

Case No. D8/23

Profits Tax – capital asset – intention at the time of purchase of asset – badges of trade – sections 2(1), 14(1), 33A, 68(4) of the Inland Revenue Ordinance (‘the IRO’).

Panel: Loh Lai Ping Phillis (chairman), Ma Yiu Tim Jimmy and Woo Hing Yip Eric.

Date of hearing: 28 March 2023.

Date of decision: 28 July 2023.

This was the Appeal of Company A (‘Company’) against the Determination of the Ag. Deputy Commissioner of Inland Revenue Department (‘Commissioner’) dated 8 July 2022 (‘Determination’) regarding the Company’s objection to the Profits Tax Assessments for the years of assessment 2015/16 to 2018/19 raised on the Company. The Company supplemented its evidence by the oral testimony of Ms B given at the hearing before this Board.

The Company was incorporated in Hong Kong as a private company and commenced business in 2015. In its Profits Tax returns for the relevant years of assessment 2015/16 to 2018/19, its principal business activities were described to be ‘properties holding and investment’.

On the date of commencement of business in 2015, the Company entered into a preliminary sale and purchase agreement for the bulk purchase of 204 parking spaces at Location V (‘the Parking Spaces’ collectively) at \$126,000,000, including 73 car parking spaces (‘CP Spaces’) and 9 vehicle parking spaces (‘LV Spaces’). To finance the purchase of the Parking Spaces, the Company obtained a 40% loan from Bank X (the “Loan”). Security against the Loan was required by Bank X and executed. The rest of the 60% from shareholders’ loans.

During the years of assessments 2016/17, 2017/18 and 2018/19 (‘the Years of Assessment’), the Company sold gradually by individual re-sale of 73 CP Spaces and 9 LV Spaces (collectively ‘the Sold Parking Spaces’), out of the total of 118 CP Spaces and LV Spaces purchased in November 2015. The total sale price in respect of sale of the above CP and LV Spaces (assignments dates from Jan 2017 to Jan 2019), resulting in a gross surplus above the purchase price of \$126,000,000.

The Assessor did not accept that the gains on disposal of the Sold Parking Spaces were capital in nature. She raised on the Company Profits Tax Assessments for the years of assessment 2015/16 to 2018/19 by adding back commercial building allowance (‘CBA’). The Company objected to the above assessments through its accountants/tax representative (‘Representative’), claiming that the gains on disposal of the Sold Parking Spaces were capital in nature and not chargeable to Profits Tax, and that CBA in respect of the Parking

Spaces should be granted.

Upon consideration of all evidence and documents produced by the Company and the arguments put forward by the Representative, the Commissioner in the Determination confirmed the view of the Assessor that the purchase of the Parking Spaces and sale of the Sold Parking Spaces by the Company amounted to an adventure in the nature of trade. Thus, the gains on disposal/ profits arising therefrom should be chargeable to Profits Tax.

Held:

1. The Company bore the burden of proof in the Appeal. ‘Trading’ requires an intention to trade, and the relevant time should be the intention existed at the time of the acquisition of the asset. The badges of trade are relevant to this Board’s ascertainment of intention. In the case of a limited company such as the present case, the Company’s intention has to be ascertained through its controlling minds (Simmons v IRC [1980] 1 WLR 1196, Brand Dragon Limited v Commissioner of Inland Revenue [2002] 1 HKC 660, Lee Yee Shing v Commissioner of inland Revenue (2008) 11 HKCFAR 6, and Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue (2016) 19 HKCFAR 54 applied).
2. The Board found that Ms B’s evidence of little value and not supportive of the Company shareholders’ alleged intention to purchase and hold the Parking Spaces for long-term investment, nor the unforeseen shareholders’ disagreements arising primarily from the unsatisfactory rental income, which disagreements had allegedly led to the subsequent sale of the Sold Parking Spaces. As the evidence showed, the shareholders’ loans were fully repaid by October 2017 upon sale of some of the Parking Spaces, with surpluses. It would be most unreasonable that the shareholders, all reputable and experienced businessmen, would allow their funds to be locked up interest-free in some long-term investment of no financial viability.
3. Applying the legal principles, the Board found that the evidence gave a neutral indication under some criteria, but collectively the badges of trade indicated a trading intention of the Company at the time of acquisition. (Simmons v IRC [1980] 1 WLR 1196, All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750, 771, Lee Yee Shing v Commissioner of inland Revenue (2008) 11 HKCFAR 6, and Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue (2016) 19 HKCFAR 54 followed).
4. The Board concluded that the Company had an intention to trade rather than to hold long-term as capital assets at the time of acquisition of the Parking Spaces. The profits derived by the Company from the sale of the Sold Parking Spaces should be chargeable to Profits Tax for the Years of

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Assessment. The Appeal was dismissed. The Board confirmed the Profits Tax Assessments for the Years of Assessment set out in 2(1), (2), (3) and (4) of the Determination, and ordered the Appellant/ Company to pay costs of \$20,000.

