

Case No. D12/21

Profits tax – profits on disposal of property – whether original intention as long-term investment – sections 2(1), 14(1), 17C, 33A, 40 and 68(4) of the Inland Revenue Ordinance

Panel: Wong Kwai Huen (chairman), Clark Douglas Stephen and Lee Wong Wai Ling Winnie.

Date of hearing: 7 June 2021.

Date of decision: 9 November 2021.

The Appellant is a private company incorporated in Hong Kong in 2011.

In February 2012, the Appellant purchased the Property, which consisted of 21 floors, with the existing 6/F Tenancy, and the remaining floors for the operation of serviced apartments.

In the audited financial statements for the period/years ended 31 December 2012, 2013 and 2014, the Property was recorded as ‘Investment Properties’ under ‘Non-Current Assets’ and the Appellant described its principal activity as provision of serviced apartments.

The Appellant commenced disposal of the Property during the year of assessment 2014/15. All units in the Property were disposed of by the year of assessment 2015/16.

The Appellant had remained inactive thereafter.

The Appellant contends that its intention was to acquire and hold the Property a long-term investment/ capital asset.

Held:

1. The main issue is what the intention of the Appellant was at the time of its acquisition of the Property.
2. The directing minds of the Appellant were Mr C and/or the Country AE investors at the time of acquisition of the Property.
3. There was no direct evidence or contemporaneous documents to substantiate an intention of the Appellant to acquire and hold the Property as a long-term investment/ capital asset at the time of acquisition.

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4. The Board is unable to give any weight to the hearsay evidence about what Mr C had conveyed to Mr AD of the original investment intention on acquisition of the Property.
5. The Appellant has failed to discharge its burden of proof.

Appeal dismissed and costs order in the amount of \$20,000 imposed.

Cases referred to:

D40/08, (2008-09) IRBRD, vol 23, 722
Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140
Li Sau Keung v Maxcredit Engineering Ltd [2004] 1 HKC 434
South China Securities Ltd v Lam Kwen Yuen [2012] 5 HKLRD
Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue [2016] 9 HKCFAR 54
Brand Dragon Ltd (In Liquidation) v Commissioner of Inland Revenue [2002] 1 HKC 660
Real Estate Investments [NT] Limited v Commissioner of Inland Revenue [2007] 1 HKLRD 198
Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51
Commissioner of Inland Revenue v Reinhold [1953] 34 TC 389
Simmons v Commissioner of Inland Revenue [1980] 1 WLR 1196
Comm Of Taxes v British Australian Wool Realization Assoc [1931] AC 224
Commissioner of Inland Revenue v Quitsubdue Ltd [1999] 2 HKLRD 481
Chinachem Investments Co Ltd v Commissioner of Inland Revenue [1987] 2 HKTC 261
Commissioner of Inland Revenue v The Board of Review ex p Herald International Ltd [1964] HKLR 224
Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue [2008] 11 HKCFAR 433

Jonathan Chang, Senior Counsel, instructed by Messrs Lu & Partners LLP, for the Appellant.
Paul H M Leung, Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. The Appellant objected to the Profits Tax Assessment for the year of assessment 2015/16 and the Additional Profits Tax Assessments for the years of assessment 2012/13 to 2014/15 raised on the Appellant.

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2. The Profits Tax Assessment for the aforesaid year of assessment and the Additional Profits Tax Assessments for the aforesaid years were raised consequent upon the Respondent not being satisfied that the profits derived by the Appellant from disposing of 6/F to 13/F, 15/F to 23/F, 26/F to 29/F and the corresponding external walls, the flat roof above 29/F and the parapet walls enclosing the flat roof above 29/F, and part of the external wall at the 1/F level, Lift No. 2 and Lift No. 3, at Address A, Hong Kong ('the Property') should be chargeable to Profits Tax and the Appellant should be entitled to commercial building allowance ('CBA') in respect of the Property.

3. By the determination dated 30 September 2020 ('Determination'), the Deputy Commissioner of Inland Revenue ('the Commissioner') rejected the Appellant's objections and confirmed the Additional Profits Tax Assessments for the years of assessment 2012/13 to 2014/15 as well as Profits Tax Assessment for the year of assessment 2015/16 together with Additional Profits Tax Assessment for the year of assessment 2013/14 to reflect the revised CBA.

4. This is an appeal lodged by the Appellant against the Determination pursuant to the provisions of section 66 of the Inland Revenue Ordinance (Chapter 112 of the Laws of Hong Kong) ('the Ordinance').

Agreed Facts

5. By a Statement of Agreed Facts filed with the Board on 11 June 2021, the parties agreed to the following:

- (1) The Appellant is a private company incorporated in Hong Kong in 2011.
- (2) The Appellant's financial year ends on the 31st day of December of each calendar year.
- (3) All the present and former directors of the Appellant are as follows:

<u>Director</u>	<u>Date of Appointment</u>	<u>Date of Resignation</u>
Company B	04-08-2011	07-11-2011
Mr C	07-11-2011	22-01-2014
Mr D	22-01-2014	-
Mr E	22-01-2014	-
Mr F	22-01-2014	12-06-2018
Mr G	22-01-2014	-
Ms H	12-06-2018	-

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- (4) The Appellant's issued share capital was one share of HK\$1. All the former and present shareholders of the Appellant are as follows:

<u>Shareholder</u>	<u>Shareholdings</u>	<u>Period</u>
Company B	100%	04-08-2011 to 06-11-2011
Company J	100%	07-11-2011 to 21-01-2014
Company K	100%	22-01-2014 to present

- (5) The Appellant declared in its financial statements for the year ended 31 December 2013 that its immediate and ultimate holding company as at 31 December 2013 was Company J, a company incorporated in the British Virgin Islands. On 22 January 2014, Company J transferred one share of Company K to Company L.
- (6) The Appellant declared in its financial statements for the years ended 31 December 2014 and 2015 that its ultimate holding entities were (i) Company M, a Cayman Islands exempted limited partnership, (ii) Company N, a Country P listed company and (iii) Company Q, a limited company incorporated in the British Virgin Islands. They were under a joint-venture on a 50:30:20 basis.
- (7) The Appellant described its principal activity in its audited financial statements for the period/years ended 31 December 2012, 2013 and 2014 as providing serviced apartments under operation by Company R until 31 May 2014. After the cessation of serviced apartments operation, the Appellant disposed of all its investment properties during the years ended 31 December 2014 and 2015 (in the manner as set out in paragraph 5(19) below) and had remained inactive thereafter.
- (8) By an agreement for sale and purchase dated 18 February 2012 ('SPA'), the Appellant purchased from Company S (which was a company unrelated to the Appellant, its sole director and shareholders) the Property at a consideration of \$1,200,000,000. ('the Acquisition'). The Property was assigned to the Appellant on 30 April 2012.
- (9) The Property consisted of a total of 21 floors. The 14/F and 24/F were omitted from the floor numbering while the 25/F, a refuge floor, was excluded. The Property also included the ancillary area, being the flat roof above the 29/F. The total gross floor area of the Property was about 79,878 square feet. The ancillary area of the Property (being the flat roof above the 29/F) was about 2,627 square feet.
- (10) The Property was built in 2001 and the Occupation Permit of the Property was issued by the Buildings Department on June 2001.

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(11) At the time of the Acquisition:

- (i) The 6/F of the Property was rented out to Company T for operating a restaurant under the trade name 'Restaurant U' pursuant to a tenancy agreement expiring on 23 October 2013 ('6/F Tenancy'). The Appellant purchased the Property subject to the said tenancy.
- (ii) The remaining floors of the Property were occupied for the operation of serviced apartments by Company R under the trade name 'Serviced Apartment V' with a total of 110 serviced apartments units. Serviced Apartment V was operated and managed by Company R pursuant to a management contract entered into with Company S (expiring on 30 September 2018) ('Company R Management Contract'). After the Acquisition, the Company R Management Contract was novated from Company S to the Appellant.

