 2(a) were 'yes'. As a result he did not need to consider the questions posed in questions 2(b) and 2(c).

The thrust of the appeal

21. Not surprisingly the failure by the Board to reach a finding on the intention of the appellant at the time of the acquisition of the property became the thrust of the appeal lodged by Mr Swaine, counsel for the appellant. He accepted that the appellant carried the burden of proof in showing that the property was acquired for the purpose of a capital asset. While he had no quarrel with the principle adopted by the Board he argued that once it failed to reach a finding on the intention it should go on further and apply the principles concerning the badges of trade in order to decide whether the property was acquired for the purpose of trade.

Simmons v. Inland Revenue Commissioners

22. The starting point in this enquiry is the case of *Simmons v. Inland Revenue Commissioners* [1980] 1 WLR 1196. Lord Wilberforce at page 1198 stated that

> 'What I think has to be considered here is, ... , precisely what the commissioners have found as to the companies' intentions, and whether their findings are consistent or intelligible.....
>
> 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.'

Badges of trade

23. It is equally true that in deciding whether a profit has been derived from a trade the general line of enquiry followed by the Inland Revenue Department has been to look for certain characteristics which are widely accepted as indicating either a trade or an adventure in the nature of a trade. These characteristics are often referred to as the badges of trade : see *Willoughby and Halkyard Encyclopaedia of Hong Kong Taxation* Vol. III para. 1486. The badges of trade were summarised in the final report of the Royal Commission on the Taxation of Profits and Income 1955 (Cmd 9474) as follows:

'(1) *The subject matter of the realisation*. While almost any form of property can be acquired to be dealt in, those forms of property, such as commodities or manufactured articles, which are normally the subject of trading are only very exceptionally the subject of investment. Again property which does not yield to its owner an income or personal enjoyment merely by virtue of its ownership is more likely to have been acquired with the object of a deal than property that does.

(2) *The length of the period of ownership*. Generally speaking, property meant to be dealt in, is realised within a short time after acquisition. But there are many exceptions from this as a universal rule.

(3) *The frequency or number of similar transactions by the same person.* If realisations of the same sort of property occur in succession over a period of years or there are several such realisations at about the same date, a presumption arises that there has been dealing in respect of each.

(4) *Supplementary work on or in connection with the property realised*. If the property is worked up in any way during the ownership so as to bring it into a more marketable condition, or if any special exertions are made to find or attract purchasers, such as the opening of an office or large scale advertising, there is some evidence of dealing. For when there is an organised effort to obtain profit there is a source of taxable income. But if nothing at all is done, the suggestion tends the other way.

(5) *The circumstances that were responsible for the realisation*. There may be some explanation, such as a sudden emergency or opportunity calling for ready money, that negatives the idea that any plan of dealing prompted the original purchase.

(6) *Motive.* There are cases in which the purpose of the transaction of purchase and sale is clearly discernible. Motive is never irrelevant in any of these cases. What is desirable is that it should be realised clearly that it can be inferred from surrounding circumstances in the absence of direct evidence of the seller's intentions and even, if necessary, in the face of his own evidence.'

Marson v. Morton

24. In *Marson v. Morton* [1986] 1 WLR 1343 Sir Browne-Wilkinson VC considered whether a single transaction in which a taxpayer bought a piece of land and disposed of it within a short period of time was an adventure in the nature of trade. He referred to the badges of trade and at page 1348 of the judgment, one of the factors he considered relevant was the intention of the purchaser as to resell at the time of the purchase. He held that

> '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 of rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.'

Which approach

25. The question then becomes : which approach should one adopt in deciding whether the transaction was a sale of a capital asset and not a trading activity? It is clear from a reading of the judgment of *Simmons* that although Lord Wilberforce focused on the question of the taxpayer's intention at the time of the acquisition of the property, this issue cannot be dealt with in isolation and has to be considered by examining all the circumstances of the case. As often said the state of a man's mind is as much a question of fact as the state of his digestion. One needs to consider all the circumstances in order to ascertain a person's intention. Once this point is clear then there really is no conflict between the approach in *Simmons* and the badges of trade approach. Both approaches will lead to the same destiny, namely, the answer to the question of whether profits arise from the sale of a trading stock or a capital asset. This is because both involve a consideration of the circumstances of the case. The badges of trade are convenient categorisation of the relevant factors when one considers the circumstances of the case. The intention to trade or to hold the property as an investment is one of the circumstances to be considered in deciding whether the property that is eventually disposed of is a capital property. At the same time if after considering all the circumstances one can conclude on the nature of the intention then this will help to answer the question posed in the enquiry.

