FACV No. 3 of 2007

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

FINAL APPEAL NO. 3 OF 2007 (CIVIL)
(ON APPEAL FROM CACV NO. 15 OF 2006)

BETWEEN

REAL ESTATE INVESTMENTS (N.T.) LIMITED Appellant

and

THE COMMISSIONER OF INLAND REVEUNE Respondent

Court : Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ, Sir Noel Power NPJ and Mr Justice McHugh NPJ

Hearing and Decision: 7 January 2008

Handing Down of Reasons : 16 January 2008

J U D G M E N T

Mr Justice Bokhary PJ :

1. At the conclusion of the hearing, the appeal was dismissed with costs (costs being sought and not resisted). The Court said that its reasons for dismissing the appeal would be handed down in due course. Those reasons are now handed down. They are given by Mr Justice Chan PJ and me for the Court.

Mr Justice Bokhary PJ and Mr Justice Chan PJ :

Exclusion of profits arising from the sale of capital assets

2. In this appeal the Court is concerned with the exclusion whereby profits arising from the sale of capital assets are excluded from charge to profits tax. This exclusion is to be found in the general profits tax charging provision itself, namely s.14 of the Inland Revenue Ordinance, Cap.112. Subsection (1) of this section says :

> "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." (Emphasis supplied.)

Assessments based on historical costs

3. The tax assessments in question consist of an additional assessment to profits tax for 1997/98 and assessments to profits tax for 1998/99 to 2001/02 on Real Estate Investments (NT) Ltd ("the Taxpayer"). They are on the Taxpayer' s profits from the sale of flats built on the site of a property at No.49 Conduit Road in the Mid-Levels ("the Property") which it had acquired in December 1979 and finished redeveloping in June 1996. At the time when the Taxpayer acquired it subject to certain tenancies, the Property consisted of that site and a medium-rise building standing thereon. This medium-rise was of seven residential storeys over one storey of carparking. On the site later cleared by the demolition of the medium-rise ("the Site"), a high-rise building of 24 residential storeys but with no carparking was eventually erected. The foregoing is a brief description of the redevelopment concerned.

4. In calculating the profits on which the assessments in question were raised, the Revenue took the historical cost of the Property i.e. the cost at which the Taxpayer acquired it in December 1979. A lower calculation of profits to be taxed would have resulted if the Revenue had taken instead the value attributable to the Site in June 1996 when the redevelopment was completed. The Taxpayer contends that the Revenue should have taken such value.

Trading stock or a capital asset?

5. Quite simply, the basis of this contention is the Taxpayer's submission that the Revenue should have treated the Property as a capital asset rather than as trading stock. This submission did not prevail below. The Board of Review ("the Board") dismissed the Taxpayer's appeal against the assessments. It did so upon its view that the Taxpayer had not discharged its onus (under s.68(4) of the Inland Revenue Ordinance) of proving that the assessments were excessive. The Taxpayer's appeal to the High Court (Deputy Judge Carlson) failed. So did its appeal to the Court of Appeal (Cheung and Tang JJA and A Cheung J). With leave granted by the Court of Appeal, the Taxpayer now appeals to this Court.

6. Relevant to the question of whether the Property should be treated as trading stock (which is how the Revenue treated it) or as a capital asset (which is how the Taxpayer submits that it should be treated), the undisputed primary facts to be noted are as follows.

Primary facts

7. The Taxpayer was incorporated in 1970. In 1978 it was taken over by a Chinachem company (referred to in the case stated simply as "Ripple"). Thus did the Taxpayer become a member of the Chinachem group. This is the well-known property group which used to be controlled and managed by Mr Wang Teh Huei, closely assisted by his wife, Mrs Nina Wang. Some time after Mr Wang was kidnapped on 10 April 1990, unfortunately never to be seen again, Mrs Wang assumed control and management of the group. Such control and management remained in her hands until, sadly, she died in 2007.