(12) External consultants had been engaged for preparing reports in relation to the Property. They were:

- (i) Company W which prepared Due Diligence Reports dated 14 December 2011, 20 January 2012 and 4 April 2012 on the Property, including converting Serviced Apartment V to offices, shops and/or restaurants. The followings were some recommendations and conclusions stated in those reports:
 - (a) Site visit revealed that the serviced apartments had a number of irregularities. The cost of repairing was estimated to be around \$3,000,000 with additional professional fee of \$600,000.
 - (b) The cost of changing the serviced apartments to shop use would be around \$3,000,000. It would take around 2 months to complete.
 - (c) The estimated cost to convert the serviced apartments to office use was around \$5,000,000 with additional \$1,000,000 for professional fee. The conversion required the approval from Buildings Department ('BD'). The time for seeking BD's approval would be 60 days and 28 days for obtaining consent. Works would take around 90 days. From completion of work to issuance of acknowledgment by BD would take around 30 to 60 days as there was no statutory requirement on this.
 - (d) The cost to upgrade the serviced apartment for applying

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a new hotel licence was estimated to be \$500,000 per room with professional fee of around \$3,000,000. Commencement of preliminary design to the issuance of hotel licence by the Home Affairs Department ('HAD') would take around 15 to 20 months.

- (e) The existing hotel licence could be transferred from Company R to the Appellant at least 6 months before the expiry of the current licence.
- (ii) Company X provided a technical opinion on hotel licence matters relating to Serviced Apartment V dated 26 January 2012 which included various options such as transferring the hotel licence to the Appellant and application for a new hotel licence. The followings were some of the opinions found in the report:
- (a) A new hotel licence could not be applied for as the authorized use of the Property at that time was not for domestic/hotel purpose. Alteration and addition submission should be made to the BD for approval for the change from approved use as 'Shop' to the new use as 'Hotel'. The estimated time required for the conversion would be around 15 to 20 months from the preliminary design to issuance of hotel licence.
 - (b) HAD would not approve the transfer of hotel licence with a validity period of more than 12 months to a company with no previous good record in managing another hotel. The way to work around it was to have Company R apply for changing the then current multi-year licence to a one-year licence. After obtaining the one-year licence, Company R could then apply for transferring the licence to another company.
- (iii) Company Y and Company Z prepared valuation reports dated 20 February 2012 on the market rent of the Property as at 14 December 2011, assuming that 6/F was for restaurant use and the remaining floors were for office uses. The respective estimated market rent was around \$3,710,000 and \$3,200,000 per month.
- (13) On 17 June 2013, the Appellant and Company T renewed the 6/F Tenancy for a period of 1 year from 23 October 2013 up to 22 October 2014. On 24 March 2014, Company T requested for an early termination of the above renewed tenancy with effect from 1 July 2014.

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- (14) In January 2014, Company AA made a proposal for divestment of the Property by strata-sale. On 7 January 2014, Company AB made a marketing and sales consultancy proposal in respect of the Property to Company AC.
- (15) The Appellant appointed Company AA and Company Z on 23 January 2014 as the lead sales promoters of the strata-title sale of the Property.
- (16) The Appellant terminated the Company R Management Contract by written notice dated 24 January 2014 with effect from 1 June 2014.
- (17) Intended purchasers of the Property submitted reservation forms (dated between 22 January 2014 and 7 February 2014 or undated), together with a cheque/cashier order of \$3,000,000 as earnest money.
- (18) On 7 February 2014, the Appellant resolved to dispose of the Property by strata- title sale.
- (19) The Appellant commenced disposal of the Property by strata-title sale during the year of assessment 2014/15. All units in the Property were sold to various purchasers with vacant possession, and were all disposed of by the year of assessment 2015/16. The details were as follows:

Sales in the year of 2014

<u>Floor</u>	<u>Date of Provisional Agreement</u>	<u>Date of Sale and Purchase Agreement</u>	<u>Date of Assignment</u>	<u>Consideration(\$)</u>
8/F Room A	06-06-2014	18-06-2014	17-11-2014	29,788,000
8/F Room B	21-05-2014	29-07-2014	17-11-2014	19,298,000
8/F Room C	12-05-2014	17-07-2014	17-11-2014	27,978,000
8/F Room D	12-05-2014	17-07-2014	17-11-2014	27,978,000
8/F Room E	24-05-2014	09-06-2014	15-09-2014	19,298,000
8/F Room F	24-05-2014	09-06-2014	15-09-2014	29,788,000
9/F Room D	06-06-2014	20-06-2014	03-12-2014	27,978,000
9/F Room E	02-07-2014	Not available	27-02-2015	19,298,000
9/F Room F	02-07-2014	Not available	27-02-2015	29,788,000
10/F	10-02-2014	24-02-2014	17-11-2014	153,800,000
11/F	10-02-2014	24-02-2014	17-11-2014	145,500,000
12/F	10-02-2014	13-03-2014	17-11-2014	146,000,000

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<u>Floor</u>	<u>Date of Provisional Agreement</u>	<u>Date of Sale and Purchase Agreement</u>	<u>Date of Assignment</u>	<u>Consideration(\$)</u>
13/F	10-02-2014	26-02-2014	17-11-2014	146,500,000
15/F	10-02-2014	26-02-2014	17-11-2014	147,000,000
16/F	10-02-2014	24-02-2014	17-11-2014	147,500,000
17/F	10-02-2014	06-03-2014	15-09-2014	148,000,000
18/F	10-02-2014	03-03-2014	17-11-2014	148,500,000
19/F	10-02-2014	03-03-2014	17-11-2014	149,000,000
20/F	10-02-2014	18-08-2014	17-11-2004	149,500,000
21/F	11-02-2014	26-02-2014	17-11-2014	156,750,000
22/F	10-02-2014	26-02-2014	17-11-2014	157,700,000
23/F	12-02-2014	06-08-2014	15-10-2014	158,650,000
26/F	10-02-2014	28-02-2014	17-11-2014	159,600,000
27/F	17-02-2014	03-03-2014	15-12-2014	168,000,000
29/F	13-02-2014	27-02-2014	17-11-2014	208,000,000
External Wall 1	Not applicable	08-08-2014	12-09-2014	2,880,000
External Wall 2	Not applicable	08-08-2014	12-09-2014	<u>10,000,000</u>
				<u>2,734,072,000</u>

Sales in the year of 2015

<u>Floor</u>	<u>Date of Provisional Agreement</u>	<u>Date of Sale and Purchase Agreement</u>	<u>Date of Assignment</u>	<u>Consideration(\$)</u>
6/F	07-09-2015	Not applicable	27-11-2015	102,000,000
7/F	08-09-2015	Not applicable	27-11-2015	97,000,000
9/F Room A	18-05-2015	03-06-2015	30-10-2015	19,958,400
9/F Room B	18-05-2015	03-06-2015	30-10-2015	14,911,200
9/F Room C	18-05-2015	03-06-2015	30-10-2015	19,859,200
28/F	Not applicable	25-06-2015	01-09-2015	<u>117,000,000</u>
				<u>370,728,800</u>

The Relevant Legislation

6. (i) Section 14(1) of the Ordinance is the charging provision on Profit Tax:

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

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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.’

- (ii) Section 2(1) of the Ordinance defines ‘trade’ as follows:

“trade” (行業, 生意) includes every trade and manufacture, and every adventure and concern in the nature of trade’

- (iii) Section 17C of the Ordinance provides that no deduction shall be allowed in respect of any expenditure of a capital nature or any loss or withdrawal of capital.

- (iv) Section 33A of the Ordinance provides that CBA shall be made to a person who incurred capital expenditure on the construction of a commercial building or structure.

- (v) Section 40 of the Ordinance defines ‘commercial building or structure’ means ‘any building or structure ... used by the person ... for the purposes of his trade, profession or business other than an industrial building or structure.’

- (vi) Section 68(4) of the Ordinance places the burden of proof on the appellant:

‘The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.’