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

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196
Church Body of Hong Kong Sheng Kung Hui v Commissioner of Inland Revenue (2016) 19 HKCFAR 54
All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750, 771
Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6
Brand Dragon Limited v Commissioner of Inland Revenue [2002] 1 HKC 660
D76/94, IRBRD, vol 9, 394
D11/14, (2014-15) IRBRD, vol 29, 602
Beautiland Company Limited v Commissioner of Inland Revenue [1991] 2 HKLR 511

Prisca Cheung, Counsel, instructed by Messrs Kok & Ha Solicitors, for the Appellant.
Julian Lam, instructed by the Department of Justice, for the Commissioner of Inland Revenue

Decision:

A. Introduction

1. This is the Appeal of Company A (**‘Company’**) against the Determination of the Ag. Deputy Commissioner of Inland Revenue Department (**‘Commissioner’**) dated 8 July 2022 (**‘Determination’**) regarding the Company’s objection to the Profits Tax Assessments for the years of assessment 2015/16 to 2018/19 raised on the Company.
2. The Company claims that the profit gains on disposal of its properties, namely 82 parking spaces, are capital in nature and not chargeable to Profits Tax under the Inland Revenue Ordinance (**‘IRO’**). This is the only issue in this Appeal.
3. This Board held the hearing of this Appeal on 28 March 2023.
4. The Company was represented by Counsel Prisca Cheung.
5. The Commissioner was represented by Counsel Julian Lam.
6. Both referred to documents submitted and correspondence exchanged on the issue before this Board.

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7. The Company has adduced a witness statement dated 21 February 2023 from its Position AA Ms B. Ms B was called to give oral evidence and cross-examined.

B. Facts & Key Events

8. The facts and key events are not disputed and are supported by documentary evidence.

B1. The Company

9. The Company was incorporated in Hong Kong as a private company in May 2015. Its issued share capital was one share of \$1 as at the date of incorporation and was increased to 100 shares of \$1 each on 3 August 2015. At all relevant times, the shareholders of the Company were as follows:

| <u>Shareholders</u> | <u>Number of shares held on</u> | | | | |
|------------------------|---------------------------------|-------------------|-------------------|-------------------|-------------------|
| | <u>12-05-2015</u> | <u>10-06-2015</u> | <u>03-08-2015</u> | <u>21-04-2017</u> | <u>21-02-2018</u> |
| Company C | 1 | - | - | - | - |
| Ms D ¹ | - | 1 | - | - | - |
| Company E | - | - | 30 | 30 | - |
| Company F | - | - | 20 | 20 | - |
| Company G | - | - | 10 | 10 | - |
| Company H | - | - | 10 | 10 | - |
| Mr J | - | - | 10 | 10 | - |
| Mr K | - | - | 10 | 10 | - |
| Mr L ² | - | - | 10 | - | - |
| Mr M | - | - | - | 10 | - |
| Company N ³ | - | - | - | - | 100 |
| | <u>1</u> | <u>1</u> | <u>100</u> | <u>100</u> | <u>100</u> |

10. The Company's directors during the relevant periods were as follows:

| | <u>Date of Appointment</u> | <u>Date of Resignation</u> |
|---------------|----------------------------|----------------------------|
| (i) Company C | 12-05-2015 | 19-05-2015 |
| (ii) Ms T | 12-05-2015 | 19-05-2015 |
| (iii) Ms D | 19-05-2015 | 26-10-2015 |
| (iv) Mr L | 26-10-2015 | 19-04-2017 |
| (v) Mr M | 19-04-2017 | 21-02-2018 |
| (vi) Ms U | 21-02-2018 | - |

¹ Companies Registry records show that Ms D resided in City P, Province Q, China and she was not a Hong Kong Identity Card ('HKID') holder.

² Companies Registry records show that Mr L resided in District R, Province S, China, and he was not a HKID holder.

³ Mr M was a 99% shareholder of Company N.

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11. The Company commenced business in 2015. In its Profits Tax returns for the relevant years of assessment 2015/16 to 2018/19, its principal business activities were described to be ‘properties holding and investment’.