8. In the early part of December 1979 the Taxpayer acquired the Property with the intention of redeveloping it. Later that month the Taxpayer's share capital was expanded by the allotment of new shares. In consequence of this expansion, 50% of the shares in the Taxpayer remained with Ripple and therefore within the Chinachem group. Forty percent was held between two wholly-owned subsidiaries of a well-known securities company, Sun Hung Kai Securities Ltd ("SHKSL"). These two SHKSL subsidiaries are referred to in the case stated simply as "Tung Wo" and "Gloria". Ten percent was held by a company (referred to in the case stated simply as "Justinian"). Justinian does not appear to have had any other relationship with the Chinachem group or SHKSL.

9. It should be mentioned that the $49.4 million for which the Taxpayer acquired the Property had come from loans advanced by Ripple, the two SHKSL subsidiaries and Justinian. They advanced those loans in proportion to their respective shareholdings in the Taxpayer.

10. In May 1979 a moratorium on building in the Mid-Levels ("the Moratorium") had been imposed by the government as a response to the problem which came to light in the aftermath of the tragic June 1972 landslide at Kotewall Road.

11. When opening the Taxpayer's appeal to the Board, Mr J J E Swaine cited *Cunliffe v. Goodman* [1950] 1 All ER 720 in which Asquith LJ (later Lord Asquith of Bishopstone) said (at p.724E) that "[if] there is a sufficiently formidable succession of fences to be surmounted before the result X aims at can be achieved, it may well be unmeaning to say that X 'intended' that result". Mr Swaine cited that case for an argument that the Moratorium made it impossible as a matter of law for the Taxpayer to have intended to redevelop the Property. But that argument, the Board said, "was not pressed in final submissions". As the Board found, the Taxpayer had been aware of the Moratorium when it acquired the Property and anticipated – as was generally anticipated – that the Moratorium would be lifted in two years' time.

12. In 1982 the Moratorium was lifted. Later that year, on 28 September, the Taxpayer submitted building plans for the redevelopment of the Property by the demolition of the low-rise and the erection of a high-rise in its place. The Building Authority rejected those plans. But on 9 September 1985, after a number of other rejections, the Building Authority approved the plans in accordance with which the Property was eventually redeveloped. As noted earlier, the high-rise was of 24 residential storeys but without carparking. The Board noted the reason for the absence of carparking. Geological limitations made underground carparking unfeasible and above ground carparking would have eaten inordinately into the residential space.

13. The Board said that it was "common ground that the Property was an investment under a joint venture between [the Chinachem group] and SHKSL". Prior to the approval of building plans, Justinian had, on 29 March 1985, transferred all its shares in the Taxpayer to Ripple. So by the time of such approval, the Chinachem group had 60% of the joint venture. The Board attached significance to the fact that the redevelopment was a joint venture between a property group and a securities company. It said in the case stated "that the presence of a joint venture partner, especially one which apparently was engaged in a different line of business, tends to militate against an intention to redevelop the Property for long-term rental income". In the same context, the Board also considered it of some significance that there was no evidence of any cashflow or feasibility analysis that might have provided some basis for SHKSL's participation in a long-term property investment held for rental income purposes.

14. According to a redevelopment report dated 8 June 1987 prepared on the Taxpayer's behalf, seven out of a total of 15 flats in the low-rise were occupied. For the years 1980/81 to 1988/89, the rental yield from the Property ranged from 2.82% to 0.30%.

15. On 30 October 1987 the Taxpayer entered in a loan agreement with a bank for a building loan facility of up to $32 million. Of this amount up to $2 million was to be used to compensate tenants evicted from the low-rise while the balance was to be used on the construction costs of the redevelopment. The entire loan was to be repaid by the end of 1991. As it happened, only $3 million was drawn down. This was during the financial years ended 30 June 1989 and 30 June 1990. The amount drawn down was repaid in full during the financial year ended 30 June 1992.

16. In 1988 the demolition of the low-rise commenced. The high-rise received its occupation permit on 5 June 1995. Between July 1995 and June 1996 interior decoration and lift installation works were carried out in the high-rise. By May 1996 the Taxpayer had begun to offer flats in the high-rise for sale.

17. SHKSL was acquired by a listed company on 23 September 1983, and on 1 June 1996 a public announcement was made about a substantial change in the shareholding of this listed company. It had been suggested by the Taxpayer's tax representative that the sale of flats in the high-rise was triggered by that change. But that suggestion was, as the Board put it, "jettisoned at the hearing".