The Relevant Case Law

7. The parties referred the Board to the following authorities:

- (i) Inland Revenue Board of Review Decision D40/08, (2008-09) IRBRD, vol 23, 722
- (ii) Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140
- (iii) Li Sau Keung v Maxcredit Engineering Ltd [2004] 1 HKC
- (iv) South China Securities Ltd v Lam Kwen Yuen [2012] 5 HKLRD
- (v) Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue [2016]

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- (vi) Brand Dragon Ltd (In Liquidation) v Commissioner of Inland Revenue [2002]
- (vii) Real Estate Investments [NT] Limited v CIR [2007] 1 HKLRD 198
- (viii) Lee Yee Shing v CIR [2008] 3 HKLRD 51
- (ix) CIR v Reinhold [1953]
- (x) Simmons Simmons v IRC [1980]
- (xi) Comm Of Taxes v British Australian Wool Realization Assoc [1931]
- (xii) CIR v Quitsubdue Ltd [1999]
- (xiii) Chinachem Investments Co Ltd v CIR [1987]
- (xiv) CIR v The Board of Review ex p Herald International Ltd [1964] HKLR 224
- (xv) Real Estate Investments (NT) Ltd v CIR [2008] 11 HKCFAR 433

Grounds of Appeal

8. The grounds of appeal raised by the Appellant in the Notice of Appeal filed with the Board are summarized as follows:

- (a) The directing mind of the Appellant at the time of acquisition of the Property was its then ultimate holding company, Company J.
- (b) Company J was set up for the purpose of making long-term investments in Hong Kong immovable properties via its wholly owned subsidiaries. Since Company J intended to derive long-term rental yield from property investments, its ultimate shareholders preferred only Hong Kong landed properties with long Government land leases beyond the year 2047; preferably with a land lease term of 999 years. Such property investments were made via its wholly owned subsidiaries including the Appellant.
- (c) In line with its intention, Company J acquired the Property (which had a land lease term of 999 years) through the Appellant as a long-term investment for rental yield return. It was considered that the estimated return of investment based on rental income of above 3.6% per annum was satisfactory, if not favourable, in light of HIBOR of around 0.35% at the time. The actual rental return for 2013/14 was 4.2% per annum.

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- (d) The Appellant was acquired by Company J (as a shell company) for the sole purpose of acquiring and holding the Property. The Appellant classified the Property as a non-current asset in its first 2011/2012 audited accounts and claimed rebuilding allowances thereon (which were granted by the assessor). This was in line with the intention to acquire and hold the Property as a capital asset and not as trading stock.
- (e) Company J/the Appellant's intention in acquiring the Property as a long-term investment was also supported by the fact that all of Company J's property investments in Hong Kong (including the Property) were funded by Company J by way of interest-free shareholder loan (with, at least for the Property, no fixed repayment term). No external funding or borrowing was engaged even at the parent level. No dividend had been declared by the Appellant during the period of ownership by Company J notwithstanding that the Appellant had generated positive cash flow from the operations of the Property during such period.
- (f) As mentioned above, at the time of acquisition, the 6th floor of the Property was rented out for commercial use to a tenant as a restaurant, and the remaining floors were used/operated as 110 serviced apartment units managed and operated by and under a hotel licence held by Company R.
- (g) Before and after the acquisition of the Property, Company J/the Appellant engaged various external consultants to focus on the possibility of enhancing the rental yield for the Property to further its long-term investment potential.
- (h) In line with the intention to hold the Property as a long-term investment for rental yield, Company J/the Appellant considered the following options relative to long-term holding of the Property:
 - (1) Continuing to operate the then serviced apartment business:
 - (i) The then existing configuration of the 110 serviced apartment units was considered the most optimal layout for the serviced apartment business at the Property under a hotel licence, which also permitted short-term leasing (less than one month) for optimization of rental leasing return.
 - (ii) At the same time, Company J/the Appellant was aware that under the Company R Management Contract, Company R had the right to terminate the management contract by a giving 6-month written notice, thereby

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resulting in the Appellant not having the necessary hotel licence to continue with the serviced apartment business.

- (iii) In this connection, Company J/the Appellant had also been advised by the external consultants that for a new hotel licence to be applied, such might entail or result in the possible re-configuration of the layout and a downsizing of the number of apartment units from 110 to 60-99 in order to comply with prevailing government licensing regulations, and in turn the inability to generate rental income during the renovation period.
 - (iv) The shortcoming on the hotel licence was duly reflected in an effective reduction of the initial asking price of HK\$1,200,000,000 by Company S (the Property's previous owner) by HK\$33,000,000 via its contribution towards stamp duty for the sale of the Property.
- (2) Alternatively, re-positioning the Property for leasing for commercial or office use instead of serviced apartment business under Company R.
- (i) As the Property was meant to be a long-term capital investment, Company J/the Appellant did not consider that there was any urgency to make a decision on these options. After all, the acquisition of the Property did not require external funding. There was no external financial pressure to service third party loans and/or interest payments.
 - (j) Company J/the Appellant's assessment on the long-term strategic planning for the rental yield on the Property was based primarily on serviced apartment business or commercial/office leasing validated by due diligence reports or feasibility studies.
 - (k) Shortly after acquisition of the Property, the Appellant received a number of unsolicited offers or expressions of interest from prospective buyers. Company J/the Appellant rejected these offers.
- (1) When the management of Company J/the Appellant received another expression of interest for the Property with an indicative price of HK\$1.7 billion via Company AA on 18 June 2013, this prompted the management to reconsider whether the Appellant should continue to hold the Property as long-term investment for rental yields or realise

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it for re-investment. Ultimately, the decision to realise the investment in the Property was based on a number of key considerations:

- (a) Inability to negotiate a revised Company R Management Contract which was acceptable to the Appellant after a period of 14 months since acquisition
- (b) The potential cost of HK\$20 million on the much needed renovation of all apartment units and facilities in the Property together with the inevitable reduced revenue/rental yield during the renovation period further entrenched the ‘stranglehold’ in favour of Company R over the Appellant.
- (c) The prospect of having to apply for a new hotel licence to replace Company R in the event of a fallout between the Appellant and Company R would likely lead to a reduction of service apartment units and loss of revenue for about 15 to 20 months.
- (d) Conversion of the serviced apartment floors of the Property to be leased for commercial/office use would likely involve extra cost, time and loss of rental revenue.
- (e) If the Property were sold, it would realize HK\$1.7 billion, representing an immediate premium return of HK\$500 million. That offer was considered too good to refuse.
- (m) It was against the above background that Company J/the Appellant decided to dispose of the Property as realization of capital asset by selling its shareholding in the Appellant in late 2013 leading to the change of the Appellant’s ultimate holding company on 22 January 2014.
- (n) The Respondent therefore erred both in law and on the facts in concluding that the Appellant acquired the Property as its trading stock.
- (o) The Board of Review (‘the Board’) was invited to consider that at most there might have been a change of intention on 22 January 2014 at the earliest when the Appellant’s ultimate holding company changed hands. That being the case, any profits tax arising from the eventual disposal of the Property from June 2014 to September 2015 under a different directing mind had to be assessed according to the value of the Property at the time of any such change of intention. In this connection, a direction hearing was conducted on 1 April 2021. (It should also be noted that at the hearing the Appellant’s case was that there was indeed a change of intention in 2014.)

- (p) Alternatively, the Board ought to remit the matter to the Respondent for re-consideration in light of all the grounds stated in paragraph 8 which the Respondent had not taken into consideration in his Determination.

Direction Hearing

- 9.
 - (i) Subsequent to the directional hearing on 1 April 2021, the Board gave the following directions concerning the Respondent's application for expert evidence on the valuation of the Property:
 - '(a) The Board will hear the factual evidence of the parties at the hearing set for 7 to 10 June 2021. It will not hear expert evidence at this hearing.
 - (b) If following the factual hearing, the Board considers it necessary to hear expert evidence on valuation of the property on certain dates, it shall give directions for the preparation of and a further hearing to hear such evidence.'
 - (ii) If necessary, the Board would give further directions on the filing of expert valuation evidence on the value of the Property as at the date of such change of intention.

The Case of the Appellant

10. The case of the Appellant was largely the same as that stated in its grounds of appeal, save that at the hearing Leading Counsel for the Appellant confirmed that the Appellant accepted that at the time the shareholding changed hands on 22-01-2014 there was a change of intention on the Appellant as to the nature of the holding of the property. The gist of its case is as follows:

- (1) Company J was the directing mind of the Appellant when the Property was acquired. It was set up for the interest of some investors outside Hong Kong and for the purpose of making long-term investments in Hong Kong.
- (2) Apart from the Property, Company J also acquired two other landed properties in Hong Kong through two other wholly-owned subsidiaries in Hong Kong. These two properties were held by the two subsidiaries up till the day of the hearing.
- (3) No external funding was required for the acquisition of the Property. The Appellant did not repay the shareholder's loan to Company J, nor did the Appellant declare any dividends payable to Company J.

