FACV No 16 of 2015

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

FINAL APPEAL NO 16 OF 2015 (CIVIL)
(ON APPEAL FROM CACV NO 41 OF 2010)

BETWEEN

CHURCH BODY OF THE HONG KONG SHENG KUNG HUI	1st Appellant (1st Respondent)
HONG KONG SHENG KUNG HUI FOUNDATION	2nd Appellant (2nd Respondent)

- and -

COMMISSIONER OF INLAND REVENUE	Respondent (Appellant)

Before: Mr Justice Ribeiro PJ, Mr Justice Tang PJ, Mr Justice Fok PJ, Mr Justice Chan NPJ and Mr Justice Gummow NPJ

Date of Hearing: 8 January 2016

Date of Judgment: 4 February 2016

J U D G M E N T

Mr Justice Ribeiro PJ:

1. I agree with the judgements of Mr Justice Tang and Mr Justice Fok PJJ and with the additional observations of Mr Justice Chan NPJ.

Mr Justice Tang PJ:

Introduction

2. Section 14 of the Inland Revenue Ordinance, Cap 112, provides that profits tax shall be chargeable — on every person carrying a trade in Hong Kong in respect of his assessable profits. Trade is defined in s 2 as including "every trade and manufacture, and every adventure and concern in the nature of trade".

3. The respondents in this appeal by the Commissioner of Inland Revenue ("the Commissioner") are the Church Body of the Hong Kong Sheng Kung Hui and the Hong Kong Sheng Kung Hui Foundation. They are respectively the incorporation of the Anglican Church in Hong Kong ("the Church Body") and the incorporation of the Anglican Bishop of Hong Kong ("the Foundation"). I will refer to them collectively as HKSKH.

4. The Church Body and the Foundation had since the 1930s been the respective owner of a large estate in Tai Po ("the Old Lots")[1] which comprised agricultural land and restricted building land[2] on which was built the well-known St Christopher's Home, an orphanage which was established in 1935. In time, with the urbanization of the New Territories and the ease of travel, the Old Lots became highly desirable for residential development. It was said to be an agreed fact that since the 1970s the taxpayers had planned to develop the Old Lots[3] but I believe it is more accurate to say that HKSKH began exploring the possibility of developing the Old Lots in the 1970s. The earlier plans all involved a measure of institutional use. However, since at least September 1989, the plans only involved a residential development.[4] The Commissioner accepted that at the time of the acquisition of the Old Lots, the intention was to hold them indefinitely,[5] and that the Old Lots were capital assets.

5. Before the Old Lots could be used for a substantial residential development two hurdles had to be overcome. First, permission was needed under s 16 of the Town Planning Ordinance Cap 131, without which large scale development of the Old Lots could

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1 Lot 429 in DD 34 was owned by the Church Body and Lot No 432 RP in DD 34 and Lot No 1302 RP in DD 36 owned by the Foundation. Lot No 1302 RP was donated to the Foundation in 1957, BR para 49(c). The total area of the Old Lots was 182,798.469 sq m. See Copies of application for town planning permission dated 28 December 1987, LWC-5 (s 16 application).

2 Board of Review ("BR") para 16.

3 BR para 15, where the different plans at different times were set out. They will be discussed more fully below.

4 With attendant commercial uses.

5 BR para 50.

not take place. Moreover, any permission granted would control the intensity or type of the permitted development.[6] Secondly, the lease restrictions have to be relaxed by the government as landlord[7] which normally requires the payment of a premium, said to be calculated on the difference in value between the Old Lots with their original lease restrictions and the New Lot with the new and relaxed restrictions. The procedure is commonly known as a surrender and regrant.[8] In December 1990, the taxpayers employed a firm of architects to apply to the District Lands Office, Tai Po ("DLO/TP") for a surrender and regrant. The basic terms were communicated to the architect in August 1991 and the premium was assessed in October 1992 at $838,260,000. The draft special conditions for the new grant were also supplied for comment. In May 1993, the premium was reduced to $704,240,000. The Old Lots were surrendered to Government on 17 November 1993 in return for the New Lot.[9] On 2 July 1993, a number of property developers were invited to tender offers to either purchase the New Lot[10] ("Option A") or to enter into a joint venture agreement to develop the New Lot ("Option B"). On 23 July 1993, Cheung Kong (Holdings) Limited ("Cheung Kong")[11] submitted their tender on both options. And on 12 August 1993, the taxpayers accepted Option B, the joint venture offer.[12] And on 3 December 1993, HKSKH entered into a joint venture agreement with Cheung Kong. Pursuant to the joint venture agreement,[13] HKSKH eventually became entitled to 129 units and 94 car parking spaces (the units) in the development.[14] Some of these properties have been sold and the proceeds divided between the Church Body and the Foundation in the agreed proportion. The Church Body and the Foundation were assessed for profits tax for the years of assessment 1998/99 to 2004/05 inclusive. The profits tax payable by the Church Body was assessed at $75,881,426, and for the Foundation, $108,912,965.[15]

6. On appeal to the Board of Review the taxpayers contended that there was no change of intention at all, alternatively, that the change of intention only occurred in 1993, when it accepted Cheung Kong's tender on 12 August or 3 December when it entered into the joint venture agreement.[16] The date of any change of intention is important because the amount of profits tax payable would vary according to the value at the time of change of

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6 BR para 66(5) mentioned a s 16 town planning application in relation to proposal SK-H (see para 14 below) and an application in December 1987 in connection with proposal SK-F (see para 13 below). Presumably there were other applications in relation to other proposals.

7 At Government's discretion.

8 BR para 16. As is commonly known the mechanism whereby lease restrictions are removed are usually achieved by means of a surrender of Old Lots for a new grant, a New Lot. Since many old agricultural lots were small and had irregular shapes and inadequate access, government often used the mechanism of a surrender and regrant to reshape the land and to provide for roads or access. Sometimes, the New Lot will be smaller in area than the surrendered lots. When government agrees to relax lease restrictions they would indicate the amount of premium payable, which although subject to contract, would normally remain the same provided they were accepted within a stated period.

9 BR para 16(e).

10 To be granted.

11 Or a subsidiary formed for the purpose. For convenience I will refer to it as Cheung Kong.

12 BR para 20.

13 As amended in 1998.

14 The Deerhill Bay.

15 BR paras 9(2), 27, 29 and 30. It is not clear on what figures the Commissioner's assessment was based.

16 Court of Appeal ("CA") para 5.

intention.[17] However, liability to pay profits tax could only arise upon a sale[18] in the course of trade and the earliest date for a sale was 12 August 1993 if, as seems likely, HKSKH had committed itself to a sale and a joint venture. Since HKSKH had accepted Option B, which entailed a joint venture agreement, it might be thought that it had entered into a venture in the nature of trade.[19] The Commissioner contended on the other hand that HKSKH had changed their intention and embarked on trade or business in:[20]

(a) February 1984 at the earliest;

(b) January 1987;

(c) December 1987; or

(d) September 1989 at the latest.