26. The same approach is adopted by the Board of Review in case number D65/87 where the Board held:

> 'We see no inconsistency between Lord Wilberforce's statement in Simmons and the badges of trade approach. For there to be an adventure in the nature of trade, an intention to trade is required. In deciding whether there was such an intention, one must look at all the circumstances and examine whether the transaction bore any of the badges of trade. If the transaction bore the badges of trade, it would mean that an intention to trade was present notwithstanding protestations by the Taxpayer to the contrary.'

Decision based on burden of proof

27. It is unsatisfactory for a tribunal vested with fact finding powers to decide a case purely on the basis of who carried the burden of proof because it was unable to decide on the crucial issue in a case. However such a decision is open to a tribunal : see a decision of this Court (Le Pichon JA, Cheung JA and Stone J) in *Li Tin Sang v. Poon Bun Chak and others* CACV 153 of 2002.

28. In this case there may well be reasons for the Board to adopt this approach because of the different explanations given by the appellant for the reason of sale of the property. The explanation given to the Commissioner by the appellant for the sale was said to be the change in the substantial shareholding of Sun Hung Kai. This explanation was abandoned before the Board. The explanation then given to the Board was that the decision to sell was taken on or about 23 May 1996 due to changed market circumstances and the very attractive then attainable price. Then it was suggested that the property was sold by reason of a change of circumstances, being the existence of the escalator connecting the mid-level with Central which mitigated the need for car parking space.

29. However irrespective of the reasons giving rise to the Board's decision it is clear that the Board had not erred in law. I have to disagree with Mr Swaine's submission that after the Board failed to reach a crucial finding on the intention of the appellant at the time of the acquisition, it should proceed to consider the badges of trade. In my view the Board had already done so when it came to that particular conclusion.

The crucial question

30. The result of the decision of the Board means that the property was a trading stock and not a capital asset since it was only on this basis that the profits tax could be charged. The crucial question in this case is whether the decision by the Board to dismiss the appeal was so

perverse having considered the circumstances of the case. In my view the decision was one that was open to the Board.

Evidence on the intention

31. The Board held that the evidence adduced by the appellant was both 'limited and unconvincing'. Chinachem Group was controlled by Mr and Mrs Teddy Wang. They did not give evidence before the Board. The saga concerning them is now well known. Mr Wang had disappeared since 1990. Hence there was no evidence from him.

32. There was also no evidence from the joint venture partner. Instead the Board heard evidence from two witnesses from the appellant concerning the intention of the appellant at the time of acquisition of the property. TW1, a company secretary and TW2, a senior executive both gave evidence that it was their understanding that Mr and Mrs Wang acquired the property for long term investment. TW2 further stated that Mr and Mrs Wang told him that the property was for rental.

33. In our view the Board was clearly right when it decided not to place any weight on this hearsay evidence especially when the evidence went to the heart of the appeal and was not capable of being tested in cross-examination. It further held that at the highest what Mr and Mrs Wang told the witnesses happened some years after the acquisition of the property.

The factors

34. Looking at the decision of the Board the following factors had been considered by the Board when it sought to ascertain the intention of the appellant concerning the property. I would list these factors but not in any order of preference.

Partner engaged in different trade

35. The Board took the view that the presence of a joint venture partner especially one which apparently was engaged in a different line of business as a factor against an intention to redevelop the property for long term rental income.

No feasibility study on long term investment

36. It further held that SHKSL and Sun Hung Kai had invested a considerable amount of money in the property and its redevelopment. There was no feasibility study or cash flow projection or any document which would have been relied upon by SHKSL to decide that it was a worthwhile long term investment for rental income.

Investment for sale

37. It further held that more likely than not SHKSL was investing in a property to be redeveloped for resale and relied upon the judgment of Mr Wang, who was very successful in that trade.