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- (4) The Property was classified as a non-current asset in the Appellant's first audited accounts. The Appellant made an irrevocable statement that the Property was a capital asset.
- (5) Company J /the Appellant acquired the Property with the existing 6/F Tenancy, and the remaining floors were used for the operation of serviced apartments.
- (6) Prior to the completion of acquisition, Company J/the Appellant engaged two valuation firms (Company Y and Company Z) to give an opinion on the potential rental yield of the Property. Based on the valuation reports, the estimated return was within the range of 3.14% to 3.64% which was almost a tenfold gain compared with the then HIBOR.
- (7) Company J/the Appellant had a genuine intention in providing serviced apartments either under the Company R Management Contract or by itself. Hence, they commissioned technical studies on matters relating to hotel licensing, viability of transfer of the hotel licence and application for a new licence and the costs for conversion of the premises into offices.
- (8) Since its acquisition of the Property, Company J/the Appellant had rejected, a number of unsolicited offers and expressions of interest from prospective buyers. The offer which prompted Company J to seriously consider and eventually decided to dispose of its interest in the Property (through the Appellant) was a HK\$1.7 billion offer from a closed-end fund (being the majority shareholder of Company L ('the Fund')) investing in real estate-related investments in the Asia-Pacific region managed by Company AC. The offer was simply 'too good to refuse'.
- (9) Company J's disposal of its interest in the Property to the Fund was completed on 22 January 2014. The fact that it was sold by Company J at a profit did not mean that it was acquired as a trading stock. An owner could legitimately acquire a capital asset, in the hope or with expectation that it would rise in value over time, and then agree to sell when an attractive offer came down the line, without being liable to profit tax. The gain was 'a mere enhancement of value' which might simply be the result of market forces. Duration of holding of the asset was thus neither here nor there since it all depended on how soon the attractive offer was made to the owner.
- (10) From the Fund's perspective, prior to the acquisition of the Property, one of the investment options was to re-sell the Property via a strata-title sale shortly after its acquisition. The estimated selling price obtained by the Fund was over HK\$3 billion. Immediate divestment

of the Property by strata-title sale therefore represented a much more lucrative investment option, and was eventually set in train by the Fund.

Mr AD's evidence

11. At the hearing, the only witness called by the Appellant was Mr AD. He was and still is the director of the Appellant and also the Head of Company AC.

- (1) The Appellant invited the Board to find that Mr AD's evidence was straightforward, cogent and coherent and that his testimony was consistent with the contemporaneous documents. The Board was asked to accept his evidence in its totality.
- (2) The Appellant contended that Mr AD's evidence was important in two material aspects.
 - (i) Firstly, Mr AD had extensive exchanges with Mr C, the director of the Appellant at the time of acquisition of the Property, on various matters relating to the Property, including Company J's investment portfolio and philosophy, its sources of funding for the acquisition, and the previous offers made to (and rejected by) Company J for the sale of the Property. All such discussions took place prior to the Appellant's tax dispute with the Respondent. Hence, there could be no question that Mr AD and Mr C had invented such discussions to fend off any intended claim by the Respondent which had not arisen at the time. There was nothing to suggest that Mr C had any motive to lie to Mr AD about Company J's investment intention during these discussions. What Mr C told Mr AD was a reliable and contemporaneous indicator of Company J's investment intention in relation to the Property.
 - (ii) In this regard, no adverse inference should be drawn against the Appellant from the unavailability of Mr C in giving evidence before the Board. Mr AD explained that:
 - (a) Company J had a parallel tax dispute with the IRD relating to its disposal of interest in the Property. Mr C therefore declined to act as a witness for the Appellant upon legal advice.
 - (b) Indeed, a draft witness statement was prepared for Mr C's review but he decided that he would not be attending the hearing so he did not sign it and the Appellant did not submit it to the Board.

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(c) Mr C was no longer a director of the Appellant so he had no duty or incentive to assist the Appellant in this appeal. The same reasoning applied to the investors outside Hong Kong behind Company J, who plainly had no direct interest in the outcome of the present appeal.

(iii) Secondly, Mr AD is a seasoned businessman with substantial expertise in real estate investment in Hong Kong. His evidence on real estate market practice provides useful objective parameters in gauging Company J's intention in acquiring the Property through the Appellant.

12. The Appellant made special references to the following facts borne out by Mr AD's evidence:

(A) Company J's investment philosophy and portfolio

(i) Company J's investment philosophy was at all material times one of long-term investment.

(ii) Company J had acquired two other landed properties also with 999-year Government lease around the same time when the Property was acquired. It could not be a coincidence. Mr C told Mr AD that the former had invested for the Country AE family i.e. the investors outside Hong Kong for generations ('the Country AE investors'). They only targeted very old land.

(iii) The other two properties are still being held by Company J's subsidiaries to this day.

(B) Acquisition funded by interest free shareholder's loan

(i) Mr C told Mr AD that there was no external funding at parent level for the acquisition of the Property.

(ii) Mr AD's evidence on real estate market practice (unchallenged by the Appellant) also reinforced that payment in full by cash bears the hallmark of a long-term investment rather than trading.

(C) Rental projection reports

(i) As already mentioned, prior to the completion of the acquisition of the Property, Company J had engaged two valuation firms (Company Y and Company Z) to give an opinion on the potential rental yield of the Property.

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- (ii) Based on Mr AD's experience, an 'ordinary flipper' would not have commissioned these rental projection reports as there would be no real need to do so.

(D) Rental yield of the Property

- (i) The Property generated substantial rental income during Company J's ownership.
- (ii) Contrary to the Respondent's suggestion that the rental yield derived from the Property was low when compared to the average 21% annualized total return from Company AJ, Mr AD submitted that Company AJ was a peculiar case, in which people invested in Company AJ essentially got a 70% discount NAV. That's how they delivered the 21% return. The yield of Company AJ was actually about 4% only.
- (iii) As for the Respondent's suggestion that it was inapt to compare the rental yield derived from the Property against the HIBOR which was 'a totally different kettle of fish' from commercial property investments, Mr AD contended that when people invested in property, they looked at the yield against what they were getting at the bank. This was the Chinese mentality. Any long-term investor would look for the positive carry. Positive carry was what one would be getting in the rental yield versus what the banks were lending at.

(E) Renewal of lease after acquisition

- (i) After acquiring the Property, the Appellant commenced discussions with Company T for the renewal of the 6/F of the Property. Since Company T was contemplating a relocation in future, a one-year renewal of the tenancy agreement was entered into. This showed that the Appellant had no intention to dispose of the Property.
- (ii) On 24 March 2014, Company T notified Mr AD that its shareholders had decided not to renew the tenancy agreement.

(F) Accounting treatment of the Property

- (i) The Property was recorded in the Appellant's audited financial statements as 'Investment properties' under 'Non-Current Assets'.
- (ii) The accounting treatment of the Property was important. The Appellant had effectively made an irrevocable statement that

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the Property was a capital asset. If the Property was subsequently disposed of at a loss, the Appellant could not claim any capital loss as future allowable loss. It was also a contemporaneous record of the status of the Property, made and verified as truthful by the directing mind of the Appellant at the time.