7. The Board of Review held that the Church Body and the Foundation had changed their intention by September 1989 at the latest, alternatively, December 1990.[21] Before the Board, the parties agreed that as at 28 September 1989, the value of the Old Lots was $192.5 million.[22] We were told that the amount of tax at stake in this appeal is around $185 million.[23]

8. After HKSKH's appeal was dismissed by Reyes J on 27 January 2010, HKSKH appealed to the Court of Appeal. In the Court of Appeal, Mr Denis Chang SC appearing for HKSKH relied on a line of cases[24] from which he submitted one could deduce what he called the "enhancement for realisation principle". The Court of Appeal[25] held that the true and only conclusion was that there was no change of intention from capital holding to trading/business by September 1989 or in December 1990 and remitted the matter to the Board to consider whether the change of intention occurred in August 1993 or December 1993 or alternatively some other date or dates (other than September 1989 or December

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17 For example, the parties agreed that the value of the Old Lots was $222.48 million as at 1 May 1990, $1.11 billion (exclusive of premium) as at 12 August 1993 and $2.3 billion (premium paid) as at 3 December 1993. The lower the value at the time of change of intention, the higher the profit and the tax payable.

18 Though for the purpose of determining the amount of profits tax payable, the date when the intention to trade was found was important, because the value on that date will be basis for the calculation of profits, if any.

19 If, however, it had accepted Option A, it may be that they had done no more than selling a capital asset and there was no trading at all. As Cheung JA suggested in the CA at 12.14, it was only when Option B was accepted that the development moved out of the zone of contemplation into the valley of decision employing the language of Asquith LJ in *Cunliffe v Goodman* [1950] 2 KB 237 at 254.

20 BR para 61.

21 BR paras 73-74.

22 BR para 75.

23 Appellant's written case para 24.

24 Including *Taylor v Good* (Inspector of Taxes)[1973] STC 383 and *Hudson's Bay Co Ltd v Stevens* (1909) 5 TC 424.

25 Cheung, Yuen JJA and Au J.

1990). Cheung JA who delivered the only reasoned judgment (with which Yuen JA and Au J agreed) said the Board erred in holding:

> "… that there was a change of intention in 1989 or 1990 when, on the facts found by the Board, all that the taxpayers had done was to have engaged in the process of realizing the Old Lots."[26]

The Certified Questions

9. On the Commissioner's application for leave to appeal to this court, the appeal committee[27] granted leave to appeal on the following questions:

> (1) Does any "enhancement for realisation principle" arise from the authorities cited in paragraph 9 of the Judgment of the Court of Appeal, and if so, what is its scope? (See: §§9, 10 and 12.6 of the Judgment).
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> (2) In determining whether a taxpayer has changed his intention regarding an asset from holding it for investment to holding it for trading, is the Board of Review required to refer to and apply the "enhancement for realisation principle" (as understood by the Court of Appeal or otherwise), and if the Board fails to do so, does this justify the appellate court's interference with the Board's finding of fact? (See: §§10, 12.2 to 12.19 of the Judgment).
>
> (3) Does a finding of fact on change of intention based solely on "enhancement activities" necessarily amount to an error of law made by the Board of Review? (See: §10.7 of the Judgment).

The Evidence

10. The Church Body became the owner of Lot No 429 in DD 34 in the 1930s and the Foundation, Lot No 432 RP in DD 34 in the 1930s. Lot No 1302 RP in DD 36 was donated to the Foundation in 1957. The site area of the Old Lots was 182,798.469 sq m. St Christopher's home, the orphanage, was built on the Old Lots. In addition, the Foundation also owned Taxlord Lot T-77 in DD 34 which was adjacent to the Old Lots. The Old Lots were surrendered in return for the New Lot on 17 November 1993. Prior to the surrender, HKSKH invited tenders from developers to purchase outright (Option A) or to enter into a joint venture with the developer to develop the New Lot (Option B). On 12 August 1993, HKSKH accepted Cheung Kong's tender on Option B and entered into a joint venture agreement dated 3 December 1993.[28] Upon the completion of the development the units

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[26] CA para 12.19.

[27] Ribeiro, Tang and Fok PJJ.

[28] We do not have copies of the tender documents nor the joint venture agreement. Presumably, the premium was paid pursuant to the tender and the provisions of the joint venture agreement.

were assigned to HKSKH, the tax assessments, the subject of this appeal, arose out of the subsequent sale of some of the units.

11. According to the agreed facts, HKSKH had planned to develop the Old Lots since the 1970s. The details are set out in para 15 of the Board's Decision ("the Decision"). As early as July 1978, the development of the Old Lots involved a high class private residential development and a Diocesan Retirement village, a special school and additional facilities to the Home. By January 1981 under plan/proposal M-1, the residential development comprised 588 units and a clubhouse on an area of 1,205,790 sq ft, and the institutional use included "existing blocks, staff quarters, children living units and special school for church members, care and attention home, retreat home, youth camp, etc." totalling 223,413 sq ft.

12. Then in January 1986 (plan/proposal SK-A), the institutional use included the Home and a retreat centre with an area of 17,000 sq m and the residential use comprised 19 blocks of 10-12 storey towers, 11 blocks of 8-10 storey towers, 38 houses, (totalling 876 units) and a club home (sic), supermarkets, food centre, nursery and kindergartens.

13. In June 1986, there were minor changes. In December 1987 (plan/proposal SK-F), the institutional use had shrunk to 5,000 sq m for the Home,[29] and the residential use increased to 131,533 sq m with a total of 1,014 units.

14. By September 1989 (plan/proposal SK-H), there was no longer any institutional use and the residential use was reduced to 109,679.08 sq m, with 20 blocks of multi-storey towers and 20 houses (totalling 838 units) and supermarkets, laundry, coffee shop, food centre and shopping mall.

15. In May 1990 (plan/proposal SK-J), the residential use was reduced to 60,000 sq m for 2-storey houses and multi-storey (maximum 575 units) and a clubhouse.

The Board's Decision

16. The Board traced the evolution of the plans regarding institutional use and discussed internal documents of HKSKH and concluded at para 67 that:
"It is clear from the appellants' own documents that, as from September 1989 at the latest, the development of the Old Lots and the re-provisioning of the Home, or the facilities provided by the Home, became separate projects."

17. It is not clear which of the plans/proposals was given a s 16 approval, and on the basis of which, the eventual surrender and regrant was granted but the premium for the surrender and re-grant was agreed in May 1993. The Deerhill Bay Development, comprising 22 houses, 5 low-rise and 5 high-rise buildings with 381 units, was eventually

[29] The Board said the proposed area for the Home fell outside the Old Lots and would be situated at the Taxlord Lot No.T-77. See BR 66(5), footnote 7.

completed and the occupation permit issued in August 1998.[30] Pursuant to the joint venture agreement as amended, HKSKH were assigned the units, and the sale of some of the units has given rise to the dispute over HKSKH's liability to pay profits tax.