Loan agreement

38. The appellant had obtained a loan agreement for the redevelopment of the property. As observed by the Board the terms of the loan agreement suggested that the property was going to be sold after redevelopment. In particular the loan was going to be repaid on a date which roughly coincided with the estimated construction period. Under the terms of the loan agreement 'development' was defined in terms to 'embrace thereafter the sale of the redeveloped property'. Furthermore the loan agreement provided for a stakeholder account for the payment of the proceeds of sale. At the same time the Board also recognized that the loan agreement only came into existence some eight years after the acquisition of the property.

Timing of sale

39. The property was sold after the redevelopment was completed. At the same time the Board also recognised that no action had been taken to market the property prior to the completion of redevelopment.

Nature of property

40. On the other hand the appellant suggested the nature of the property itself militated against the intention of acquiring the property for the purpose of trade. It was suggested by the appellant that it was very difficult to sell high rise residential property without parking facilities, but the lack of such facility would not affect the letting of such property. However the Board referred to evidence of the witness on behalf of the appellant who also accepted the proposition that the lack of car parking facilities might only affect the price of the property in the sale market as compared with properties which had the benefit of such facility. The comparatively lower profits to be made from selling the property might still be attractive enough to justify a sale.

Length of holding

41. The appellant also relied on the fact that the property had been held for 15 years before it was finally disposed of. However it should also be borne in mind that it was the common ground of the parties that the property was acquired with the intention of redevelopment. The length of time held by the appellant of the property must also be considered in the context of the moratorium imposed on the property, the time taken by the appellant to redevelop the property and the prevailing market conditions. The evidence showed the market only began to recover from a fall in December 1995.

Funding by the shareholders

42. The appellant also relied on the fact that the property was acquired with the funding by its shareholders. The idea is that since the appellant did not require outside finance to acquire the property there was no urgency to sell the property in order to discharge the loans that may be obtained for the purpose of financing the purchase. This is said to be an indication that the appellant intended to hold the property as a long term investment.

43. In respect of this point the evidence heard by the Board was that the Chinachem Group as well as Sun Hung Kai were financially strong.

Treatment of the property in the accounts

44. The appellant laid great emphasis on the fact that in the accounts of the appellant, the property had been described as a fixed asset for 15 years.

45. Mr Swaine relied on the case of *Galloway v. Schill, Seebohm and Co. Limited* [1912] 2 KB 354 in which Lord Alverstone CJ adopted the description of fixed capital and circulating capital in *Buckley's On Companies* 9th Edn. page 653, namely, fixed capital is property acquired and intended for retention and employment with a view to a profit as distinguished from circulating capital which means property acquired or produced with a view to sell or resell at a profit. The judge held that for the purpose of that case, fixed asset may be taken to mean the same thing as fixed capital employed in the particular year to which the balance sheet relates.

46. Mr Swaine further referred to *Patrick (Inspector of Taxes) v. Broadstone Mills Ltd.* [1954] 1 All ER 163 in which a particular industry had adopted the accounting method of treating stocks as capitals. The court held that such a method, while accepted in the industry, was not appropriate for the purpose of assessment to income tax.

47. Mr Swaine also referred to the book *Business Accounting I* by Wood 5th Edn. page 54 to 55 in which the author referred to the order in which the assets of a company are displayed in the balance sheet namely, fixed assets and current assets. The author stated,

> 'Assets are called Fixed Assets when they are of long life, are to be used in the business and were *not* bought with the main purpose of resale. Examples are buildings, machinery, motor vehicles and fixtures and fittings.
>
> On the other hand, assets are called Current Assets when they represent cash or are primarily for conversion into cash or have a short life. An example of a short-lived asset is that of the stock of oil held to power the boilers in a factory, as this will be used up in the near future. Other examples of current assets are cash itself, stocks of goods, debtors and bank balances.'

48. The Board had considered this factor but took the view that much of its force was reduced by the agreed evidence of the experts that the accounting treatment of the property could simply be a reflection that the property was to be held for longer than 12 months. Mr Swaine now invited us to reject this evidence as being incorrect. It should be noted that the expert evidence was called at the request of the appellant. That the Board should have rejected this evidence was not one of the questions framed by the Board for the judge's consideration.