- (iii) From a real estate business practice angle, Mr AD contended that a trader would unlikely book the Property as ‘Non-Current Assets’ which was one of the key reasons why Company AC did not request Company J to provide a tax indemnity when it acquired the interest in the Property from Company J.
- (G) Company J/the Appellant’s rejection of unsolicited sale offers and intention of holding the Property as long-term investment:
- (i) Since its acquisition of the Property, Company J/the Appellant did not put up the Property for sale. In this evidence, Mr AD explained that as a seasoned investor, he had knowledge of what was on the market and what was not. He averred that the Property was not on the market at the material time.
 - (ii) Company J rejected a number of unsolicited offers and expressions of interest from prospective buyers through various property agents. Mr AD named three of such offers in his witness statement.
 - (iii) According to Mr AD, when he first met Mr C, the latter’s first reaction was also that the Property was not for sale. He also said that the Country AE investors really had no intention of selling the Property.
 - (iv) It was Mr AD’s understanding from Mr C that Company J’s eventual decision to sell the Property was partly due to its unfruitful negotiation with Company R for a revised hotel management contract and that Company R had complete control of the situation over Company J.
 - (v) Company J was influenced to sell the Property by the highly attractive offer from Company AC. Mr AD referred to a record in Company AC’s internal report:

‘The vendor Company AF acquired the Property in April 2012 for HK\$1.2 billion. Post-acquisition, the Property was continued to use as service apartment operated by Company R. The vendor is now considering the sale of the Property as it represents a substantial profit from its initial investment.’

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Badges of Trade

13. The Appellant submitted a table of the objective facts and contemporaneous evidence it relied upon in its case. The Board does not consider it necessary to repeat the objective facts here as they have already been mentioned elsewhere in this finding. However, for the sake of completeness and easy reference, the analyses of the case against the ‘badges of trade’ as prepared by the Appellant and the Respondent are summarised below:

Badges of Trade	Analysis by the Appellant	Analysis by the Respondent
(1) Whether the Appellant has frequently engaged in similar transactions	Company J/the Appellant had not engaged in any other transactions involving sale/resale of landed property. Company J had acquired two other landed properties through its subsidiaries. These properties are still being held by the subsidiaries to this day.	No. However, after the sale of the Property, the Appellant did not acquire another property nor did it engage in any other business activity. This goes to show that holding properties as long-term investments was not something the Appellant was set up or intended to do.
(2) Whether the Appellant has held the asset or commodity for a lengthy period	The duration of holding of the asset is not conclusive. An owner can legitimately acquire a capital asset in the hope or expectation that it would rise in value over time, and then agree to sell when an attractive offer came down the line.	No. Held the asset for about 2 years only
(3) Whether the Appellant has acquired an asset or commodity that is normally the subject of trading rather than investment	This factor is neutral in the present case, since the Property can be used both for trading or for investment. However, it is highly unlikely that a trader would acquire a property (i) with full cash payment and (ii) without any external funding.	A rental-yielding property can equally be the subject of trading as an investment.

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Badges of Trade	Analysis by the Appellant	Analysis by the Respondent
(4) Whether the Appellant has bought large quantities or number of the asset or commodity	Company J/the Appellant had not purchased any other landed property apart from the Property.	No.
(5) Whether the Appellant has sold the asset or commodity for reasons that would not exist if the Appellant had an intention to resell at the time of acquisition	Company J disposed of its interest in the Property to Company L after being presented with an offer price of HK\$1.7 billion which was 'too good to refuse'. It also spared Company J from all the uncertainties in negotiating with Company R over the management contract.	The Property was sold at a very significant profit after a relatively short holding period, for a offered price allegedly 'too good to resist'.
(6) Whether the Appellant has sought to add re-sale value to the asset by additions of repair	There is no evidence of any substantial value-adding work done by the Appellant to add re-sale value to the Property.	No.
(7) Whether the Appellant has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class	Company J/the Appellant had never held out or market to sell the Property. As a matter of fact, Mr C had rejected a number of unsolicited offers and expressions of interest from prospective buyers through various estate agents.	Company AA and Company Z were both engaged as 'lead sales promoters' to offload the units in a sales campaign, after Company AA's 'Proposal of Divestment' presentation to the Appellant a project timeline of selling all floors of the Property within 2 months, i.e. by March 2014.
(8) Whether the Appellant has conceded an actual intention to resell at a profit when the asset or commodity was acquired	Company J/the Appellant had never indicated that it had any intention to resell the Property at the time the Property was acquired.	No.

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Badges of Trade	Analysis by the Appellant	Analysis by the Respondent
(9) Whether the Appellant had purchased the asset for personal use or pleasure or for income	Company J/the Appellant acquired the Property to carry out its principal activity of providing serviced apartments operated by Company R for the purpose of generating rental income.	No.

The Case of the Respondent

Unavailability of Mr C and burden of proof

14. The Respondent submitted that the main issue in this appeal was whether the Appellant disposed of the Property as capital assets or trading stock. This was an issue that depended on the Appellant's intention at the time of its acquisition. The onus of proof is on the Appellant to prove that it disposed of the Property as capital assets.

15. Mr C was the sole director of the Appellant at the relevant time. However, there was no witness statement of Mr C filed for this appeal nor was he called to give evidence at the hearing. Instead, a witness statement of Mr AD had been put forward and he was the sole witness at the hearing. It should be noted that Mr AD became a director of the Appellant on 22-01-2014 i.e. much later than the acquisition date of 18-02-2012.

16. The Respondent argued that Mr AD's witness statement was almost entirely hearsay evidence, based on what Mr C told him almost from start to finish. Where a person, without proper explanation, failed to call as a witness a person whom he might reasonably be expected to call, it was open to the court or tribunal of fact to infer that that person's evidence would not have helped that party's case.

17. It was up to the Appellant to adduce evidence in support of its contention that at the time of acquisition of the Property, it had the intention of acquiring it as capital asset rather than as trading stock. Mr AD, being a late comer to the scene, could only tell so much or so little, by way of probative evidence, about the Appellant's intention back in February 2012.

18. Although the directing mind at the time of the acquisition of the Property was said to be Company J, it should be noted that it was only a corporate entity. On the other hand, Mr C, being the Appellant's sole director, and owed his fiduciary duties to the company, should in the absence of other evidence to the contrary explain the intention of the Appellant at the time of acquisition.

19. The Respondent also submitted that it might well be that the Country AE investors were actually behind Company J/the Appellant. However, the Appellant did not call any of these individuals as witnesses to bolster its case on the intention of the Appellant in February 2012.

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20. Since the controlling mind of the Appellant at the time of the Property's acquisition would have been Mr C and/or the Country AE investors, and certainly not Mr AD, without any evidence from the former, which would have been highly probative on the crucial question of intention, the burden of showing that the Property was a capital asset could not be discharged.

21. As for the allegations that Mr C did not want to become a witness because Company J had a parallel tax dispute relating to its disposal of interest in the Property to Company L; and that Mr C did not wish to be 'vexed twice' with giving evidence before the Board, the Respondent argued that these allegations should not be readily accepted by the Board for the following reasons:

- (i) Mr C would only be telling the truth to the Board of what the considerations or intention of the Company J/the Appellant was or were at the time of acquisition of the Property. It would be a relatively simple and straightforward process; being 'vexed twice' should not be much of a challenge to him.
- (ii) Mr C was a solicitor of very considerable standing being admitted in 1975 and was himself a panel member of the Board of Review for over 10 years. It was rather surprising that he would choose not to assist given how pivotal his evidence could be in the determination of this appeal.
- (iii) There was no documentary evidence before the Board showing any attempt made by the Appellant to obtain Mr C's confirmation of the Appellant's allegations regarding its intention of acquisition. Any correspondence or emails from Mr C to show his agreement with the Appellant's case or the contents of Mr AD's witness statement would help.
- (iv) A witness statement in draft had been prepared for Mr C to approve and sign for the purpose of this appeal; however, despite many attempts and meetings, Mr C did not sign it. According to Mr AD, Mr C had been advised by senior counsel that it would be unwise for him to act as the Appellant's witness at the hearing of this appeal. However, Mr AD did not elaborate further on this allegation.

22. In such circumstances, whilst admissible as a matter of law, the Respondent contended that no weight ought to be placed on any of such hearsay evidence of what Mr C was claimed to have told Mr AD. As observed by the Court of Appeal in Real Estate Investment (NT) Ltd v CIR [2007], such hearsay materials would tend to go to the very heart of the present appeal but was not capable of being tested in cross-examination. They deserved no weight; irrespective of whether Mr AD would be accepted by the Board as a reliable or honest witness.