18. Since it was common ground that the Old Lots were acquired and held by HKSKH not for the purpose of trading but as it were as an investment or a capital asset, they would remain "an investment unless the owner changes his intention to that of trading. If findings of this kind are to be made, precision is required. There must be evidence which establishes that change of intention. An investment does not turn into trading stock because it is sold."[31] The Commissioner has rightly accepted that the enhanced value obtained from the mere realisation of an investment or a capital asset does not become assessable to tax,[32] and the issue is whether the owner sold merely as owner or as trader.[33] The authorities cited on behalf of the Commissioner in this context included a dictum from Gibbs CJ in *FCT v Whitfords* at 368 that "If the taxpayer does no more than realise an asset, the profits are not taxable. It does not matter that the taxpayer goes about the realisation in an enterprising way, so to secure the best price".[34] In *Taylor v Good*,[35] Russell LJ[36] after examining a long line of authorities,[37] said he would not regard an owner of land as being engaged in trade if "not being himself a developer, (he) merely takes steps to enhance the value of the property in the eyes of a developer who might wish to buy for development".[38] Whether an owner sells as owner or as trader is a question of fact which "depends on the interaction between the various factors that are present in any given case".[39] But as Browne-Wilkinson VC went on to say there are factors (commonly called badges of trade) which provide "common sense guidance to the conclusion which is appropriate".[40]

19. The Board concluded that the change of intention to trade took place by September 1989 at the latest because "as from September 1989 at the latest, the development of the Old Lots and the re-provisioning of the Home, or the facilities provided by the Homes, became separate projects".[41] And that HKSKH continued to market the Old Lots "in an organised and coherent way with a view to maximising the income from the

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30 CA para 2.13.

31 *Per* Mr Andrew Li QC as he then was in D65/87 IRBRD Vol 3 66, based on the observations of Lord Wilberforce and Lord Salmon in *Simmons v IRC* [1980] 9 1 WLR 1196 at 1199B and 1203H respectively.

32 Para 108, the Commissioner's written case, citing in support *Californian Copper Syndicate v Harris* (1904) 5 TC 159 at 165-166; *Whitfords Beach* at 367-368, 372, 394-395; D65/87 at 80; *Kirkham* at 868H.

33 See for example, Farwell LJ in *Hudson's Bay* at 438, and Mason J in *FCT v Whitfords Beach Pty Ltd* at 371.

34 In *McClelland v Commissioner of Taxation* [1971] 1 WLR 191, Lord Donovan, delivering the majority judgment of the Privy council on appeal from Australia, made a similar statement at 197E.

35 [1974] 1 WLR 556.

36 Whose judgment was agreed to by Stamp and Orr LJJ.

37 Including *Hudson's Bay Co. Ltd. v Stevens* (1909) 5 TC 424, CA.

38 At 560D.

39 Browne-Wilkinson VC in *Marson v Morton* [1986] 1 WLR 1343 at 1348B.

40 1348D.

41 BR para 67.

development. They sought and subsequently obtained a new grant by surrendering the Old Lots, thereby substituting the Old Lots by the New Lot".[42] The Board held in the alternative that the intention was changed in December 1990 when HKSKH's architect applied for a surrender and regrant.[43]

20. It is implicit in the Decision that HKSKH had sold as trader, presumably when they accepted Option B on 12 August 1993 or when HKSKH entered in the joint venture agreement dated 3 December 1993 but the Board did not appear to realise that the issue they had to decide was when HKSKH first intended to sell not merely as owner but as a trader and what was the evidence which established that change of intention.

21. The Old Lots were agricultural land with restricted building rights, given their size, their situation at a scenic spot off the Tai Po Road, they had great potential for residential development and were highly valuable.[44] It is common sense that the achievable price might vary according to whether planning permission had been obtained and if so the extent of the development permitted, and the amount of premium payable to government for changes to the lease terms which would enable the development to be complete. Neither planning permission nor relaxation of the lease restrictions could be taken for granted, and it is plain common sense for HKSKH as owner to seek planning permission and the lifting of lease restrictions[45] before marketing them.

22. It is in this context that the so-called enhancement for realisation principle requires consideration and I turn to the first question.

The first question

23. It is unhelpful to ask whether there is an "enhancement for realisation principle" and I would not use that expression. I believe the expression "enhancement for realisation" describes a state of affairs which may provide a guide to the ultimate decision whether in the realisation of the relevant asset the owner was engaged in "trade — (or any) adventure (or) concern in the nature of trade".[46] It is not controversial that an owner of a capital asset who sells it "as is" would not be liable for profits tax. Nor is it likely that, the owner of a home, who has done it up before putting it onto the market, or one who obtained planning permission for an extension before marketing the property, would be faced with the enquiry whether he was selling merely as owner or was he engaged in trade. In such

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42 BR para 70.

43 BR para 74.

44 The Old Lots had an agreed value of $192.5 million as at 28 September 1989. BR para 75. The valuation must have reflected in part its development value. As at 12 August 1993, the value was $1.11 billion exclusive of the premium. We do not know how much of the increase is attributable to a rise in the market and how much to the fact that the requisite permissions had been obtained. Presumably the valuation in 1989 took into account their redevelopment potential discounted by the uncertainty in obtaining the necessary permissions.

45 By means of a surrender and regrant and an indication of the premium payable which is likely to affect the price at which the land could be sold.

46 Definition of "trade" s 2 Inland Revenue Ordinance Cap 112.

simple cases, a finding that the owner was "trading" would be inconceivable. But, I agree with Mr Fung SC for the Commissioner, that the answer depends "on the facts of the particular case. It is essentially a question of fact and degree".[47] But guidance is available on how the question should be answered in the particular case. These are the so-called badges of trade. Useful guidance is provided by McHugh NPJ in *Lee Yee Shing v CIR*, [48] namely:

> "Whether the taxpayer…
>
> (7) Has expended time, money or effort in selling the asset or commodity that *goes <u>beyond</u>* what might be expected of a non-trader seeking to sell an asset of that class?" (emphasis added)(the 7th badge of trade)

24. Mr Fung, has rightly accepted that if an owner of a capital asset, in selling it has done no more than what a non-trader owner might have done in similar circumstances, it would be difficult to infer that the owner intended to trade. It follows that if the facts of this case showed that HKSKH had done no more, the Decision based on such inference could not be supported. Mr Fung's concession is well supported by the authorities referred to in para 18 above. I will add a few observations. First, I will examine *Taylor* more closely. There, the taxpayer purchased a house at an auction for £5,100. It was his case that he purchased the house as a possible family home, and not for the purpose of trade but when it was found to be unsuitable, he sold it about 4 years later after obtaining planning permission to erect in its place 90 houses, for £54,500. He was assessed to income tax on the profits by the Commissioners on the basis that there was intent to trade from the date of the purchase. However, the Crown conceded on appeal that the house was bought as an investment thus any intention to trade had to post-date the purchase. Megarry J remitted the case back to the Commissioners to determine when the intention to trade was first established. The Court of Appeal set aside the remittal and importantly, Russell LJ said at 560G:

> "that activities such as those in the present case, designed only to enhance the value of the land in the market, are (not) to be taken as pointing to, still less as establishing, an adventure in the nature of trade."