18. Prior to being reclassified in the Taxpayer's accounts for the year ended 30 June 1996 as a *current* asset, the Property had been described in the Taxpayer's accounts from 1980 to 1995 as a *fixed* asset. No rebuilding allowance had ever been claimed in respect of the Property. The Board noted Mr Swaine's submission that the 1990 to 1995 accounting treatment of the Property as a fixed asset constituted evidence of Mr Wang's intention over the Property. But the Board was of the view that "much of the force of that submission was reduced by the agreed evidence of the experts that the accounting treatment could simply be a reflection that the Property was to be held for longer than 12 months". As to the failure to claim rebuilding allowance, the Board noted the evidence of the Chinachem group's chief accountant that such failure was an omission on the part of the Taxpayer's tax representative.

Directing mind and will

19. After setting out the undisputed facts, the Board indicated what it saw as its "first task", saying this :

> "Our first task is to decide who was/were the directing mind and will of the Taxpayer at the time the Property was acquired as we need to decide, on the evidence before us, what was the intention of such person(s)."

The Board found that Mr and Mrs Wang constituted the directing mind and will of the Taxpayer at the time when it acquired the Property.

Witnesses before the Board

20. Not having been seen since being kidnapped in 1990, Mr Wang was of course not available as a witness before the Board. But there was no apparent reason why Mrs Wang could not have been called. Nevertheless she was not called. Nor was any director of SHKSL, Tung Wo or Gloria. As for such witnesses as the Taxpayer did call, the Board said that their evidence as "scanty" and that "little of [it] went to the critical issue of the Relevant Intention". Nevertheless the

Board provided a summary of the evidence given by each of them. It is unnecessary to rehearse the summary. But certain aspects of the evidence should be mentioned. It will be convenient to refer to the witnesses in the manner adopted by the Board, namely by the letters "TW" (which presumably stands for Taxpayer's Witness) and a number (which obviously represents the order in which he was called).

21. TW1, a director of the Taxpayer since 1984, said that he had understood from Mr and Mrs Wang that the Property was for "long-term investment". The Board felt unable to place any weight on such hearsay. And it cannot be faulted for that. It is perhaps worth repeating that although Mr Wang was not available, there is no apparent reason why Mrs Wang could not have been called.

22. In his witness statement which he adopted in-chief, TW1 said that when the Property was acquired the Taxpayer had it in mind that selling high-end residential property without parking facilities would be very difficult but that the lack of such facilities would not affect the renting of such property. But under cross-examination he accepted that the comparatively lower profits to be made from selling the Property might still be attractive enough to justify a sale.

23. TW2 was a Chinachem executive who reported directly to Mr and Mrs Wang. He said in effect that the redevelopment had been aimed at rental rather than sale. His evidence did not impress the Board. He had dealt with the bank with which the loan agreement of 30 October 1987 had been entered. Mr J Mok SC for the Revenue confronted him in cross-examination with various terms of the loan agreement which, as the Board accurately put it, "suggested that the Property was going to be sold after redevelopment". The Board felt – and was entitled to feel – unconvinced by TW2's explanation that those terms were simply standard terms imposed by the bank to which he agreed under time constraint. As the Board noted, it had emerged from TW2's own evidence that the bank was keen to do business with the Taxpayer and that there had been at least one month between the time when the bank was approached and the time when the loan agreement was signed.

24. Upon being recalled, this witness said that the public escalator between the Mid-Levels and Central constituted a change of circumstances leading to the decision to sell. The Board said that it was "sceptical about this piece of evidence". It gave two acceptable reasons why. One was the fact that it only came out when this witness was recalled. The other was that it was, at the very least, a variation of the case opened on the Taxpayer's behalf, which was that the decision to sell was taken on or about 23 May 1996 due to changed market circumstances and the very attractive prices then attainable.

25. TW3 was a Chinachem sales manager while TW4 and TW5 were estate agents. On the evidence of these three witnesses, the Board found these facts. In 1995 TW3 was instructed by Mr and Mrs Wang that the high-rise was for letting. That the high-rise was for letting was the stance which the Chinachem group maintained in public from June 1995 to May 1996. But it was only in

December 1995 that the property market began to recover from the fall which it had suffered. So those instructions and that stance could have been based on the condition of the market at the time.