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23. The Respondent cited that ‘where a person without satisfactory explanation fails to call as a witness a person whom he might reasonably be expected to call if that person’s evidence would be favourable to him, then although the tribunal of fact may not treat as evidence what it may as a matter of speculation think that person would have said if he had been called as a witness, nonetheless it is open to the tribunal to infer that that person’s evidence would not have helped that party’s case’. This citation was stated in Li Sau Keung v Maxcredit Engineering Ltd [2004].

24. The Board was therefore invited to infer that Mr C’s evidence would not have helped the Appellant’s case.

25. The Respondent further contended that there was no clear or direct evidence to show whether Mr C was the directing mind or acting merely as the ‘front’ of, and taking instructions from the Country AE investors. If it was the latter case, Mr AD’s evidence of what Mr C had reportedly told him was not only hearsay but could also be ‘double hearsay’. As such, the reliability of Mr AD’s evidence should be discounted even further.

26. The Respondent also contended that the hearsay evidence of Mr AD was all the more unreliable because of the following factors:

- (a) the statement concerning the intention was not made contemporaneously but more than one year after the acquisition;
- (b) Mr C was representing the vendor whereas Mr AD was representing the purchaser in the deal; and
- (c) if the Property were a capital asset, no Profits Tax issue would arise when it was sold. Thus, to facilitate or help close the deal in the sale of the Property, there could have been motive on the part of the vendor to conceal the true intention at the time of acquisition to avoid further discussion on the potential Profits Tax liability.

27. Based on the above submissions, the Respondent argued that the Board could decide the present appeal on the onus of proof in favour of the Respondent. Having said that, the Respondent went on making the following additional submissions on the objective facts.

Tax Representatives’ Admissions

28. The Respondent asserted that if the tax representatives of the Appellant had made any admission of fact contrary to the Appellant’s own case, such admission might be of considerable weight.

29. The Respondent averred that the Appellant had been undecided whether there was a change of intention on the part of the Appellant until the Opening of the case when the leading counsel for the Appellant informed the Board that there was indeed a change of intention.

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30. The Respondent referred to a letter from the Appellant's tax representatives, Company AG, to the Commissioner dated 30 October 2018 admitting that there was no evidence of the Appellant subsequently having changed its intention with respect to the Property and that the change of shareholders was irrelevant.

31. The Respondent therefore sought to submit that since the Property was eventually disposed of as a trading asset and given the aforesaid admission that there was no change of intention on the part of the Appellant post-acquisition, it necessarily followed that the Property had been acquired as a trading asset in the first place.

32. Mr AD sought to explain that this 'slip' was due to a mess-up made by Company AG and the Appellant's former tax representatives, Company AH.

Intention to trade

33. The Respondent averred that where a company's objective was said to be 'to invest in immovable properties', it could mean 'to acquire immovable properties (i) as a long-term investment, (ii) as trading stock, or (iii) a combination thereof'. It did not necessarily have to mean 'to acquire properties as capital assets or permanent investments only'.

34. Some investors would buy with a view to selling at a profit when a good price was offered. They might wait for a year or two, sometimes longer still, but their intention remained that of trading rather than holding the asset as a long-term investment.

Parallels between Company J and Company L / Company AC / Company M

35. The Respondent drew parallels between the positions of the Appellant when it was under the management of Company J on one hand, and Company L / Company AC / Company M on the other:

- (i) Both Company J and Company L / Company M involved foreign investors as their ultimate stakeholders.
- (ii) Both conducted detailed rental projection analyses on the Property.
- (iii) Both considered having all the serviced apartments in the Property converted into other commercial and office uses involving the termination of the Company R Management Contract.
- (iv) The rental projection analyses of both were on the basis that the serviced apartment floors were to be converted into commercial use.
- (v) Under the management of both Company J/the Appellant and Company L, the accounting treatment of the Property in the audited balance sheet was classified as 'a non-current asset'. Yet, Company

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L disposed of the Property within a few months after it took over the management of the Appellant.

(vi) Both invested in a property with subsisting tenancies.

(vii) Both invested in a property with a 999-year lease.

36. In view of the above, the Respondent submitted that if the intention of Company L/Company M was to treat the Property as a trading asset (which Mr AD has admitted), then all the above-mentioned parallels suggested that the intention of Company J in causing the Appellant to acquire the Property could equally have been to treat it as a trading asset.

Investment Environment

37. The Respondent refuted the Appellant's contention that the latter had an intention to hold the Property as a long-term investment by reason of its 'high rental yield return'. The Respondent referred to the investment returns of US Treasury bond, Company AJ and Company AK during the relevant periods in order to demonstrate that they generated much higher returns than the Appellant's projected gross rental returns of 3.14% to 3.64% per annum.

38. It should be noted that the Appellant protested against the Respondent's reliance on Company AK's financial results as they had not been disclosed at the hearing. Further, in the absence of any evidence on the market value, asset management strategies and risk profile of the REIT's portfolios, it would be futile trying to make any meaningful comparison between REITS' return rates with rental return. The Board will deal with this below.

39. The Respondent also asserted that any comparison between rental yield and HIBOR would be meaningless not only because of the timing of the availability of the Company Y and Company Z reports (being after the contract) but also because ordinary investors did not use HIBOR as a reference rate of return on investments. The Respondent doubted that Mr C would have used HIBOR to benchmark the investment return of the Property.

Commerciality Considerations

40. The Respondent refuted the Appellant's contention that a trader would have no commercial reason to buy a property with the subsisting Company R Management Contract and the 6/F Tenancy. The Respondent averred that the Company R Management Contract was terminable with 6 months' prior written notice. Any new buyer could easily get rid of the sitting tenant and resell the property in a vacant possession condition. Further, an income-yielding landed property could also be traded like any income-yielding investment vehicle or asset.

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41. The Respondent also contended that Company J/the Appellant had adopted a ‘buy low, sell high’ strategy by acquiring the Property at a significant discount due to a large part of the stamp duty for the purchase in the sum of \$33 million being borne by the vendor, Company S at the time of acquisition. Equally, in the Company L Deal, the purchase price of \$1.7 billion was considered a ‘deep discount’. Hence, the most important consideration for a trader in real estate was the discount on the price.

42. The Respondent pointed out that there was no evidence of how many property-holding corporate entities Company J owned at all material times other than the Appellant and the two other companies in Hong Kong. Company J could own more vehicles in its portfolio. The Appellant had not provided a full picture of the investments made by Company J.

43. Without the evidence from Mr C testifying that Company J owned no other asset-holding vehicles, the Board did not have a complete picture. The Appellant could not satisfactorily show that Company J was only interested in holding properties long-term for rental return. Besides, there was no information about the rental income of these two properties or investment returns to the two other companies. Nor did the Board know whether the two companies had received any offers, or attractive offers, to buy their properties.

Other Relevant Facts

44. The Respondent drew the attention of the Board to the following particular facts said to be relevant to our deliberation on the intention of the Appellant in the acquisition of the Property:

- (i) Short period of ownership – the Property was agreed to be acquired in February 2012 and the bulk of the strata-sales were struck in February 2014.
- (ii) One-off acquisition of asset – Company J/the Appellant did not reinvest the sales proceeds in some other property.
- (iii) The lease term of the Property being 999 years – a buyer of a property with a 999-year lease term could equally be acquiring it with the intention of trading it. The Fund was a good example.
- (iv) The valuation reports of Company Y and Company Z – they were dated after the Appellant had agreed to acquire the Property. There was no evidence that the Appellant had been informed of the projected rental yield before these reports were issued. Hence, the Appellant might well have decided to purchase the Property before it considered the rental yield stated in the reports.
- (v) The Property in the Appellant’s audited financial statements was recorded as ‘non-current asset’ – the fact that an asset has been

classified as non-current did not necessarily mean the company had no intention of holding it as a trading asset. It should be noted that the unsold units of the Property were still classified as ‘Non-current asset’ as at 31 December 2014 after the strata-sale of the Property began in February 2014.

- (vi) Funding for the acquisition of the Property – the Appellant had adduced no evidence, other than hearsay, suggesting that Company J had the financial strength to fund all the property acquisitions of its subsidiaries without any external financing. The Appellant’s financial statements disclosed that the amount due to Company J was repayable on demand. In any event, using internal finance to acquire property was not necessarily inconsistent with acquiring a property as trading stock.