25. Russell LJ also noted that in *Hudson's Bay Co Ltd v Stevens*,[49] the court upheld the finding that there was no trade in buying and selling and that an owner who sold land purchased as an investment is no different in substance from a person who has inherited land, if he dealt with it merely as owner even if he might have expended money in getting the property up for sale.[50]

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47 *Pilkington v Randall* (1966) 42 TC 662 at 674.

48 (2008) 11 HKCFAR 6 at 28 para 60, with the express agreement of Ribeiro PJ and Sir Noel Power NPJ. Bokhary and Chan PJJ who delivered a separate judgment said at para 40 that they "found (McHugh NPJ's) helpful generally".

49 (1909) 5 TC 424, CA.

50 At 559H.

26. Also, in *Whitfords*, Gibbs CJ said he "should make it clear that [he] regard it as established that profit yielded by the mere realisation of a capital asset" is not taxable[51] and emphasised the importance of the words "mere" or "merely" which are often used in such context. Although whether the taxpayer sold merely as owner is essentially a question of fact and degree, it is necessary to identify evidence which establishes the change of intention.[52] McHugh NPJ's 7th badge of trade provides guidance for the identification of such evidence. Conduct of the taxpayer going beyond what a non-trader owner might have done in similar circumstances is such evidence but if there is no such evidence, it is difficult to imagine a case where a finding of trading or intention to trade could be supported. In the present case, in my view HKSKH's conduct in 1989 and 1990 had not gone beyond what might be expected of a non-trader owner in similar circumstances.

27. The Board of Review concluded that there was a change of intention from capital holding to trading/business and that took place by September 1989. The significant event relied on by the Board for this conclusion appeared to be the fact that by September 1989 "the development of the Old Lots and the re-provisioning of the home, or the facilities provided by the homes, become separate projects".[53] With respect, the fact that no part of the Old Lots was required for HKSKH's use might explain why HKSKH decided to sell all of the Old Lots and Rowlatt J's succinct statement "merely realizing is not trading"[54] shows that a mere sale of a capital asset is not trading. I do not understand why the decision to sell should be thought to support the conclusion that this was the date by which an intention to trade must have commenced. The same could be said of the Board's alternative finding. If, as I think, a non trading owner might apply for a surrender and regrant, the fact that HKSKH made a similar application cannot support a finding of intention to trade.

28. The Board went on to say at para 70 that:[55]

> "(1) Mr Li Fook Hing was appointed a co-chairman of the Tai Po Kau Joint Development Committee in May 1989, after the re-provisioning of the Home had been separated from the development of the Old Lots and the retirement village project had been frozen for a long time. (2) It is clear from the evidence of Mr Li Fook Hing that he approached the matter on commercial principles, with the laudable object of raising as much income as possible for HKSKH and its charitable activities. (3) The appellants continued to retain the services of professional advisers including architects and lawyers to work on the development of the Old Lots. (4) They actively marketed the disposal of the Old Lots by approaching leading developers in Hong Kong for offers and tenders. (5)

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51 *Whitfords* was concerned with the interpretation of s 25(1) and s 26(a) of the Income Tax Assessment Act 1936 with which we are not concerned, but Gibbs CJ's words are apposite to determining whether an owner was selling as owner or as trader.

52 See per Mr Andrew LI QC cited in para 18 above.

53 BR para 67.

54 *Alabama Coal, Iron, Land and Colonization Co. Ltd. v Mylam* (1926) 11 TC 232, approved *Commissioner of Taxes v British Australian Wool Realization Association, Ltd* [1931] AC 224 at 252.

55 I have numbered the sentences for ease of reference.

> They sought and subsequently obtained town planning permission. (6) The appellants have performed activities in relation to the Old Lots in an organised and coherent way with a view to maximising the income from the development. (7) They sought and subsequently obtained a new grant by surrendering the Old Lots, thereby substituting the Old Lots by the New Lot. (8) They have chosen to carry on a separate adventure or enterprise of a lucrative commercial and trade character, different and distinct from their charitable work."

29. I do not believe the conduct of HKSKH described in the first 7 sentences went beyond what a non-trader owner might have done in similar circumstances and they do not support a finding of change of intention. The Board rightly applauded Mr Li Fook Hing's object of raising as much income as possible for HKSKH and its charitable activities but failed to consider whether what Mr Li and his committee had done went beyond what a non-trader owner might have done in similar circumstances. The eighth sentence does not follow from the earlier sentences and no useful purpose will be served by further consideration.

30. The Board also considered the badges of trade. "Badges of trade" is a convenient expression to describe the various factors which might help a tribunal to decide whether there was trading or intention to trade.[56] As Browne-Wilkinson VC said "the most they can do is provide common sense guidance to the conclusion which is appropriate".[57] The badges of trade are not to be applied mechanically since the relevance and importance of each badge of trade may vary according to the circumstances of the particular case. The Board has quoted[58] McHugh NPJ's 9 badges of trade in full, namely, "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?
>
> (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

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56 *Lee Yee Shing v CIR* (2008) 11 HKCFAR 6 *per* McHugh NPJ at para 60.

57 *Marson v Morton* [1986] 1 WLR 1343 at 1348D.

58 At para 58(c).

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?"

31. It is obvious that some of these badges of trade have little relevance, for example, the second badge, given that the Old Lots were capital assets, it was irrelevant how long they had been held. Moreover, it is obvious that since the issue is whether HKSKH had sold merely as owner or as a trader, the 7th badge was of critical importance. Inexplicably, the Board went on to consider each of the badges of trade with the exception of the 7th badge and concluded that " there was a change of intention from capital holding to trade/business".[59]

32. This is what the Board said at para 71:

" 71. We turn now to the '**badges of trade**' listed by McHugh NPJ and quoted by us in paragraph 58 (c) above. This is not a mechanical exercise of counting the number of scores. What we are required to do, in the words of McHugh NPJ, is to 'make a value judgement after examining all the circumstances involved in the activities claimed to be a trade'. In considering the 'badges of trade', we must not lose sight of the fact that some of the factors are more relevant to the question of intention at the time of acquisition. In the cases before us, it is common ground that at the respective times of acquisition, the appellants' intention was to hold the Old Lots indefinitely. The issue here is whether there was a change of intention:

(a) Whether the appellants have frequently engaged in similar transactions – no.

(b) Whether the appellants have held land for a lengthy period – yes for the Old Lots but no for the New Lot.

(c) Whether the appellants have acquired an asset that is normally the subject of trading rather than investment – land can be the subject of trading or investment. It is normal to seek surrender and re-grant in trading cases.

[59] BR para 72.

