

**Case No. D19/22**

**Profits tax** – whether or not the Appellant’s profits derived from the disposal of the property was trading profits – section 68(4) of the Inland Revenue Ordinance – the onus of proving that the profits tax assessment is excessive or incorrect is on the Appellant – short period of ownership supports the inference that the Property was acquired for trading – badges of trade

Panel: Maurice Joseph Chan (chairman), Chan Kin Pun and Hui Lap Tak.

Date of hearing: 1 December 2020.

Date of decision: 29 November 2022.

The Appellants entered into the preliminary sale and purchase agreement to acquire the Property on 8 October 2012, and the Property was assigned to them on 26 October 2012. On 21 January 2013, the Appellants entered into the preliminary sale and purchase agreement to sell the Property on 21 January 2013, and the Property was assigned to the purchaser on 8 April 2013. The Assessor was of the view that the gain on the disposal of the property was revenue in nature and should be chargeable to profits tax. The Assessor raised the Appellant profits tax assessment. The Appellant repeatedly stated that the property was acquired by the Appellants for the purpose of earning rental income. The reason for selling the Property was only that they found the costs of maintaining or leasing out the Property was so high that it was out of their expectation. The Appellants had attempted to lease the Property, but it was unsuccessful, and hence they had no choice but to sell the Property.

The issue of this appeal is whether the Appellant’s profits derived from the disposal of the property was trading profits, and hence chargeable to profits tax.

**Held:**

1. Pursuant to section 68(4) of the Inland Revenue Ordinance, the onus of proving that the profits tax assessment is excessive or incorrect is on the Appellant. Hence, to succeed in the appeal, the Appellants must show to the Board’s satisfaction, by way of credible and accepted evidence, that the Property was a capital asset.
2. The Board considers that such short period of ownership supports the inference that the Property was acquired for trading. The disposal of the Property within such short period of time was also contrary to the contention of the Appellants that they acquired the Property for long-term investment. The Appellants also failed to provide any credible (oral or documentary) evidence to support that their stated intention was genuinely

held.

3. Upon a holistic consideration of the circumstances of the case, and particularly in light of the commonly known badges of trade, we find as a fact that the Appellants had acquired the Property for trading purpose rather than for investment purposes (Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6 followed).
4. Further or alternatively, we find that the Appellants have failed to discharge their burden of proof under section 68(4) of the Ordinance to show that the Property was acquired for non trading purposes. For all the above reasons, we make a finding of fact that in all likelihood, that the Property was acquired as a capital asset for short term trading rather than for long term investment purposes.

### **Appeal dismissed.**

Cases referred to:

Lionel Simmons Properties Limited (in liquidation) and others v Commissioners of Inland Revenue [1980] 2 All ER 798  
All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750  
Marson (Inspector of Taxes) v Morton and Others [1986] 1 WLR 1343  
Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6  
Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140  
Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433

Marco Wong, CPA of World Smart Accounting Services Limited, for the Appellants.  
Chan Wai Lin, Lai Ming Yee and Yun Rita, for the Commissioner of Inland Revenue.

### **Decision:**

### **Background**

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue dated 12 August 2020 (**‘the Determination’**). The Determination confirmed the Profits Tax Assessment for the year of assessment 2013/14 raised on the Appellants.
2. Mr Marco WONG (**‘Mr WONG’**), a certified public accountant of World Smart Accounting Services Limited (**‘the Representative’**), and Ms. K, being the family member of Mr A, one of the Appellants, appeared for the Appellants. Mr WONG gave the oral submission, and Ms K gave the oral evidence.