Badges of Trade

45. The Respondent submitted that badges of trade were factors which only served to assist a tribunal in deciding whether there was trading or intention to trade. The relevance and importance of each badge might vary according to the circumstances. The Respondent prepared its analysis of the badges of trade against the facts in this case. They have been summarised in the table in paragraph 13 above.

Analysis

The Issue

46. At the opening of the Appellant’s case, leading counsel informed the Board that it was the Appellant’s case that there had been a change of intention on the part of the Appellant as to the nature of the holding of the Property when the shareholding changed hands on 22 January 2014.

47. The main issue for the Board’s decision is therefore what the intention of the Appellant was at the time of its acquisition of the Property.

48. It is trite law that whether the nature of an asset is trading stock or capital asset is to be ascertained from the intention of the acquirer at the time of acquisition of the asset. That 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 in order to ascertain the acquirer’s intention.

49. In this appeal, even the veracity of the stated intention was called into question by the Respondent. It was because the only person or persons i.e. Mr C and, possibly, the Country AE investors who were said to be the controlling or directing minds of Company J/the Appellant and were in a position to state the mind of the Appellant at the time of acquisition had not been called to give evidence at the hearing.

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50. The Respondent contended that without the evidence of Mr C which was pivotal in this appeal to tell the Board what the intention was at the time of acquisition, the Appellant had not even begun to discharge its burden of proof under section 68(4) of the Ordinance.

51. As already mentioned above, the Respondent invited the Board to decide this appeal on the basis of onus of proof alone in favour of the Respondent.

52. The Appellant disagreed and argued that section 68(4) of the Ordinance only required an appellant to ‘substantiate its case’. Once the Appellant had given prima facie evidence of disputed facts, the Commission would be entitled to introduce evidence in the rebuttal. The Appellant cited CIR v The Board of Review ex p Herald International Ltd [1964] in support.

53. The Appellant further contended that a case should only be decided on burden of proof as a last resort when the Board was unable to come to a positive decision one way or the other, and deciding on the burden of proof was the ‘only just course to take’. The Appellant referred to Real Estate Investment (NT) Limited v CIR [2006].

54. The Appellant went on to submit that in this appeal, the Appellant had clearly ‘substantiated its case’. The Appellant relied on the testimony of Mr AD and what Mr C had conveyed to Mr AD in relation with Company J/the Appellant’s investment intention at the time of acquisition. The Board was also asked to consider the objective facts and the contemporaneous documents.

55. Given that the testimony of Mr AD, in particular, the part which related to what Mr C had conveyed to Mr AD, i.e. the hearsay evidence, was arduously disputed by the Respondent both in terms of its veracity and evidential weight, the Board will first explore and examine the objective facts and the contemporaneous documents in this case to see if they alone could assist the Board in ascertaining the original investment intention of Company J/the Appellant. The Board will then deal with the hearsay evidence in detail later in this finding.

56. Having taken into consideration the following objective facts, the Board has the following observations:

- (i) The lease term of the Property was 999 years. The Appellant was said to have intended to invest in immovable properties in Hong Kong as a long-term investment. The Board finds that this fact alone is not sufficient to show the Appellant’s intention to hold the Property as capital asset. Any property with a long lease may still be trading stock.
- (ii) As regards the Appellant’s investment philosophy i.e. the Country AE investors would only invest in land with long lease term and the rental return of the Property being higher than HIBOR would be considered very acceptable, the Board considers that without the Country AE

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investors or Mr C giving evidence in this respect, these facts alone are insufficient to assist the Appellant's case. Whilst the Board does not consider it necessary to examine the Respondent's references to the rates of return from US Treasury, Company AJ or Company AK; the Board has difficulty in accepting the allegation that the Country AE investors were old-fashioned people looking only to rental yield against what they would obtain at the bank without the testimony of Mr C or the Country AE investors in support. The long lease term of the Property and the rental return against HIBOR alone did not prove the original intention one way or another.

- (iii) No external funding for the acquisition of the Property was another fact relied upon by the Appellant. While acquisition without external funding might be an indication of a long-term investment, there was no absolute certainty. The Board has also observed that there was no information regarding the source of funding for Company J to extend the loan to the Appellant. Other than what Mr C had told Mr AD, it was uncertain whether it was indeed true that no external funding was needed at the level of Company J. Again, Mr C could have dispelled this uncertainty.
- (iv) The classification of the Property as a non-current asset in the 2011/2012 audited accounts and the Appellant having claimed rebuilding allowances were, in the submission of the Appellant, in line with the intention to acquire and hold the Property as a capital asset. However, the Respondent sought to rely on the tax representative's admission and the so-called 'slip' saga to refute that submission. It is the Board's view that no useful purpose would be served by dwelling on this point. Suffice to say, the classification of an asset in the financial statement is not conclusive evidence of the nature of the asset being held.
- (v) The rental projection reports prepared by Company Y and Company Z were said to be indications that the Appellant was not an 'ordinary flipper'. However, given these reports being dated 20 February 2012 i.e. after the Appellant having entered into the SPA on 18 February 2012, there was doubt whether the Appellant's decision to acquire the Property was directly related to the rental yields stated in the reports. Besides, even flippers like Company L / Company AC / Company M would seek expert's opinion on the rates of rental return of a target property to be acquired as trading stock.
- (vi) The Property was acquired with the subsisting Company R Management Contract and the 6/F Tenancy, the latter of which was renewed for one year after the acquisition. The Board observes that the Company R Management Contract was terminable with 6 months' prior notice and was so terminated later. The one-year renewal of the

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6/F Tenancy would not be sufficiently long to prove the Appellant's intention to hold the Property on a long-term basis.

- (vii) Company J/the Appellant were said to have rejected a number of unsolicited sale offers. Without any oral evidence or contemporaneous documents in support, the Board has difficulty in accepting this allegation. After all, it might also be argued that these offers were simply not attractive enough to tempt the Appellant to sell. Mr C's testimony would be pivotal in persuading the Board to think otherwise.
- (viii) As regards the badges of trade, the Board has not found them particularly helpful in this case. They have not shed much light on the issue of intention. Out of the nine badges, more than half of them were either not applicable in this case or they could point to one conclusion rather than another. The factors relied upon by both parties in their analyses were in no sense a comprehensive list of all relevant matters, nor was any one of them decisive in this case. They did not fall to be considered separately from the issue of intention or any assertion made by the Appellant as to intention. The question of whether the Property was a trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.

57. Mr AD is undoubtedly a seasoned businessman with substantial expertise in real estate investment in Hong Kong. His evidence on real estate market practice would, to a certain extent, provide some parameters in gauging Company J/the Appellant's intention at the time of acquisition of the Property. However, that did not follow that his testimony could substitute for the direct evidence of the controlling mind of the Appellant. After all, Mr AD was called as a factual witness but not an expert witness even though he might be the best in the field as he proclaimed at the hearing. Mr AD's views on some of the facts including long-term investors' goal being obtaining rates of return higher than HIBOR; no flipper acquiring investment properties without external funding; traders unlikely booking properties as 'non-current assets', and his not having heard of the Property being offered for sale in the market were all merely indicators of possible intention of long-term investment. They were suggested by Mr AD according to his personal experience. Yet, they carried little weight in proving Company J/the Appellant's true intention. In fact it is quite surprising that the Fund would be contented with these indications of intention of long-term investment and prepared to forgo obtaining any tax indemnity from the Appellant.

58. In view of the above observations, the Board finds that just by examining the objective facts alone which are both limited and inconclusive, it is unable to make a positive finding on the investment intention of the Appellant at the time of acquisition. There were no doubt certain features in the evidence borne out by the objective facts and contemporaneous documents were capable of supporting the contention that the Appellant acquired the Property as a long-term investment. However, there were also traits of the Property being held as trade stock; in particular the fact that it was held for a relatively short

period of time and was disposed of at a substantial profit. More importantly, the Respondent had successfully raised a lot of doubts and pointed out the limitations in the evidence to support its rival contentions. In the course of its examination of the objective facts, the Board found that the Appellant had, as it were, a case to answer. All the doubts and clouds of uncertainties could be dispelled if the relevant witness or witnesses were called to give evidence and be cross-examined.