B2. The Purchase/ Financing

12. On the date of commencement of business in 2015, the Company entered into a preliminary sale and purchase agreement for the bulk purchase of 204 parking spaces at Location V (**‘the Parking Spaces’** collectively) at \$126,000,000. The agreement for sub-sale and purchase was executed on August 2015 and the assignment was completed on 30 November 2015.

13. The purchase price was to be paid in the following manner:

| <u>Date</u> | | <u>\$</u> |
|------------------|---------------------------|--------------------|
| XX July 2015 | Preliminary deposit | 12,600,000 |
| X August 2015 | Balance of deposit | 12,600,000 |
| 30 November 2015 | Balance of purchase price | <u>100,800,000</u> |
| | | <u>126,000,000</u> |

14. The Parking Spaces comprise the following at locations of:

- (i) 103 car parking spaces (**‘CP Spaces’**) - Nos. 1 to 67 in the Basement and Nos. 1 to 36 in Level 2;
- (ii) 15 large vehicle parking spaces (**‘LV Spaces’**) - A to H, J to N, P and Q in the Basement; and
- (iii) 86 bicycle parking spaces (**‘Bicycle Spaces’**) - Nos. 1 to 86 in the Basement.

15. The Company purchased the 118 CP Spaces and LV Spaces with an existing licence agreement of a term of 2 years from 1 September 2014 to 31 August 2016. The licensee or car park operator was Company W. The annual rent was \$3,930,000 or 72% of annual gross revenue, whichever was the greater, payable every month.

16. Total cost of purchase of the Parking Spaces was \$137,086,662 as follows:

| | <u>\$</u> |
|----------------|--------------------|
| Purchase price | 126,000,000 |
| Stamp duty | 10,710,000 |
| Legal fee | <u>376,662</u> |
| | <u>137,086,662</u> |

17. To finance the purchase of the Parking Spaces, the Company obtained a 40% loan of \$50,400,000 from Bank X. Interest was charged at 1-month HIBOR plus 2% per annum. The loan was to be repaid by 59 equal monthly instalments of \$280,000 each

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commencing one month after drawdown plus a final instalment of \$33,880,000.

18. The following security against the Loan was required by Bank X and executed:

- (i) An 'All Monies' legal charge over the Parking Spaces; and
- (ii) A guarantee limited to \$50,400,000 (together with default interest and other costs and expenses) provided by Mr M.

B3. Change of Licensee/Car Park Operator

19. About 6 months after completion of purchase of the Parking Spaces, the Company issued to Company W a written notice of termination dated 1 May 2016 effective on 31 August 2016 (ie the original termination date as provided in the licence agreement).

20. The Company then entered into a new licence agreement dated 1 September 2016 and licence the CP Spaces and LV Spaces to another car park operator Company Y for a term of 2 years from 1 September 2016 to 31 August 2018. The annual rent was the same as that provided in the previous licence agreement with Company W, ie \$3,930,000 or 72% of annual gross revenue, whichever was the greater, payable every month.

B4. The Sale

21. Commencing from October 2016 (dates of the first preliminary sale agreements) and during the years of assessments 2016/17, 2017/18 and 2018/19, the Company sold gradually by individual re-sale of 73 CP Spaces and 9 LV Spaces (out of the total of 118 CP Spaces and LV Spaces purchased in November 2015). The assignments dates were from 17 February 2017 to 21 January 2019. Total sales are as follows:

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| Year of assessment | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|--|--|--|--|
| Total consideration | \$109,210,000 | \$13,680,000 | \$19,640,000 |
| No. of parking spaces sold | 63 (‘the 1st Lot’) | 8 (‘the 2nd Lot’) | 11 (‘the 3rd Lot’) |
| No. of parking spaces sold subject to licence back arrangement | 60 | 8 | 5 |
| Location of CP Spaces sold | (a) 56 CP Spaces in the Basement (Nos. 2-11, 15, 21-23, 36, 40, 49, 52, 60, 63-65) and Level 2 (Nos. 2, 3, 5-36) | (a) 7 CP Spaces in the Basement (Nos. 12, 13, 24, 25, 44, 47 and 61) | (a) 10 CP Spaces in the Basement (Nos. 18, 28, 37, 38, 46, 57-59 and 62) and Level 2 (No. 4) |
| Location of LV Spaces sold | (b) 7 LV Spaces in the Basement (B, C, K, L, M, N and P) | (b) 1 LV Space in the Basement (F) | (b) 1 LV Space in the Basement (D) |

22. Details of the sale of the 82 CP Spaces and LV Spaces sold in the 1st Lot, the 2nd Lot and the 3rd Lot (collectively **‘the Sold Parking Spaces’**) including the dates, prices and payments are summarised respectively in 3 tables attached to the Determination.