**Facts**

3. With reference to the facts as agreed by the Appellants and other documents made available to us, we find the following facts relevant to this case:

- (a) By a preliminary sale and purchase agreement dated 8 October 2012, Mr. B purchased Office A, Address C (**‘the Property’**) at a price of \$9,030,000. The Property was assigned to the Appellants and purchase was completed on 26 October 2012.
- (b) By a provisional agreement for sale and purchase dated 21 January 2013, the Appellants sold the Property at a price of \$10,800,000. The purchase was completed on 8 April 2013.
- (c) In response to the Assessor’s enquiries, the Appellants provided, among other things, the following information concerning the purchase and sale of the Property:

- (i) Intended or actual usage of the Property : Letting
- (ii) Reason for selling the Property : The Appellants could not let out the Property several months after purchase and decided to dispose of the Property to reduce expenses on monthly mortgage interests and management fees.
- (iii) Calculation of profits : \$
  - Gross profits : 1,770,000
  - Less: Expenses
    - Legal fee on purchase : 25,000
    - Stamp duty : 338,625
    - Agency fee on purchase : 35,000
    - Bank interest expense : 51,410
    - Legal fees on sale : 25,000
    - Agency fee on sale : 90,000
    - Bank charges : 91,300
    - Building management : 12,890

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

fees		
Insurance	:	<u>9,030</u>
Total expenses	:	678,255
Net profit	:	<u>1,091,745</u>

- (d) The Assessor was of the view that the gain on the disposal of the Property was revenue in nature and should be chargeable to Profits Tax. He raised on the Appellants the following Profits Tax assessment for the year of assessment 2013/14:

	\$
Assessable Profits	<u>1,091,745</u>
Tax Payable thereon	<u>153,761</u>

- (e) World Smart Accounting Services Limited, on behalf of the Appellants, objected to the above Profits Tax assessment on the ground that the assessment was excessive. In response to the Assessor's enquiries, the Appellants replied as follows:

- (i) The intention for the purchase of the Property was for letting and earning rental income on a long-term basis (and therefore not for trading in the short term);
- (ii) 50% of the purchase price was financed by the Appellants' personal savings. The remaining balance of \$4,515,000 was financed by a secured bank loan from Bank D repayable by 240 monthly instalments of \$24,479 each.
- (iii) The Appellants purchased the Property as an investment because:
  - (a) The amount for investing the Property were close to their budget.
  - (b) The Property was newly constructed and the interior design of the lobby and other public area were attractive.
  - (c) The Appellants expected the Property had a higher rate of return than other properties in District E. It was asserted that the average rate of return for commercial properties in District F was about \$20 to \$23 per square whereas in other areas of District E was about \$16 to \$18 per square feet.
  - (d) The Appellants expected the demand for commercial

units in District E would be increased as there were news that the government was going to develop the area.

- (iv) The Appellants actively searched for potential tenants through estate agents, which include at least Agency G and Agency H, and by placing free advertisement on websites of estate agents. The asking monthly rent was \$23 per square feet and later reduced to \$20 per square feet. Moreover, Mr. NG had also been approached by Agency J since around early November 2012 for the possible lease or disposal of the Property.
  - (v) The Appellants expected that the rental income of the Property would be sufficient to cover the monthly instalments payment. Since the Appellants were unable to let out the Property, they financed the monthly instalments payment personally.
  - (vi) The Appellants put the Property for sale in early January 2013. The Property was disposed of through Agency G on 21 January 2013.
  - (vii) The Appellants disposed of the Property because they were unable to let out the Property. The Appellants' only source of income was their salaries. It was a burden for them to pay about \$28,000 each month for the monthly instalments payment and the management fee without any rental income.
- (f) To support its objection, the Appellants furnished, among other things, a copy of an exclusive agency authorization letter dated 19 October 2012 entered into between Mr. A and Agency H. Mr. A claims that he appointed Agency H as the exclusive agent for the period from 19 October 2012 to 31 March 2013 to let out the Property at a monthly rent of \$30,000.

### **The issue of this appeal**

4. The issue of this appeal is whether the Appellants' profit derived from the disposal of the Property was trading profits, and hence chargeable to Profits Tax.

### **The law**

5. We agree with the Respondent's submission and find that the following provisions of the Inland Revenue Ordinance apply to this appeal:

(a) Section 14 provides:

*'(1) Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on*

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

*every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'*

(b) Section 2(1) defines 'trade' to include 'every trade and manufacture, and every adventure and concern in the nature of trade'.