(d) Whether the appellants have bought or acquired large quantities of land – there is no evidence on whether the appellants hold other land.

(e) Whether the appellants have sold the asset (or parts thereof) for reasons that would not exist if they had any intention to resell at the time of acquisition – no for the New Lot, see paragraph 70 above.

(f) Whether the appellants have sought to add re-sale value to the asset by additions or repair – yes, see paragraph 70 above.

(g) Whether the appellants have conceded an actual intention to resell at a profit when the asset was acquired – no.

(h) Whether the appellants have acquired the asset for personal use or pleasure or for income – for 'personal' use in the provision of charitable activities in respect of the Old Lots, for re-sale in respect of the New Lot."

33. Given the obvious importance of the 7th badge of trade, its omission robbed the Board's conclusion of any validity. The Board's treatment of the other trading badges also suffered from the omission. The distinction drawn between the Old Lots and the New Lot in (b), (c), (e) and (h), as well as the references to para 70 in (e) and (f), is, I believe the product of the Board's mistaken belief that the decision of HKSKH to sell the Old Lots after institutional use of the Old Lots was abandoned in 1989 was itself evidence of an intention to trade. Also, the comparison of the surrender and regrant with "additions or repairs" is inapt. There was no attempt to evaluate any of the badges of trade. I am unable to gather from para 71 which of the badges of trade, the board regarded as support for their conclusion. I will say no more.

34. Contrary to Mr Fung's submission, there is no support for the Board's conclusion and it does not help to say that the Board had taken everything into consideration. It is obvious that the Board failed to realise that the issue they had to decide was whether HKSKH intended to sell merely as owner or as trader.

35. On the facts of the present case, with respect, I agree with the Court of Appeal that the Board's conclusion is one which no reasonable Board of Review properly instructed in the law could find.[60]

36. I can deal with the other two certified questions briefly.

Second question

[60] CA para 12.1.

37. I have already said I would not use the expression "enhancement for realisation principle". However, the Board failed to consider whether HKSKH had intended to sell merely as owner or as a trader, and for that reason, its conclusion was vitiated and properly set aside.

Third question

38. Since there was no evidence to support a finding of change of intention in September 1989 or December 1990, the Court of Appeal was right to have set aside the Decision and made the order for remittal.

Disposition

39. Since writing the above I have had the advantage of reading the judgment of Mr Justice Fok PJ and the observations of Mr Justice Chan NPJ, for the above reasons and those given by Mr Justice Fok PJ and Mr Justice Chan NPJ, I would dismiss the Commissioner's appeal and make an order *nisi* that the respondents are to have the costs of the appeal, such costs to be taxed unless agreed.

Mr Justice Fok PJ:

A. Introduction

40. I agree with the judgment of Mr Justice Tang PJ and the additional observations of Mr Justice Chan NPJ.

41. This appeal concerns a charge to profits tax, the correctness of which depended on the validity of a finding of fact by the Board of Review. Although the Court of First Instance upheld the finding of fact on an appeal by way of Case Stated, the Court of Appeal overturned that finding, applying what was described as the "enhancement for realisation principle" (addressed in more detail below). The questions that arise in this appeal are, first, whether such a principle exists and, secondly, regardless of the answer to that question, whether the Court of Appeal was correct to overturn the Board of Review's finding of fact.

42. As will be seen from the summary of the facts more fully set out in the judgment of Tang PJ, which I gratefully adopt, the essential facts were these. The taxpayers owned land which, when originally acquired, was intended to be held indefinitely. Many years later, the taxpayers planned to redevelop the land and took steps to obtain planning permission and to apply for a land exchange with a view to redeveloping it and generating as much income as possible. The taxpayers accepted a tender from a property developer and then entered into a joint venture agreement to develop an extensive residential complex. The taxpayers sold the residential units and car parking spaces allocated to them under the joint venture and made substantial profits. These profits were assessed to profits tax by the Commissioner whose determinations confirming the relevant assessments were the subject of the proceedings in the courts below.

B. The material issue of fact

43. Profits tax is chargeable only on profits arising in or derived from the carrying on by a taxpayer of "a trade, profession or business" in Hong Kong and profits arising from the sale of capital assets are excluded from such charge: Inland Revenue Ordinance (Cap.112), section 14(1).

44. It clearly follows from this statutory charging provision that a landowner may sell his land at an enhanced price above his acquisition cost but not be subject to tax on the profits thereby generated unless in doing so he is embarking on a trade or business of selling land. So the material issue of fact in the present case was whether the taxpayers were carrying on a trade or business when they made the profits sought to be taxed, or whether those profits arose from the sale of a capital asset.

45. The question of whether an activity amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the relevant fact-finding body on a consideration of all the circumstances: see *Lee Yee Shing v Commissioner of Inland Revenue*[61] and *Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue*[62].

46. An intention to trade is essential. As Lord Wilberforce said in *Simmons v IRC*:[63]

> "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

61 (2008) 11 HKCFAR 6 at [38] and [56].
62 (2008) 11 HKCFAR 433 at [40] and [55].
63 [1980] 1 WLR 1196 at 1199A-D.

> little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review."[64]

47. As this passage shows: (1) the relevant time to consider intention is when the relevant asset is sold; (2) the intention then may be different to the intention when the asset was originally acquired; but (3) if a change of intention is to be relied upon as the basis for a finding of an intention to trade, precision in the fact finding process is required.

C. Disposal of land may or may not be in the nature of trade

48. It is well-settled that an owner of land may dispose of his land at a higher price than that for which he acquired it and not be liable for profits tax on the gain, since his gain is "a mere enhancement of value"[65] which may simply be the result of market forces. Moreover, he may expend money improving the property in advance of such disposal without being held to have embarked on an adventure in the nature of trade. So, a landowner may lay out roads and sewers on his land or sub-divide it into smaller lots prior to sale, or re-invest the sale proceeds from part of the land to further improve the remaining parts of the land for further sales, without being found to have been carrying on a trade or business.[66]

49. Equally, however, a landowner may act in relation to the sale of his land in such a way that he will be found to have disposed of it in the course of a trade or business even if he did not himself buy the land but instead inherited it or has held the land for a long time for his own use.[67] This may be so even if the disposal is a 'one-off' transaction.[68]

D. Determining whether there is an intention to trade

50. As indicated above, in determining whether an activity amounts to trading, the fact-finding tribunal must consider all the circumstances involved in the activity. It will then have to make a "value judgment"[69] as to whether this constitutes trading and whether the requisite intention to trade can be inferred. Regardless of what is claimed to be the intention subjectively, the question falls to be determined objectively having regard to all the surrounding circumstances.[70]

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64 This passage was cited with approval by this Court in *Lee Yee Shing v Commissioner of Inland Revenue* (*supra*) at [57] and in *Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue* (*supra*) at [39].

65 *Californian Copper Syndicate (Limited and Reduced) v Harris* (1904) 5 TC 159 per the Lord Justice Clerk (Lord Kingsburgh) at 166.