59. It is now necessary to turn to the issue of hearsay evidence.

Hearsay Evidence

60. The Appellant invited the Board to accept the evidence of Mr AD in its totality on the ground that his evidence was given in a straightforward, cogent and coherent manner. His testimony was consistent with the contemporaneous documents. The Appellant submitted that Mr AD's extensive exchanges with Mr C took place prior to the Appellant's tax dispute with the Respondent. There could be no question that Mr AD and Mr C had invented such discussions and there was nothing to suggest that Mr C had any motive to lie to Mr AD about the investment intention of Company J/the Appellant. The Appellant averred that no adverse inference should be drawn against the Appellant from the unavailability of Mr C in giving evidence before the Board for the reasons mentioned in paragraph 11(ii) above.

61. The Appellant sought to contend that although Mr C and the Country AE investors were unavailable as witnesses, the Board was still fully capable of making and should make factual findings on Company J/the Appellant's investment intention based on the testimony of Mr AD including what had been conveyed to him by Mr C.

62. With respect, it is the Board's view that it cannot place much weight, if any, on a piece of hearsay evidence which was so crucial to this appeal and which had not been tested by cross-examination. In this regard, the Board has referred to section 49 of the Evidence Ordinance (Chapter 8 of the Laws of Hong Kong) relating to hearsay evidence. The relevant part is stated below:

'(1) In estimating the weight, if any, to be given to hearsay evidence in civil proceedings, the court shall have regard to any circumstances from which any inference can reasonably be drawn as to the reliability or otherwise of the evidence

(2) For the purposes of subsection (1), regard may be had, in particular, to the following-

(a) whether it would have been reasonable and practicable for the party by whom the evidence was adduced to have produced the maker of the original statement as a witness;

(b) whether the original statement was made contemporaneously with the occurrence or existence of the matters stated;

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- (c) *whether the evidence involves multiple hearsay;*
 - (d) *whether any person involved had any motive to conceal or misrepresent matters;*
- ...’

63. The Board has no reason to doubt the credibility of Mr AD. He was a clear and straightforward witness. The Board accepts that the extensive exchanges between he and Mr C in relation to the Property did take place. What is at issue is the veracity and accuracy of the contents of those conversations which is hearsay evidence.

64. The Board has no difficulty in finding that the directing minds of the Appellant were either Mr C or the Country AE investors or both at the time of acquisition of the Property. These were the only people who could have been able to say what the original intention was. Mr AD is certainly not one of them. However, the Board has been hampered by the absence of such key witnesses who could have dispelled a lot of doubts and uncertainties and clarified a lot of queries raised by the Respondent and, for that matter, this Board by testifying and being cross-examined at the hearing.

65. The Board reasons that whilst it would have been impracticable and inconvenient for the Appellant to call the Country AE investors to appear at the hearing of this appeal given the pandemic, the same cannot be said about Mr C who is based in Hong Kong. Given that Mr C is legally qualified and formerly a member of this Board, it is reasonable and logical to expect the Appellant to call him as a witness. His testimony would be no more than stating the true intention of the Appellant at the time of acquisition. The Board accepts the Respondent’s contentions in this respect as mentioned in paragraph 21 above.

66. The Board takes note of the fact that Mr C is no longer a director of the Appellant. He owes no duty to assist the Appellant. The Board is also aware of Company J’s parallel tax dispute with the Respondent arising from the same underlying facts of this appeal. What the Board does not understand is how by Mr C’s repeating the investment intention of the Appellant at the time of acquisition as he had allegedly told Mr AD would in any way jeopardise Company J’s case in the other tax dispute. Mr C would simply repeat what he had told Mr AD during those exchanges between them.

67. As for Mr C’s advice obtained from senior counsel in his other tax appeal case, the Board does not have the benefit of knowing what the advice was about. Nor did Mr AD clarify this at the hearing. The Board is not at liberty to speculate on this issue.

68. The Board finds some force in the Respondent’s contention that the statement regarding the original intention of the Appellant was made more than one year after the acquisition during one of those ‘extensive exchanges’ between Mr AD and Mr C. There was no direct evidence or contemporaneous documents to assist the Board in finding that such an intention in fact existed at the time of acquisition. Bare assertion of intention

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made almost two years after the acquisition cannot be given any weight. This is irrespective of the fact that the statement was made prior to the tax dispute with the Respondent.

69. As pointed out by the Respondent in paragraph 25 above, if the Country AE investors were the controlling minds, what Mr C told Mr AD could be double hearsay.

70. Without suggesting that Mr C did conceal any truth or misrepresent matters to Mr AD, an objective analysis of the circumstances would support the Respondent's contentions in paragraph 26 that there were reasons why Mr C might not have told Mr AD the full picture of the original intention of the acquisition. It should be borne in mind that Mr C was representing the vendor and Mr AD was the purchaser. A vendor would, so to speak, try to sweeten the deal by suggesting that there was no profit tax liability.

71. Needless to say, Mr C could have come forward to testify at the hearing in order to allay all these misgivings mentioned above.

72. The Board takes the view that, as a director of the Appellant at the time of acquisition, Mr C's testimony was pivotal to the Appellant's case. Without having the primary evidence of Mr C which should be tested by cross-examination, the Board feels unable to give any weight to the hearsay evidence about what Mr C had conveyed to Mr AD in relation with the original investment intention on acquisition.

73. Mr C was reasonably expected to have material evidence to give relating to the thinking and decision – making process of Company J/the Appellant at the time of acquisition. His absence and silence did not assist the Appellant's case at all.

74. Given the state of the evidence, the Board is not satisfied to the requisite degree and therefore unable to come to a positive finding that the Appellant has substantiated its case on the investment intention of the Appellant. The Board is driven to the conclusion that the Appellant had not discharged its burden of proof in this appeal.

75. The Appellant submitted that the Appellant had given prima facie evidence of disputed facts and the Respondent would be entitled to introduce evidence in the rebuttal. In this appeal, the Respondent had not adduced any positive evidence to controvert Mr AD's testimony. The Appellant cited CIR v The Board of Review ex p Herald International Ltd [1964] in support.

76. The Board does not find the Herald International case particularly helpful; bearing in mind that the case was decided in 1964 while section 68(4) of the Ordinance was replaced by section 34 of Inland Revenue (Amendment) Ordinance in 1965. Suffice to say, the Respondent has no legal obligation to introduce any evidence to support its case. It is sufficient for the Respondent to raise doubts on the Appellant's case. In this appeal, it was for the Appellant to prove that the Property was a capital asset. It was not for the Respondent to prove that it was a trading stock.

77. The Respondent cited Real Estate Investment (NT) Ltd v CIR [2008] in which the CFA upheld a decision of the Board that since the taxpayer's controller who could

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have been the most important witness went missing, the Board made a decision on the onus of proof in favour of the Commissioner. The Respondent submitted that a fortiori the same should apply to this Appeal as Mr C was in Hong Kong and his last communication with Mr AD was merely one month prior to the hearing.

78. As has been mentioned in numerous authorities, as far as possible the Board has to decide on something more than the onus of proof. No court or tribunal likes to decide a case by the mere application of the burden of proof. As pointed out by the Appellant, that should be a decision of last resort.

79. Since the Board is not bound to make a finding on the issue of whether the Property was a capital asset or a trading stock, if, having regard to the evidence adduced, the Board finds itself unable to make a positive decision one way or the other, the only course open to the Board to take is that the Appellant has failed to discharge its burden of proof and the appeal must be dismissed.

80. In this appeal, the Board finds that without the benefit of hearing Mr C's testimony to dispel the doubts raised by the Respondent, it is indeed unable to make a positive finding that the intention of acquisition of the Property was for long-term investment. The Board is driven to find that the Appellant has not overcome its burden of proving that the assessments in question were incorrect or excessive under section 68(4) of the Ordinance. That being the case, the appeal is dismissed.

81. Given the finding of the Board, it is not necessary to make any decision in relation with expert valuation of the Property.

82. The Appellant is to pay a sum of HK\$20,000 as costs of the Board which is to be added to the tax charged and recovered therewith.