(c) Section 68(4) provides:

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

6. We also agree with the Respondent's application of the legal principles from the following cases and their application to this appeal.

(a) Lionel Simmons Properties Limited (in liquidation) and others v Commissioners of Inland Revenue [1980] 2 All ER 798;

(b) All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750;

(c) Marson (Inspector of Taxes) v Morton and Others [1986] 1 WLR 1343;

(d) Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6;

(e) Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140; and

(f) Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433.

7. According to Simmons, '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?' (per Lord Wilberforce at page 800).

8. Mortimer J in All Best Wishes at page 771 stated:

*'The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realizable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact,*

*no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words.'*

9. Sir Nicolas Browne-Wilkinson VC summarized the relevant principles in Marson as follows:

- (a) As a matter of law a single, one-off transaction can be an adventure in the nature of trade (at page 1347).
- (b) The question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and on interaction between the various factors that are present in any given case (at page 1348).
- (c) There are certain features or badges the answers to which may point to one conclusion rather than another, and the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide a common sense guidance to or an inference of an appropriate conclusion. The answers to the following questions may indicate what the badges are, and what conclusions can be drawn from them. Some of such questions are as follows:
  - (i) Was the transaction a one-off transaction, which, as a matter of law, is capable of being an adventure in the nature of trade?
  - (ii) Was the transaction in some way related to the trade which the taxpayer otherwise carries on?
  - (iii) Did the transaction involve a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realization?
  - (iv) Was the transaction carried through in a way typical of the trade in a commodity of that nature?
  - (v) What was the source of finance of the transaction?
  - (vi) Was the item which was purchased resold as it stood, or was the work done on it or relating to it, for the purposes of resale?

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (vii) Was the purchased item resold in one lot as it was bought, or was it broken down into saleable lots?
- (viii) What were the purchasers' intentions as to resale at the time of purchase?
- (ix) Did the item purchased either provide enjoyment or pride of possession for the purchaser, or did it produce income pending resale? (pages 1348 to 1349)

10. In Lee Yee Shing, Bokhary and Chan PJJ emphasized in paragraph 38 that the question whether something amounts to the carrying of a trade 'is a question of fact and degree to be determined by the fact-finding body upon a consideration of all the circumstances. On the question of 'trade', McHugh NPJ stated in paragraph 60 that for most cases, the 'badges of trade' that indicate the carrying on of a trade are affirmative answers to the questions whether the taxpayer:

- (a) has frequently engaged in similar transactions?
- (b) has held the asset or commodity for a lengthy period?
- (c) has acquired an asset or commodity that is normally the subject of trading rather than investment?
- (d) has bought large quantities or numbers of the commodity or asset?
- (e) 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?
- (f) has sought to add re-sale value to the asset by additions or repair?
- (g) 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?
- (h) has conceded an actual intention to resell at a profit when the asset or commodity was acquired?
- (i) has purchased the asset or commodity for personal use or pleasure or for income?

11. In Real Estates Investments, one of the questions posed in the case stated was whether, in distinguishing trading stock from a capital asset, should one only focus on the taxpayer's intention at the time the property was acquired, or otherwise to consider all the circumstances (the badges of trade) Bokhary and Chan PJJ answering the question in paragraphs 40 and 55 as follows:



- (a) *'40. It is clear that question (ii)(b) uses the expression "badges of trade" to mean the circumstances that shed light on the issue of intention. Those circumstances simply do not fall to be considered separately from the issue of intention or any assertion made by the Taxpayer or on its behalf as to intention.'*
- (b) *'55. The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.'*

12. On the question of burden of proof, in Real Estate Investments, Bokhary and Chan PJJ first said, at paragraph 32 that it *'is natural and appropriate to strive to decide on something more satisfying than the onus of proof'*. However, they also acknowledged that tax appeals do begin on the basis of Section 68(4), and so, *'it is possible although rare for such an appeal to end – and be disposed of – on that basis'*. The judges further held, at paragraph 47, that the *'taxpayer will have to prove his contention'* and so *'his appeal to the Board of Review would fail if the Board positively determines that, contrary to his contention, [the Property was a trading stock]. And it would likewise fail if the Board merely determines that he has not proved his contention' that the property was capital asset.'* This means that no appeal by the taxpayer could succeed unless the court is of the view that the true and only reasonable conclusion is that the position is what the taxpayer contends, being a long term investment asset.