49. Mr Swaine relied on the case of *Commissioner of Inland Revenue v. Secan Ltd* [2000] 3 HKLRD 627 in which the Court of Final Appeal held that the court itself has to make a final decision as to whether the practice of accountants corresponds to the correct principles of commercial accountancy. Mr Swaine submitted that the evidence of the experts in this case is not in accordance with correct commercial accountancy principles.

50. In my view the case does not turn on whether the experts' view was correct or not because first this was not a question that had been framed for consideration by the judge. But more importantly the description of the property in the appellant's accounts as a fixed asset for this length of time is only one of the many factors to be taken into account in ascertaining the intention of the appellant. This cannot be a conclusive factor. In *Commissioner of Inland Revenue v. Quitsubdue Ltd* [1999] 2 HKLRD 481 the properties of a taxpayer had been classified in its financial statements throughout as fixed assets. Yuen J (as she then was) held that 'these assertions by the taxpayer are of course not conclusive, and it may be said (as the Board did) that they are self-serving, but they remain primary direct evidence of the taxpayer's treatment of these properties'.

51. I agree with Yuen J's view but at the same time the fact remains that the accounting treatment of the asset is only one of the factors to be considered.

How the sale came about

52. Finally the appellant relied on the evidence of how the sale of the property came about. The appellant said it had intended to market the property for rental purpose then it decided to sell the property as a result of an unsolicited request by an estate agent.

53. This is a matter that had clearly be considered by the Board. It held that,

> '..... the fact that from June 1995 (grant of occupation permit) to May 1996, (Chinachem Group) maintained that the Property was for letting has to be considered in conjunction with the prevailing market conditions. The market only began to recover from a fall in December 1995. Therefore, the instructions that the Redeveloped Property was for rent could simply be a decision made in accordance with the market condition. We bear in mind that the Property was acquired in 1979,

> the redevelopment had taken an extraordinary long period of time and common sense dictates that reasonable businessman would adjust their business plan according to the market condition. In other words, if the Relevant Intention was to redevelop the Property for sale, (Chinachem Group and Sun Hung Kai) would not have blindly followed the intention regardless of the market condition, especially when they were in a strong financial position. We do not believe that the position maintained by (them) during the said period was a weighty factor for the finding we have to make here.'

Decision not perverse

54. Mr Swaine was prepared to accept that the Board had indeed considered the circumstances of the case. His attack was that the result reached by the Board was perverse in nature. In my view the circumstances considered by the Board do not compel it to reach a conclusion only in favour of the appellant. The ultimate affirmation that the property was not a capital asset is one that was open to the Board to make. Its decision was not perverse at all. In my view the judge had answered the questions correctly.

Amendment of the Case Stated

55. The appellant had applied before the judge to amend the Case Stated by including two additional questions. The two questions were:

> ' (i) Whether, as a matter of law, and upon our holdings as to fact, it was open to us to dismiss the appeal and to confirm the relevant Determination of the Commissioner of Inland Revenue in respect of Additional Profits Tax Assessment for 1997/98 and Profits Tax Assessments for 1998/99 to 2001/02.
>
> (ii) Whether as a matter of law, upon the evidence before us, the only true and reasonable conclusion at which we could property have arrived, contrary to our Decision, was that the profits of the appellant the subject matter of the appeal were profits arising from the sale of capital assets within the meaning of Section 14 of the Inland Revenue Ordinance and therefore exempt from tax.'

56. The application to amend arose because the Board had previously rejected an application by the appellant to state certain questions, the contents of which are recorded at paragraph 8 of the Case Stated.

57. Section 69(4) of the *Ordinance* allows a judge of the Court of First Instance to cause a case to be sent back to the Board for amendment. In order to ensure that the judge will deal with all the relevant questions at the appeal one would expect the application to amend to have taken

place before the appeal: see for example *Kim Eng Securities (Hong Kong) Ltd v. Commissioner of Inland Revenue* HCIA 7 of 2004.

58. In this case Mr Swaine explained that because there were only eleven weeks between the finalisation of Case Stated by the Board and the date of the hearing before the judge he decided to lodge the application to amend on the day of the hearing.

59. The judge considered both the application to amend and the arguments on the appeal itself but as recorded in his judgment he indicated that he would consider the amendment before embarking on any substantive ruling on the appeal. He ruled against the appellant on the amendment. His reason is that the case had been sufficiently presented in order to enable him to properly disposed of the appeal.