66 *Hudson's Bay Co Ltd v Stevens* (1909) 5 TC 424 at 437-438; and *Rand v Alberni Land Co Ltd* (1920) 7 TC 629 at 638-639.

67 *Alabama Coal Co Ltd v Mylam* (1926) 11 TC 232; *All Best Wishes Ltd v Commissioner of Inland Revenue* (1992) 3 HKTC 750.

68 *Marson (Inspector of Taxes) v Morton* [1986] 1 WLR 1343 at 1347H; and see, by way of example, *Hong Kong Oxygen & Acetylene Co Ltd v Commissioner of Inland Revenue* [2001] 1 HKLRD 489.

69 *Lee Yee Shing* per McHugh NPJ at [56].

70 *All best Wishes Ltd v Commissioner of Inland Revenue* (*supra*) at 771.

51. For this purpose, various factors have been identified as constituting "badges of trade", the presence or absence of which may assist in the ultimate determination of whether there is an intention to trade or the carrying on of a trade. In *Lee Yee Shing*, McHugh NPJ identified the following "badges" at [60], namely:

> "… 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?
>
> (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?"

These are very similar to the "badges of trade" listed by Sir Nicolas Browne-Wilkinson V-C (as he then was) in *Marson (Inspector of Taxes) v Morton*,[71] which McHugh NPJ also set out in his judgment in *Lee Yee Shing* at [62].

52. It is important to note that Sir Nicolas Browne-Wilkinson V-C stated that it was clear the question of whether or not there was an adventure in the nature of trade depended on (a) "all the facts and circumstances of each particular case" and (b) "the interaction between the various factors that are present in any given case".[72] He was also at pains to emphasise that "the factors … are in no sense a comprehensive list of all relevant matters, nor is any one of them … decisive in all cases".[73] As Lord Bridge has observed, "the law has never succeeded in establishing precise rules which can be applied to all

71 [1986] 1 WLR 1343 at 1348D-1349C.
72 *Ibid.* at 1348B.
73 *Ibid*. at 1348C; he emphasised this again at 1349C.

situations to distinguish between trading stock and capital assets."[74] Indeed, it is perhaps unfortunate that the various factors are referred to as "badges of trade", since that phrase tends to suggest that the mere presence of one or more of those badges may mean that an activity is in the nature of a trade. This is not the intent of the list of factors, the purpose of which is to identify the facts and matters to which a fact-finding tribunal will look holistically in order to determine if the inference of an intention to trade is or is not to be drawn.

E. Is there an "enhancement for realisation" principle?

53. The Court of Appeal held that the Board of Review had erred in finding an intention to trade on the part of the taxpayers by September 1989 at the latest or, alternatively, by December 1990. In reaching that conclusion, the Court of Appeal, purportedly following a line of cases culminating in *Taylor v Good (Inspector of Taxes)*,[75] applied what was described as the "enhancement for realisation" principle.[76] At [10.7] in his judgment, Cheung JA (with whom Yuen JA and Au J agreed) explained the principle in these terms:

> "In my view the ambit of the *Taylor* line of authorities is that the activities relating to the enhancement of the value of the property for the purpose of sale would not necessarily point towards a change of intention to one of trading (rendering the transaction an adventure in the nature of a trade) when the property was initially held for investment and later disposed of. If a finding of change of intention is solely based on such enhancement activities then this amounts to an error of law in the context of a tax appeal."

It will be observed that the two sentences quoted above are somewhat contradictory in that the first sentence is equivocal ("not necessarily") but the second is unequivocal ("If … solely based … then this amounts to an error of law"). The decision of the Court of Appeal proceeds, though, on the basis that the "enhancement for realisation" principle is that stated, unequivocally, in the second sentence.

54. In my view, there is no "enhancement for realisation" principle as held by the Court of Appeal (and as the taxpayers contended for in this appeal). As McHugh NPJ said in *Lee Yee Shing*, "No principle of law defines trade."[77] Whether time, effort or money expended on an asset to enhance its sale price is or is not such as to justify a finding of intention to trade must be a matter of fact and degree and depend on the extent of such expenditure. This is expressly acknowledged by McHugh NPJ's 7th badge of trade set out above. It follows, therefore, that enhancement for realisation, if going beyond what might be expected of a non-trader preparing to sell a long term capital asset, may be sufficient to

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74 *Waylee Investment Ltd v Commissioner of Inland Revenue* [1990] STC 780 at 784g.
75 [1973] STC 383, [1974] 1 WLR 556.
76 CA Judgment at [9.9].
77 (2008) 11 HKCFAR 6 at [56].

support a finding of fact that the landowner has formed the intention to sell the land in the course of a trade or business. That finding of fact, based as it must be on the drawing of an inference that the landowner has formed the intention to trade, will depend on whether the fact-finding tribunal is satisfied that, in the colourful words of Asquith LJ (as he then was) the scheme to sell "moved out of the zone of contemplation – out of the sphere of the tentative, the provisional and the exploratory – into the valley of decision."[78] However, in reaching that decision, the fact-finding tribunal will look to all the facts and circumstances of the case and their interaction before reaching an ultimate conclusion on the issue.

55. Not only is the "enhancement for realisation" principle contrary to the holistic approach to take into account all the facts and circumstances of the particular case, it is inconsistent with judicial statements which suggest that the act of expending time, effort or money on an asset to enhance its sale price may on its own be sufficient to support a finding of an intent to trade. Ultimately, it will depend on whether, on the particular facts, an inference of trading can properly be drawn.

(1) In Pilkington v Randall, Salmon LJ (as he then was) said:

> "I do not read the decision of this Court in *Hudson's Bay Co. v Stevens*, or the decision of Rowlatt, J., in *Rand v Alberni Land Co., Ltd.* as laying down a proposition of law to the effect that, whenever a property owner develops his land by making roads and laying sewers and selling plots, he can never be carrying on a trade."[79]

(2) And in *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd*[80], in concluding that the profits in question were taxable under the second limb of section 26(a) of the Income Tax Assessment Act 1936 (Cth), if not under section 25(1) (which was the conclusion of the majority of the High Court), Mason J (as he then was) said:

> "In this respect I do not agree with the proposition which appears to be founded on remarks in some of the judgments that sale of land which has been subdivided is necessarily no more than the realization of an asset merely because it is an enterprising way of realizing the asset to the best advantage. That may be so in the case where an area of land is merely divided into several allotments. But it is not so in a case such as the present where the planned subdivision takes place on a massive scale,

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78 *Cunliffe v Goodman* [1950] 2 KB 237 at 254; see also *Crawford Realty Limited v Commissioner of Inland Revenue* (1991) 3 HKTC 674 at 693, where Barnett J drew a distinction between "enhancement" of an asset (which would not be trading) and such extensive enhancement as to constitute "substitution" (which would be trading).