13. In Crown Brilliance Ltd, G Lam J held that the Board misdirected itself in law and/or erred in law in relying on and/or giving undue weight to the taxpayer's representatives' assertions or representations, which were unsupported by any evidence and were not adduced as evidence.

### **The Appellants' Grounds of Appeal**

14. In the statement of the grounds of appeal, the Appellants, through its Representative, claimed that:

- (a) the Appellants acquired the Property solely for the purpose of earning rental income as they expected a high rate of return by leasing out the Property;
- (b) the period of ownership did not conclusively imply the intention of acquisition and holding of the Property;
- (c) the Appellants did have a plan to finance the holding of the Property in the long term. The Appellants would be able to pay the expenses of the Property by leasing out the Property for rental income;
- (d) the Appellants had tried their best in seeking for tenants but could not leased out the Property after three months from the date of acquisition.

There was a lower chance of success in leasing out the Property in the near future due to high vacancy percentage of the building; and

- (e) the exclusive agency authorization agreement dated 19 October 2012 (**'the Agency Agreement'**) entered into between Agency H proved that the Appellants had been looking for tenants. The Agency Agreement provided that even if the Property was leased out through other property agents, the Appellants had to pay agency fee to Agency H. As a result of such a term, the Appellants did not take other concrete steps in leasing out the Property.

### **The Appellants' submission at the hearing**

15. The Appellants did not provide any written skeleton. Mr WONG made the oral submission, which essentially followed the Appellants' grounds of appeal as stated above.

16. In the oral submission of Mr WONG, he further submitted that to lease the Property, it was the market's expectation that the Appellants, as landlord, would need to bear costs of installing fire and air-conditioning systems. The Appellants expected that they would need to pay approximately HK\$100,000 for such installations. However, as first-time purchasers of commercial properties, they had not expected such costs, and such costs were considered as a burden to them.

### **The Evidence of Ms K**

17. The Appellants called one witness, Ms K, who was the family member of Mr A.

18. Ms K had not given any witness statement in writing. The Board has thus carefully considered her oral testimony.

19. Upon cross-examination, Ms K admitted that she was the person authorized by the Appellants to contact the estate agents for the lease as well as the subsequent sale of the Property. Ms K denied however that it was the Appellants' initial intention to dispose of the Property. Instead, Ms K alleged that the Property was acquired for the purpose of earning long-term rental income.

20. When asked about the telephone system records of Agency J which showed that since 2 November 2012, Ms K had been in discussion with Agency J for lease and/or sale of the Property (and since 1 December 2012, the discussion mainly related to sale of the Property instead of its lease), Ms K said that she could not recall the details of the alleged telephone conversations; however, Ms K confirmed that she was approached by Agency J first, and the focus was on the lease of the Property. With regard to the offer prices for selling the Property, Ms K said that it was only Agency J's records, not hers, and she could not recall the details and was not in a position to make any comments.

21. In the course of giving evidence, Ms K confirmed that she had indeed passed the key of the Property to Agency J, which was marked so in the computerized record of Agency

J as of 8 December 2012.

22. Ms K stated that the intention for selling the Property was due to the fact that the monthly expenses of the Property had become a heavy burden to the Appellants, and hence, they had to sell the Property.

**Application of the badges of trade**

23. The Respondent had submitted that where the badges of trade as summarized by McHugh NPJ in Lee Yee Shing are applied in the present case, they would all yield the following negative and/or neutral answers, which are adverse to the Appellant's contentions (or otherwise do not advance them):

(a) *Whether the Appellants have frequently engaged in similar transactions?*

No. Further, it is well-settled that a single, one-off transaction can be an adventure in the nature of trade: Marson.