26. On those facts, the Board did not think that such instructions and stance constituted a weighty factor in what it had to decide.

27. TW6 was an architect employed within the Chinachem group. He gave evidence about the geological limitations of the Property and said that it had been expected that, in consequence of the Kotewall Road landslide, it would take an extremely long time to redevelop the Property.

28. Under cross-examination this witness agreed that when the Moratorium was imposed in May 1979 "everybody knew that it would be for two years, unless something was done later to extend it"

29. TW7 was an accountant called as an expert by the Taxpayer. The Board dealt with his evidence together with the evidence of the accountant called as an expert by the Revenue. This witness for the Revenue, who was the only witness it called, was referred to by the Board as "IRW1". Presumably "IRW" stands for Inland Revenue Witness. The Board said that "there was no material dispute in the evidence of [these] two experts".

30. As to the accounting treatment of the Property as a fixed asset, TW7 said that "a fixed asset would be an asset which will be held for longer than one year normally". IRW1 did not quarrel with that. As to the accounting treatment of the shareholders' loans as current liabilities, TW7 said – and IRW1 agreed – that such treatment reflected the lack of any formal agreement governing the terms of repayment.

31. TW8 was the Chinachem group's chief accountant. He confirmed that the group had strong and liquid financial resources. As noted earlier in this judgment, this witness also said that the failure to claim rebuilding allowance was on omission on the part of the Taxpayer's tax representative.

Board's conclusion on the onus of proof

32. The Board considered the evidence and arguments. It said that there was no direct evidence on the Taxpayer's intention at the time when it acquired the Property and that the evidence adduced by the Taxpayer was both limited and unconvincing. Referring to that intention as "the Relevant Intention", the Board came to the conclusion which it expressed in these terms :

> "Given the state of the evidence, we, regrettably, are unable to come to a positive finding on the Relevant Intention and we are driven to conclusion that the Taxpayer had not discharged its burden of proof in this appeal."

The regret there expressed is to be understood in the context of the Board' s statement earlier in the case stated that its approach was "where possible, to make a positive finding on the Relevant Intention rather than allowing the matter to be decided on the basis of whether the Taxpayer had discharged its burden of proof". 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.

Accounting treatment only some evidence. Onus of proof not shifted

33. As noted above, the Property had been described in the Taxpayer' s accounts from 1980 to 1995 as a fixed asset. It is argued on the Taxpayer' s behalf as follows. Such accounting treatment gave rise to a *prima facie* case that the profits in question arose from the sale of a capital asset. Consequently, the onus of proof shifted so that the Revenue had to show by evidence that the assessments were correct.

34. That argument is misconceived. Consistency between a taxpayer' s audited accounts and its stance does not go so far as to set up a *prima facie* case of that stance' s correctness in law. Where a taxpayer' s audited accounts are consistent with its stance, such consistency is some evidence in support of that stance. Even where accounting treatment amounts to strong evidence, it still falls to be considered together with the rest of the evidence adduced in the case.

35. 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.

Questions posed in the case stated

36. These are the questions posed in the case stated :-

> "(i) 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.
>
> (ii) (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."

Did the Board make any specifically identifiable error of law?

37. If the Board made any specifically identifiable error of law, such error would of course provide a basis for intervention. Otherwise, subject to the Taxpayer's submission that the stated case should be amended, the only possible basis of intervention would be that the true and only reasonable conclusion contradicts the determination appealed against so that it is to be assumed that the determination resulted from an error of law.

38. Relevant to question (ii)(a), this is what the Board said as to its understanding of the law :

> "It is trite law 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 ('the Relevant Intention'). Further, the Relevant Intention is to be ascertained from all the surrounding circumstances. Stated intention of the Taxpayer is not conclusive. It has to be scrutinized against the surrounding circumstances to see if it was genuinely held and realistic."

That reference to the time of acquisition is to be read together with the Board's observation "there was no suggestion that the intention of [Mr and Mrs Wang] over the Property had changed between the time of its acquisition and the joint venture". As can be seen, the Board did not resolve the issue of intention against the Taxpayer merely because neither Mrs Wang nor any director of SHKSL, Tung Wo or Gloria was called. The Board looked at all the surrounding circumstances. And the Board is plainly right in its view that a taxpayer's assertion as to intention is not conclusive and is open to scrutiny.