79 (1966) 42 TC 662 at 673; to the same effect, in the same case at first instance, Cross J (as he then was) said (*ibid*. at 669), "I do not think that one can lay down hard and fast rules, such as that the construction of roads and sewers and the installation of services can never be enough to make the case one of embarking upon trade."

80 (1982) 150 CLR 355.

> involving the laying out and construction of roads, the provision of parklands, services and other improvements. All this amounts to development and improvement of the land to such a marked degree that it is impossible to say that it is mere realization of an asset."[81]

56. I regard *Taylor v Good (Inspector of Taxes)*, which it should be noted was decided before the House of Lords' decision in *Simmons v IRC*, as a decision on its own facts rather than as laying down the principle of law applied by the Court of Appeal in the present case. The cases cited by Russell LJ[82] (who gave the only reasoned judgment of the Court of Appeal), are not authority for the purported principle. Instead, the issue before the English Court of Appeal was whether the activities of the taxpayer "in this case"[83] after the purchase of the property (which was accepted by the Crown was not part of an adventure in the nature of trade) could be regarded as constituting such an adventure. The Court of Appeal held that those activities[84] were not of such a quality or degree as properly to be regarded as constituting an adventure in the nature of trade. The case was therefore clearly a decision on its own facts.

57. The Court of Appeal cited (at [9.8] and [10.7]) Board of Review Case No. D65/87[85] as an example of a case in which *Taylor v Good (Inspector of Taxes)* was applied. However, this was a decision on its own facts, involving findings by the Board of Review, in relation to particular properties acquired as capital assets, that the taxpayer did not form any intention to trade in respect of them. It does not, therefore, lend support to the existence of the "enhancement for realisation" principle.

F. Was the Court of Appeal nevertheless right to overturn the Board of Review's finding of fact?

58. To interfere with the Board of Review's finding that the taxpayers formed the intention to trade the land by September 1989 at the latest or, alternatively, by December 1990, the Court of Appeal had to find that, on the facts found by the Board of Review, the true and only reasonable conclusion was that there was no such intention by then.[86]

59. On the other hand, as the Commissioner contended in this case, if the primary facts as found were capable of supporting two alternative inferences, it was not open to the appellate tribunal to substitute its preferred inference for that legitimately drawn by the

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81 *Ibid.* at 385.

82 [1974] 1 WLR 556 at 559G-560D, namely: *Hudson's Bay Co Ltd v Stevens*, *Rand v Alberni Land Co Ltd*, *Alabama Coal Co Ltd v Mylam* and *Pilkington v Randall*.

83 *Ibid.* at 561C.

84 *Ibid.* at 558D-E, namely: a first application for planning consent to use the land for residential purposes; preparation of plans for the lay-out of houses and a successful application for planning permission for such lay-out; and the procuring of co-operation from a neighbouring landowner to facilitate suitable road access.

85 IRBRD Vol.3 66.

86 *Edwards v Bairstow* [1956] AC 14 at 36; *Kwong Mile Services Ltd v Commissioner of Inland Revenue* (2004) 7 HKCFAR 275 at [31] and [36].

fact-finding tribunal.[87] That was the view of Reyes J in the Court of First Instance leading him to uphold the Board of Review's decision and dismiss the appeal.[88]

60. Notwithstanding its error in applying the so-called "enhancement for realisation" principle, was the Court of Appeal right to overturn the Board of Review's finding of fact that, by September 1989 at the latest or, alternatively, by December 1990, the taxpayers had formed the intention to trade in the land? In my judgment, it was.

61. It was not in dispute that the taxpayers acquired the land as a long term capital asset. It was the Commissioner's contention that the taxpayers had changed their intention in relation to the land so that, in disposing of it, they were carrying on a trade. This involved the proposition that, as a matter of fact, there was a change of intention on the part of the taxpayers. The question is whether this change of intention could properly be inferred from the primary facts found by the Board of Review. In this respect, it must be borne in mind that it is a requirement of drawing an inference that: (1) the inference must be grounded on clear findings of primary fact; and (2) the inference must be a logical consequence of those facts.[89]

62. A preliminary point to note is that the Board of Review's finding that the taxpayers had formed the intention to trade by September 1989 at the latest or, alternatively, by December 1990 is not formulated with particular precision, a requirement stressed by Lord Wilberforce (see above). By definition, the alternative finding is inconsistent with the finding of a change of intention by the earlier date "at the latest". Moreover, a period of 15 months in the life-span of a trade or business is not insignificant: values material to a tax assessment may fluctuate substantially and substantial activities may take place within a window of time of that magnitude. If such a finding were to be taken further, greater precision, therefore, would be required.

63. The primary facts which led the Board of Review to conclude that the taxpayers had the intention to trade by one or other of September 1989 or December 1990 were those set out in paragraph 70 of the Board of Review's decision (set out by Tang PJ in paragraph 28 above). However, the agreed facts before the Board of Review included the fact that: on 2 July 1993, the taxpayers invited various property developers to submit tender offers either to purchase the New Lot or to enter into a joint venture agreement for development of the New Lot; on 23 July 1993, Cheung Kong (Holdings) Limited submitted two tender offers which included Option A, being a sale and purchase offer; on 12 August 1993, the taxpayers accepted Option B, which was Cheung Kong's joint venture offer; on 3 December 1993, the taxpayers entered into a joint venture agreement with Cheung Kong for the development of the New Lot into the private residential development later known as

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87 *Richfield International Land and Investment Co Ltd v Inland Revenue Commissioner* [1989] STC 820 at 824h.

88 HCIA 2/2009, unrep., Judgment dated 27.1.2010 at [38].

89 *Nina Kung v Wong Din Shin* (2005) 8 HKCFAR 387 at [185]; whilst in a criminal case there is an additional third requirement that the inference must be irresistible (*Winnie Lo v HKSAR* (2012) 15 HKCFAR 16 at [115]), the first two requirements remain essential in respect of any case.

"Deerhill Bay"; on 18 March 1998, a supplemental agreement allocated 129 residential units and 194 car parking spaces to the taxpayers; the occupation permit for the development was issued in August 1998 and between that date and 2006, the taxpayers sold their residential units and car parking spaces, thereby generating the profits subject to the disputed profits tax assessments.

64. In those circumstances, had the taxpayers accepted Option A, an outright sale of the land, it is difficult to see that they would be trading in the land and, in my judgment, it could not be said that a firm intention to commit to one method of disposal rather than the other had been formed before such time they had determined to accept Option B, involving the entry into a joint venture agreement with Cheung Kong to participate in the property redevelopment. Moreover, I do not regard the activities of the taxpayers identified in paragraph 70 of the Board of Review's decision as having gone beyond what a non-trading property owner might do by way of improving his property with a view to its disposal at the best possible price. Consequently, the inference that the Board of Review drew as to a change of intention by September 1989 at the latest or, alternatively, by December 1990 is not logical and cannot therefore be supported. On the contrary, the primary facts found by the Board of Review do not show that what the taxpayers had done, whether by September 1989 or December 1990, went beyond what might be expected of a non-trader preparing to sell a long term capital asset.