60. It became clear in the course of this appeal that the focus of Mr Swaine on the amendment was in respect of the treatment of the property in the accounts. What Mr Swaine intended to ask was for a rejection of the experts' evidence on how fixed assets could be so described and also an inclusion of their other evidence, namely, a fixed asset is a capital asset, by reference to their reports and evidence given before the Board. These specific questions were not before the judge. The evidence that was sought to be relied upon was also absent. In any event, as also pointed out earlier, the accounting treatment of the property was only one of the many relevant factors that had been considered by the Board. Hence even if the proposed amendment before the judge embraced what Mr Swaine now sought in this appeal it would not have any significant impact on the outcome of the case. I will reject the notion that once the experts agreed that fixed assets are capital assets then the appellant had established its case. The nature of the property is to be ascertained by considering all the circumstances of the case. Accordingly the judge was correct to refuse to amend the Case Stated.

Further error of law

61. The only further matter I need to deal with is that at the conclusion of this appeal Mr Swaine argued that the Board had committed another error of law. He referred to paragraph 30 of the Decision of the Board which stated that

> 'the disadvantage of Property at the time of acquisition would not necessarily preclude an intention to sell the Property some years in the future when the market condition (including preference for parking facility) might change.'

62. Mr Swaine referred to *Simmons* which held that it is not possible for an asset to possess an indeterminate status – neither trading stock nor permanent asset. He submitted that the Board in effect stated that the asset had an indeterminate status at the time of the acquisition.

63. In my view this is not a fair way of reading paragraph 30. The reference to selling the property in the future when the market condition might change simply means that the property was not to be sold immediately. It does not suggest in any way that the Board had considered that the property possessed an indeterminate status.

Conclusion

64. Accordingly the appeal is dismissed with costs *nisi* to the Commissioner.

Hon Tang JA:

65. For the reasons given by my brethrens, I would dismiss the appeal.

Hon A. Cheung J:

66. I agree with the judgment of Cheung JA. I simply wish to add a few words of my own to explain why I am of the view that the appeal should be dismissed.

67. Section 14(1) of the Inland Revenue Ordinance makes all assessable profits chargeable to profits tax. The only relevant exception is "profits arising from the sale of capital assets". Section 68(4) places the burden of proving an assessment incorrect on the taxpayer. In other words, it is for the taxpayer to prove that the profits in question arose from the sale of a capital asset, and therefore they were not chargeable to tax and thus the assessment was wrong. If he fails to prove that the asset in question was a capital asset, his appeal against the assessment must fail. Put another way, for the purpose of an appeal, it is for the taxpayer to prove that an asset was a capital asset; it is not for the Commissioner to prove that it was a trading stock – he may, if he so chooses, simply sit back and put the taxpayer to proof. *CIR v. Common Empire Ltd.*, HCIA 1/2004, A To DJ (8/11/2006).

68. I will put to one side the correct test of determining whether an asset was a capital asset or trading stock and first concentrate on the burden of proof and evidence.

69. The Board was unable to make a positive finding on the evidence that the asset was a capital asset, nor was it able to find that it was a trading stock. These two "non-findings" must be fatal to the appeal. The latter non-finding is insufficient for the appellant. What it needs in order to prove the assessment wrong is a finding that the asset sold was a capital asset. This it failed to achieve, given the first non-finding of the Board. The appellant therefore fails to prove that the profits arising from the sale of the asset were profits arising from the sale of a capital asset, which were not chargeable to tax. It must follow that it fails to prove that the assessment was incorrect.

70. That disposes of a main point raised by the appellant at the hearing of the appeal.

71. The appellant argued that the Board erroneously gave too little weight to the accounting treatments of the land and building in the appellant's accounts over the years as "fixed asset" in evaluating the evidence. If the Board had given those treatments their due evidential weight, and given that the Board had found the two competing possibilities (i.e. capital versus trading) evenly balanced in terms of probabilities, the additional evidential weight, no matter how little, thus given to the accounting treatments would have tipped the scales in favour of the appellant. The Board ought to have found that the asset was a capital asset in those circumstances.