39. On a fair reading of what it said, the Board's understanding of the law is in conformity with this statement on the point by Lord Wilberforce in *Simmons v. IRC* [1980] 1 WLR 1196 at p.1199A-D :

> "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."

40. Even assuming that intention is not always the test, the fact remains that the appeal to the Board was fought out on the issue of intention. That issue fell to be resolved upon the circumstances as a whole. Mr Swaine told us about the process by which he formulated the questions posed in the case stated and persuaded the Board to pose them. 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. There is no specifically identifiable error of law on the part of the Board.

Should the case stated be amended?

41. Section 69(4) of the Inland Revenue Ordinance provides that the High Court "may cause a stated case to be sent back for amendment and thereupon the case shall be amended accordingly". Mr Swaine asked the judge to send the case back to the Board for amendment. The judge refused, and the Court of Appeal supported his refusal. At one stage of the argument, Mr Swaine invited us to travel beyond the case stated and look at : the Taxpayer's accounts from 1979 to 2002; part one of the Commissioner of Inland Revenue's determination; and the transcript of the evidence of TW1, TW4, TW5, TW6 and TW7. But Mr Swaine later modified his submission to us so as to bring it in line with his submission to the courts below. This is essentially

to the effect that the case stated does not contain such recital of the evidence as is, or pose such questions as are, necessary for the Taxpayer's appeal to be fully argued.

42. For a picture of the amendments sought under the first limb of that submission, it suffices to quote this part of the judge's judgment :

> "Firstly, as to the complaint about insufficiency of evidence in the Case as drafted Mr Swaine submits that it is not possible for me to fairly rule on this appeal without at least a sight of the accounts and, at the very least, of the accountants' evidence which would present a fuller picture of the importance and significance of the accounts which for 15 years showed the property as being held as a capital asset rather than as stock in trade. Indeed, given more leeway, Mr Swaine would have wished to have attached to the case evidence and witness statements of a number of his clients 8 witnesses before the Board."

The questions which Mr Swaine put forward for inclusion by amendment of the case stated are these additional ones:

> "(a) 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; and
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> (b) Whether as a matter of law, upon the evidence before us, the only true and reasonable conclusion at which we could properly 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."

43. Neither the recital of evidence sought by the Taxpayer nor those additional questions would have contributed anything worthwhile to the proper disposal of the appeal from the Board. It is plain that the case stated is not in need of being sent back for amendment.

44. That having been said, this should be made clear. It is not to be thought that this Court would disturb the Court of Appeal's refusal to send a case back for amendment unless persuaded that sending it back is unnecessary. The power to send a case back for amendment is discretionary. In *Ume v. Ezechi* [1964] 1 WLR 701 the Federal Supreme Court of Nigeria had, in an appeal to it by the plaintiffs, substituted an order of non-suit for the trial judge's order dismissing the action. The defendants appealed to the Privy Council, asking that the trial judge's order dismissing the action be restored while the plaintiffs asked that the Federal Supreme Court's order of non-suit be left undisturbed. Delivering the advice of the Privy Council, Lord Evershed said (at p.704) that the

power to order a non-suit being discretionary, their Lordships would not disturb the intermediate appellate court's order unless persuaded to give an affirmative answer to the question "has the order proceeded upon some substantial error or is some real injustice thereby done?" It would be inimical to necessary finality in the legal process if this Court, being a final appellate court, were to review an exercise of discretion on grounds less serious than those.

45. As Lord Greene MR noted in *Bradford Third Equitable Benefit Building Society v. Borders (No.2)* [1939] 3 All ER 29 at p.33 E-F, a judicial discretion is one "which the holder of the judicial office exercises either because it has been conferred upon him by some statute or rule of law or because it is something which is inherent in the judicial office itself". There are often many occasions even in a single case for exercising a discretion. This does not mean that no appeal lies against the exercise of a discretion. But the grounds on which this Court, being a final appellate court, can properly be invited to review an exercise of discretion must disclose real prospects of success and go to a matter of such gravity as an error of governing legal principle, a crucial misapprehension of fact or an utterly unjust result.