65. Furthermore, the Board of Review's curious omission, when considering the "badges of trade" (in paragraph 71 of its decision[90]), to consider the 7th badge of trade listed by McHugh NPJ (see above) materially undermines its conclusion as to the proper inference to draw regarding the taxpayers' intention.

66. I therefore consider that the Court of Appeal was right, notwithstanding its error in applying the so-called "enhancement for realisation" principle, in concluding that the true and only reasonable conclusion was that there was no change of intention from capital holding to trading or carrying on a business by September 1989 or December 1990 and in allowing the appeal from the Court of First Instance to the extent it did. It also follows, since there is every reason to think that, although there was no change of intention by September 1989 or December 1990, there may have been such a change subsequent to those dates, that the Court of Appeal was right to remit the matter to the Board of Review to ascertain when that change of intention occurred.

G. ***Conclusion***

67. For these reasons, I would dismiss this appeal with costs.

Mr Justice Chan NPJ:

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[90] Set out by Tang PJ in paragraph 32 above.

68. I agree with the judgment of Mr Justice Tang PJ and the judgment of Mr Justice Fok PJ. I would like to add the following observations.

69. When considering whether a person is liable to pay profits tax, the starting point must be the statutory provision, s.14(1) of the Inland Revenue Ordinance, Cap 112. It provides, among other things, that tax is payable on profits arising from a trade, but excludes profits arising from the sale of capital assets. "Trade" is defined in s.2 as including every adventure and concern in the nature of trade. Most disputes involve the determination of whether what was done in a particular case amounts to an adventure in the nature of trade or merely a realization of capital assets.

70. It is not disputed that a single one off transaction can be an adventure in the nature of trade (see e.g. *Marson v Morton*, [1986] 1 WLR 1343, 1347H). However, as Lord Wilberforce said in *Simmons v IRC* [1980] 1 WLR 1196, 1199A, "Trading requires an intention to trade". Evidence of intention is necessary to establish whether a transaction in question is an adventure in the nature of trade and not merely a realization of capital assets. The intention at the time of acquisition of an asset which was later sold at a profit is usually "a very strong pointer" (*Marson v Morton*, 1348H; see also *All Best Wishes Ltd v IRC* (1992) 3 HKTC 750, 771), but that intention may be changed (*Simmons v IRC*, 1199, 1202).

71. Whether there has been a change of intention is a question of fact. The answer depends on all the facts and circumstances of each case and the interaction between the various factors present. There are "features or badges" which are relevant in the determination of this question, but no list of relevant factors can be exhaustive and no single factor can be decisive (see *Marson v Morton*, 1348B). To arrive at a proper assessment on the facts, the correct approach is "to stand back, having looked at those matters and look at the whole picture" and ask the question: whether there was an adventure in the nature of trade (*Marson v Morton*, p1349C).

72. I do not think Mr Denis Chang SC is right in submitting that there is a principle of law which he calls "enhancement for realization principle" that must be applied to cases involving enhancement activities and that failure to apply such principle will result in a conclusion that the transaction in question was an adventure in the nature of trade to be set aside. The authorities cited by Mr Chang do not support his propositions. I believe the true effect of the authorities is as follows.

73. Where property was originally acquired as capital investment, the owner can take steps to improve his property or, as it is sometimes put, engage in activities to enhance the value of the asset so as to obtain the best or maximum price when he disposes of it. This in itself would not convert the disposal into an adventure in the nature of trade unless such steps or activities go beyond what would be regarded as the mere realization of capital. Where, on the facts of the case, the steps and activities taken have gone beyond the mere realization of capital, they would be regarded as evidence pointing towards the conclusion that there was a change of intention on the part of that person to embark on an adventure in the nature of trade. (See Williams J in *Scottish Australian Mining Ltd v Federal*

Commissioner of Taxation [1950] 81 CLR 188, 195; Lord Donovan in *McClelland v Tax Commissioners* [1971] 1 WLR 191, 198; Russell LJ in *Taylor v Good* [1973] 49 TC 277, 296; Gibbs CJ in *Federal Commissioner of Taxation v Whitfords Beach Pty Ltd* (1982) 150 CLR 355, 367; Nourse LJ in *Kirkham v Williams* [1991] 1 WLR 863, 868H.) Whether the steps or activities taken in a particular case can be so regarded must depend on all the circumstances of that case including the subject matter of the asset and the nature and extent of the steps and activities taken. Enhancement activities are only one of the factors, albeit an important factor, to be considered in ascertaining whether the owner has the intention to carry on an adventure in the nature of trade.

74. It is common ground that the property concerned in this case was intended as an investment at the time it was acquired. The respondents had since the 1970s made several plans and taken various steps in its proposed development. But on the facts of this case, contrary to Reyes J's view, I do not think it was open to the Board of Review to conclude that there was a change of intention on the part of the respondents in September 1989 or at the latest December 1990 to develop the property concerned as a trade. The Board had, wrongly in my view, regarded the fact that by September 1989, the development of the property concerned became a separate project as the critical turning point in the events. This can be seen from paragraphs 68 and 70 of its Decision. In these two paragraphs, the Board seemed to suggest that not only was there no explanation on the part of the respondents as to why they chose to proceed with the development of the property after that date, but the respondents had also proceeded with such development actively in an "organized and coherent" manner by appointing professional advisors and Mr Li Fook Hing as chairman of a development committee, approaching developers and applying for town planning permission and for a new grant. The Board had obviously overlooked the fact that the property concerned was an agricultural and restricted building land which would not yield a very attractive price if it were to be sold as such. The steps and activities taken by the respondents were necessary for finding out the potential of the property concerned and ascertaining the maximum value which it could fetch. With respect, I also have difficulty in understanding paragraph 71 of the Board's Decision. If the Board was there purporting to apply the badges of trade as proposed by McHugh NPJ in *Lee Yee Shing v Commissioner of Inland Revenue* (2008) 11 HKCFAR 6 to the facts of this case, the simple answers given in that paragraph are, without elaboration, hardly helpful at all. In my view the true and only reasonable conclusion is that paragraphs 72 to 74 of the Board's Decision cannot be supported on the basis of the respondents' activities up to September 1989 or December 1990.

Mr Justice Gummow NPJ:

75. I agree with the judgment of Mr Justice Fok PJ, and thus with the judgment of Mr Justice Tang PJ, and the additional observations of Mr Justice Chan NPJ.

(R A V Ribeiro)
Permanent Judge

(Robert Tang)
Permanent Judge

(Joseph Fok)
Permanent Judge

(Patrick Chan)
Non-Permanent Judge

(William Gummow)
Non-Permanent Judge

Mr Eugene Fung SC and Mr Wilson Leung, instructed by Department of Justice, for the respondent /appellant

Mr Denis Chang SC and Mr Newman Lam, instructed by PC Woo & Co, for the 1st and 2nd appellants / 1st and 2nd respondents