(b) *Whether the Appellants have held the asset or commodity for a lengthy period?*

No. The Appellants held the Property for less than 6 months.

(c) *Whether the Appellants have acquired an asset or commodity that is normally the subject of trading rather than investment?*

In Hong Kong, real property can be acquired for trading or investment purposes, so this badge does not advance the Appellants' case.

(d) *Whether the Appellants have bought large quantities or numbers of the commodity or asset?*

No. The Appellants only dealt in the Property. However, as mentioned in paragraph (a) above, a one-off transaction can be an adventure in the nature of trade.

(e) *Whether the Appellants have sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?*

No. The Appellants claimed that the Property could not be leased out after three months from the date of acquisition.

(f) *Whether the Appellants have sought to add re-sale value to the asset by additions or repair?*

No. The Appellants acquired and sold the Property with vacant possession.

- (g) *Whether the Appellants have expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?*

No. Although the Appellants appointed Agency H as their exclusive agent to lease out the Property, the Property was actually sold through Agency G, and there is information which shows that the Property had also been put up for sale through Agency J. No serious attempts had been made to appoint Agency G or Agency J be to let out the Property.

- (h) *Whether the Appellants have conceded an actual intention to resell at a profit when the asset or commodity was acquired?*

The Appellants claimed that the intention for acquisition of the Property was for leasing and earning rental income on a long term basis.

- (i) *Whether the Appellants have purchased the asset or commodity for personal use or pleasure or for income?*

No. The Property was not leased out during the period of ownership at all.

## Analysis

24. Pursuant to section 68(4) of the Inland Revenue Ordinance (**‘the Ordinance’**), the onus of proving that the 2013/14 Profits Tax Assessment is excessive or incorrect is on the Appellants.

25. Hence, to succeed in the appeal, the Appellants must show to the Board’s satisfaction, by way of credible and accepted evidence, that the Property was a capital asset.

26. Mr WONG, in his submissions, and Ms K, in her oral evidence, repeatedly stated that the Property was acquired by the Appellants for the purpose of earning rental income. The reason for selling the Property was only that they found the costs of maintaining or leasing out the Property was so high that it was out of their expectation. The Appellants had attempted to lease the Property, but it was unsuccessful, and hence they had no choice but to sell the Property.

27. It was undisputed that the Appellants entered into the preliminary sale and purchase agreement to acquire the Property on 8 October 2012, and the Property was assigned to them on 26 October 2012. On 21 January 2013, the Appellants, through Agency G, entered into the preliminary sale and purchase agreement to sell the Property on 21 January 2013, and the Property was assigned to the purchaser on 8 April 2013.

28. The Board considers that such short period of ownership supports the inference that the Property was acquired for trading.

(2022-23) VOLUME 37 INLAND REVENUE BOARD OF REVIEW DECISIONS

29. Furthermore, the Board considered that if it were indeed the genuine intention of the Appellants to hold the Property for long-term investments, they should have made more allowance of time seeking for tenants, rather than merely having waited for seven days as per Agency J's records.

30. The disposal of the Property within such short period of time was also contrary to the contention of the Appellants that they acquired the Property for long-term investment. The Appellants also failed to provide any credible (oral or documentary) evidence to support that their stated intention was genuinely held.

**Conclusion**

31. Upon a holistic consideration of the circumstances of the case, and particularly in light of the commonly known badges of trade, we find as a fact that the Appellants had acquired the Property for trading purpose rather than for investment purposes. Further or alternatively, we find that the Appellants have failed to discharge their burden of proof under section 68(4) of the Ordinance to show that the Property was acquired for non trading purposes. For all the above reasons, we make a finding of fact that in all likelihood, that the Property was acquired as a capital asset for short term trading rather than for long term investment purposes.

32. Accordingly, we dismiss this appeal and confirm the 2013/14 Profits Tax Assessment.