Intervention on the "true and only reasonable conclusion" basis?

46. On the question of whether the Property was trading stock or a capital asset, the Board stopped short of coming to any positive determination one way or the other. It merely determined that the Taxpayer had not discharged its onus of proving that the Property was a capital asset.

47. 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.

48. For "the position is X" read "the Property was trading stock", and for "the position is Y" read "the Property was a capital asset". That gives you the situation in the present case. In other words, the Taxpayer fails unless the true and only reasonable conclusion is that the Property was a capital asset.

49. How the Taxpayer puts its arguments on this part of the appeal may be taken from this paragraph of its printed case :

> "On the facts of the case as found by the Board, there was in truth *no basis* upon which to treat the Property as trading stock as at the date of its acquisition. To the contrary, the Property was eminently capital in nature :
>
> (i) It was producing and continued to produce rent;
> (ii) It was held for over 17 years;
> (iii) It was acquired and redeveloped without need for external finance;
> (iv) A third party estate agent, TW4, proposed that the Property be sold, despite and not because of the Taxpayer's publicly stated position that it was intended for rent."

50. As to point (i), it is of course true that the low-rise was producing rent when the Property was acquired and continued to produce rent until it was demolished to make way for the high-rise the flats in which were sold. But facts of that nature shed little, if any, light on whether the property concerned was trading stock or a capital asset. The 17 years referred to in point (ii) is the period between the time when the Property was acquired and the time when the flats in the high-rise were offered for sale. Demolition of the low-rise began nine years after acquisition. But even a period of 17 years or more between the acquisition of a property and the demolition of a low-rise thereon to make way for a high-rise would not necessarily have shed much, if any, light on the question of whether the property concerned was trading stock or a capital asset. The assertion in (iii) that the Property had been acquired and redeveloped without the need for external finance has to be qualified since $3 million had been drawn down under the building loan. In any event, using internal finance to acquire and redevelop property is not necessarily inconsistent with the acquisition and redevelopment of such property as trading stock. Point (iv) can be disposed of simply by repeating this. As the Board found, it was only in December 1995 that the property market began to recover from the fall which it had suffered. So, as the Board found, the Chinachem group's public stance from June 1995 to May 1996 that the high-rise was for letting could have been based on the condition of the market at the time.

51. Those answers to the Taxpayer's points rest essentially on commonsense and obvious commercial realities. It is nevertheless worthwhile mentioning two authorities relevant to those answers. One of those authorities is *Chinachem Investment Co. Ltd v. CIR* (1987) 2 HKTC 261. It is relevant to the answers to points (i), (ii) and (iv). The properties there in question had been held for substantial periods, in some instances for as long as 15 years. And they had generally been let throughout. Profits tax was charged on the profits derived from their disposal, it being the Revenue's case that they were trading stock. The taxpayer challenged that charge to profits tax, its case being that the properties were capital assets.

52. Sir Alan Huggins VP, having accepted that the facts were consistent with that taxpayer's case, then turned to the question of whether they were inconsistent with the Revenue's case, and gave this answer (at p.311) :

> "They are not – particularly having regard to the economic climate of Hong Kong during the relevant periods : [the taxpayer] may have been waiting for a favourable opportunity to sell and merely have been turning the properties to good account in the mean time. Equally, the fact that the properties were let at full economic rents is consistent with the case of both sides, although if the lettings had been at rents below the economic rents that would clearly have supported [the Revenue's] contention. Again, the renewal of the leases was equivocal and it is immaterial that the initiative was taken by [the taxpayer] : these facts may indicate nothing more than that the 'favourable opportunity to sell' had not arrived and that it was expected that lettings would be more beneficial than sales within the period of the new leases."

The other members of the Court of Appeal agreed.

53. As for the authority relevant to the answer to point (iii), it is *Marson v. Morton* [1986] 1 WLR 1343, a decision of Sir Nicolas Browne-Wilkinson VC (as Lord Browne-Wilkinson then was) sitting in the Chancery Division to hear an appeal from the General Commissioners. It is the case in which the Vice-Chancellor listed certain features or badges that may point to one conclusion or other on the question of whether or not there has been an adventure in the nature of trade. The value of the idea contained in the expression "badges of trade" is attested by Lord Radcliffe's use of that expression in *Edwards v. Bairstow* [1956] AC 14 at p.38. And 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.