72. I disagree. The appellant's argument proceeded on the assumption that the Board had found the two competing conclusions (i.e. capital investment versus trading – there being no halfway house as per *Simmons v. IRC* [1980] 1 WLR 1196) equally *likely* and had not been able to decide which one was more probable than the other, so that any additional evidential weight given in respect of one would have tipped the balance in its favour and warranted the making of a finding in terms.

73. But the Case Stated did not say so. The Board's overall comment on the appellant's evidence on intention was that it was "both limited and unconvincing" (para. 30). Nor did the Board say that it had found both conclusions evenly balanced in terms of probabilities (and thus any additional weight attached to one would have tipped the scales in its favour). All it said was that it was "unable to come to a positive finding" on the intention of the appellant at the time of acquisition (para. 36). It did not say that the two competing conclusions were equal in terms of likelihood.

74. Even in a case where there are only two competing conclusions (i.e. an "either or" situation), when a tribunal of fact comes to the view that it cannot make a finding one way or the other, it does not necessarily mean that it finds both conclusions equally likely to be true. Rather it could mean that in its view, owing to the unsatisfactory state of evidence or otherwise, it cannot decide which particular version of facts amongst several possible ones – one or some of them would lead to one conclusion and the remaining one or more would lead to the other conclusion – is, on the balance of probabilities, the true one. In that latter situation, it is simply wrong to say that some additional evidence for one conclusion or one version of facts leading to that conclusion must be sufficient to take it beyond a possibility and turn it into a fact (on the balance of probabilities).

75. In the present case, given what has been said (and not been said) by the Board, there is simply no basis for saying that the extra evidential weight that (the appellant says) ought to be added in favour of the possibility of a capital acquisition would have been *sufficient* to prove it, on the balance of possibilities, as a fact.

76. As to the supposed discrepancy between the *Simmons v. IRC* approach and the "badges of trade" approach, in a case where there has been *no change of intention throughout*, logically one can look at the taxpayer's intention at any given point of time and the answer one gets must, by definition, be the same, whether it be an investment intention or trading intention. *Ex hypothesi*, the intention has remained the same throughout from day one to the date of sale. Thus

it must be legitimate to look at all the facts and happenings over the years to find out the intention of the taxpayer. Some of them may have happened on day one and some in subsequent years, yet others on the day of sale. This is the approach of the badges of trade – some of those badges focus on the time of acquisition whereas some others on events that happened subsequently (e.g. the reason for resale).

77. That said, day one (i.e. the time of acquisition) must remain a special day worthy of special attention, speaking generally. By the nature of things, it should be the best time to find out the intention of the taxpayer. The Newtonian law of inertia suggests that there must have been a reason to prompt the taxpayer to acquire the asset in the first place – and that reason would, generally speaking, provide the answer or clue to whether he intended to acquire the asset for capital investment or as a trading stock – thus the character of the asset. That explains, in my view, the emphasis of Lord Wilberforce in *Simmons* on the taxpayer's intention at the time of acquisition.

78. That focus, by itself, requires one to look at all the circumstances of the case, including those happening before and those happening subsequently. What happened subsequently could, for instance, help to corroborate or, as the case may be, contradict an alleged intention said to have been held by the taxpayer at the time of acquisition. In any event, things that happened subsequently would certainly help to throw light on what the intention of the taxpayer was *at the time when they happened*. And where, as here, no change of intention is in issue, finding out that intention is, as explained, as good as discovering what the intention of the taxpayer was *at the time of acquisition*.

79. I therefore agree that the discrepancy between the two approaches is more apparent than real.

80. In the present case, the Board has specifically considered the relevant badges of trade as part of the entire circumstances of the case when applying the *Simmons* test. There is no question of the Board needing to consider the badges of trade once again after it came to the conclusion that no positive finding could be made on the taxpayer's intention at the time of acquisition based on the *Simmons* test (question of law no. 2(b)). That would have been an exercise in futility.

81. The appellant's argument based on the (alleged) inadequacy of merely applying the *Simmons* test and the need, where that test fails to provide a finding one way or the other, to apply separately the badges of trade test must therefore be rejected.

(Robert Tang) Vice President	(Peter Cheung) Justice of Appeal	(Andrew Cheung) Judge of the Court of First Instance

Mr. John J. E. Swaine, instructed by Messrs Cheng, Chan & Co., for the Appellant

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