54. 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.

55. 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. Prof. John Tilley says (in his book *Revenue Law*, 5th ed. (2005) at p.400) that "whether an item is trading stock must depend on the nature of the trade". He cites *Abbott v. Albion Greyhounds (Salford) Ltd* [1945] 1 All ER 308 and *General Motors Acceptance Corp. (UK) Ltd v. IRC* [1985] STC 408. It can happen that a taxpayer carries on his trade or business in such a manner that items of a

certain type are always used in the same way. If so, the nature of his trade or business may of itself be enough to tell one whether or not such items are trading stock for tax purposes. But a taxpayer may carry on his trade or business in such a manner that items of a certain type are not always used in the same way. If so, deciding whether any given item of that type was trading stock for tax purposes would naturally involve examining the particular use to which that item had been put.

56. Property developers may redevelop property for sale or to let. The Board appreciated that, and proceeded accordingly. Upon the whole of the circumstances of the present case, there is no warrant for holding that the true and only reasonable conclusion is that the Property was a capital asset. This appeal must therefore be dismissed.

Disposing of cases on the onus of proof

57. A word should be said about disposing of cases on the onus of proof. Cases that have to be disposed of in that way are rare and exceptional. One example is to be found in *Mariner International Hotels Ltd v. Atlas Ltd (No.2)* [2007] 4 HKLRD 194 where this Court said as follows at p.199, para.18 :

> "A party seeking to displace the general rule that costs should follow the event naturally bears the burden of showing that the circumstances justify the exceptional course of such displacement. While a court naturally prefers to have a clearer picture than one in which a case has to be decided on the burden of proof, that is not always possible. The present situation is a difficult one in which a final appellate court is confronted with acute controversy over the hows and whys of the way in which a 64-day trial was fought out. Giving our best consideration to the rival submissions, we feel unable to conclude that the Vendor has discharged the burden of proof it bears. Accordingly, costs here and in both courts below must follow the event."

As can be seen, it was with regret – and out of necessity flowing from unusual circumstances – that the Court felt driven to deciding the matter on the onus of proof.

58. In so far as such evidence as was adduced before the Board pointed in one direction rather than the other, such evidence pointed to the Property having been trading stock (as the Revenue thought in making the assessments in question) rather than a capital asset (as the Taxpayer contended in disputing those assessments).

59. But it has to be acknowledged that there were features of the case which might have caused the Board to see this as one of those rare and exceptional occasions for deciding a case on the onus of proof. One such feature is the fact that the Taxpayer advanced three different explanations of its motivation. The difficulty which that contradictory stance presented to the Board was compounded by the fact that the Board had to cope with it without the benefit of any evidence from Mr Wang. And, as already been noted, it was through no fault of either party that Mr Wang

was not available to give evidence. In the circumstances, it would be understandable if the Board saw that as a reason to decide against the Taxpayer simply on the onus of proof. "It has often been said", as Lord Reid observed in *Dorman Long (Steel) Ltd v. Bell* [1964] 1 WLR 333 at p.335, "that after all the evidence has been led the initial onus of proof is rarely of importance". Mr Wang could have been the most important witness for the Taxpayer. Perhaps the Board felt that his unavailability as a witness resulted in the Taxpayer not leading important – indeed the most important – evidence which it would otherwise have led.

Result

60. For the foregoing reasons, the appeal was dismissed with costs, so that the assessments appealed against stand and the Revenue has its costs here as well as in the courts below.

(Kemal Bokhary) Permanent Judge

(Patrick Chan) Permanent Judge

(R.A.V. Ribeiro) Permanent Judge

(Sir Noel Power) Non-Permanent Judge

(Michael McHugh) Non-Permanent Judge

Mr J J E Swaine and Mr Anthony Wu (instructed by Messrs Cheng, Chan & Co.) for the appellant

Mr J Mok SC and Mr Stewart K M Wong (instructed by the Department of Justice) for the respondent