23. The total sale price in respect of sale of the 1st Lot, the 2nd Lot and the 3rd Lot (assignments dates from Jan 2017 to Jan 2019) amounted to \$142,530,000, ie resulting in a gross surplus of \$16,530,000 above the purchase price of \$126,000,000.

24. After the gradual sale of more parking spaces, the Company renewed the licence agreement with Company Y on 1 February 2018, for a term of 2 years up to 31 January 2020 at a much reduced monthly licence fee of \$200,000.

25. Later by a supplemental licence agreement dated 1 January 2019 made between the same parties, the monthly licence fee was further reduced to \$153,191 with effect therefrom.

26. The rental income derived from the CP Spaces and LV Spaces held by the Company since purchase completed on 30 November 2015 for the years of assessment 2015/16 to 2018/19, as shown in the Company’s detailed income statements, was as follows:

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| <u>2015/16</u> | | <u>2016/17</u> | | <u>2017/18</u> | | <u>2018/19</u> | |
|----------------|---------------------|----------------|---------------------|----------------|---------------------|----------------|---------------------|
| \$ | | \$ | | \$ | | \$ | |
| | Apr-16 | 387,540.00 | Apr-17 | 352,940.00 | Apr-18 | 200,000.00 | |
| | May-16 | 386,444.88 | May-17 | 335,040.00 | May-18 | 200,000.00 | |
| | Jun-16 | 410,263.92 | Jun-17 | 357,180.00 | Jun-18 | 200,000.00 | |
| | Jul-16 | 424,113.84 | Jul-17 | 386,662.00 | Jul-18 | 200,000.00 | |
| | Aug-16 | 394,086.24 | Aug-17 | 381,137.00 | Aug-18 | 200,000.00 | |
| | Sep-16 | 425,285.00 | Sep-17 | 385,591.00 | Sep-18 | 200,000.00 | |
| | Oct-16 | 409,996.00 | Oct-17 | 394,346.00 | Oct-18 | 200,000.00 | |
| | Nov-16 | 290,000.00 | Nov-17 | 376,290.00 | Nov-18 | 200,000.00 | |
| Dec-15 | 406,572.48 | Dec-16 | 402,671.00 | Dec-17 | 388,378.00 | Dec-18 | 200,000.00 |
| Jan-16 | 424,574.64 | Jan-17 | 375,043.00 | Jan-18 | 300,430.00 | Jan-19 | 153,191.00 |
| Feb-16 | 378,438.48 | Feb-17 | 351,517.00 | Feb-18 | 200,000.00 | Feb-19 | 153,191.00 |
| Mar-16 | <u>386,722.08</u> | Mar-17 | <u>353,865.00</u> | Mar-18 | <u>200,000.00</u> | Mar-19 | <u>153,192.00</u> |
| | <u>1,596,307.68</u> | | <u>4,610,825.88</u> | | <u>4,057,994.00</u> | | <u>2,259,574.00</u> |

B5. The Profits Tax Returns/ The Determination

27. The Company reported the following assessable profits or adjusted losses in the Profits Tax computations for the years of assessment 2015/16 to 2018/19 in its audited reports and financial statements:

| <u>Year of assessment</u> | <u>2015/16</u> | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|-------------------------------|--------------------|--------------------|--------------------|--------------------|
| | \$ | \$ | \$ | \$ |
| Assessable Profits / | | | | |
| (Adjusted Loss) | <u>(2,063,922)</u> | 2,407,456 | <u>(2,415,638)</u> | 1,117,556 |
| <u>Less: Loss set-off</u> | | <u>(2,063,922)</u> | | <u>(1,117,556)</u> |
| Net Assessable Profits | | <u>343,534</u> | | <u>-</u> |
| <u>Statement of loss</u> | | | | |
| Loss b/f | - | 2,063,922 | - | 2,415,638 |
| <u>Add: Loss for the year</u> | <u>2,063,922</u> | - | <u>2,415,638</u> | - |
| <u>Less: Loss set-off</u> | <u>-</u> | <u>(2,063,922)</u> | <u>-</u> | <u>(1,117,556)</u> |
| Loss c/f | <u>2,063,922</u> | <u>-</u> | <u>2,415,638</u> | <u>1,298,082</u> |

28. In arriving at the assessable profits or adjusted losses in paragraph 27 above, the Company deducted or added, among other things, the following items:

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| <u>Year of assessment</u> | <u>2015/16</u> | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|---|----------------|----------------|----------------|----------------|
| | \$ | \$ | \$ | \$ |
| <i>After deducting:</i> | | | | |
| Gains on disposal of parking spaces | - | 34,895,834 | 4,368,029 | 7,357,479 |
| Commercial Building Allowance ('CBA') | 3,010,777 | 1,449,633 | 1,248,915 | 981,290 |
| Sales of parking spaces – deposit forfeited | - | 150,500 | - | - |
| <i>After adding back:</i> | | | | |
| Depreciation | 4,422,150 | 2,129,184 | 1,834,373 | 1,441,294 |
| Balancing charge | - | 1,561,144 | 401,437 | 802,874 |

29. The gains on disposal of the 1st Lot, the 2nd Lot and the 3rd Lot (sold respectively in 2016/17, 2017/18 and 2018/19) was computed as follows:

| <u>Year of assessment</u> | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|--------------------------------------|--------------------------|-------------------------|-------------------------|
| | \$ | \$ | \$ |
| Sales proceeds (Total consideration) | 109,210,000 | 13,680,000 | 19,640,000 |
| <u>Less: Cost ^(Note)</u> | <u>71,081,973</u> | <u>9,139,111</u> | <u>12,185,481</u> |
| Accumulated depreciation | (2,292,967) | (589,620) | (1,179,240) |
| Direct cost | | | |
| -Commission and bonus | 4,650,000 | 620,000 | 1,060,000 |
| -Legal fee | <u>875,160</u> | <u>142,480</u> | <u>216,280</u> |
| Gain on disposal | <u><u>34,895,834</u></u> | <u><u>4,368,029</u></u> | <u><u>7,357,479</u></u> |

Note

The total cost of purchase of the Parking Spaces of \$137,086,662 (paragraph 16 above) was allocated to each parking space as follows:

| | Number of parking space | Allocated basis | Individual cost allocated to each parking space |
|---------------|-------------------------|-----------------|---|
| | | | \$ |
| CP Space | 103 | 103 | 1,015,456.76 |
| LV Space | 15 | 30 | 2,030,913.51 |
| Bicycle Space | <u>86</u> | <u>2</u> | <u>23,615.27</u> |
| | <u>204</u> | <u>135</u> | |

The purchase costs of the 1st Lot, the 2nd Lot and the 3rd Lot of the Sold Parking Spaces (respectively in 2016/17, 2017/18 and 2018/19), with reference to the numbers of CP Spaces and LV Spaces, were therefore calculated respectively as follows:

- (i) the 1st Lot:
 $\$1,015,456.76 \times 56 + \$2,030,913.51 \times 7 = \$71,081,973$
- (ii) the 2nd Lot:
 $\$1,015,456.76 \times 7 + \$2,030,913.51 \times 1 = \$9,139,111$
- (iii) the 3rd Lot:
 $\$1,015,456.76 \times 10 + \$2,030,913.51 \times 1 = \$12,185,481$

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30. The balance sheets of the Company as at 31 March 2016 to 2019 showed, among others, the following particulars:

| As at | 31-03-2016 | 31-03-2017 | 31-03-2018 | 31-03-2019 |
|---|--------------------|-------------------|-------------------|-------------------|
| | \$ | \$ | \$ | \$ |
| Non-current assets | | | | |
| Property, plant and equipment | 132,664,512 | 61,746,322 | 51,362,458 | 38,914,923 |
| Current assets | | | | |
| Accounts receivables | 59,222 | 353,865 | 200,000 | 59,574 |
| Other receivables | - | 727,500 | 10,328,591 | 6,277,707 |
| Due from a related company / shareholder | - | 3,620,634 | - | 18,505,083 |
| Tax recoverable | - | - | 521,445 | 521,445 |
| Cash and bank balances | <u>3,035,506</u> | <u>3,254,963</u> | <u>2,608,138</u> | <u>419,257</u> |
| | 3,094,728 | 7,956,962 | 13,658,174 | 25,783,066 |
| Current liabilities | | | | |
| Deposit received, accruals and other payables | 677,000 | 1,672,443 | 7,115,450 | 6,465,800 |
| Due to shareholders ⁴ | 80,122,750 | 21,533,957 | 18,381,802 | 18,379,552 |
| Due to a related company ⁴ | 9,160,568 | 200,000 | - | - |
| Interest-bearing bank borrowings | <u>49,280,000</u> | <u>14,621,900</u> | <u>6,882,900</u> | <u>-</u> |
| | 139,240,318 | 38,028,300 | 32,380,152 | 24,845,352 |
| Net Current Assets / (Liabilities) | (136,145,590) | (30,071,338) | (18,721,978) | 937,714 |
| Net Assets / (Liabilities) | <u>(3,481,078)</u> | <u>31,674,984</u> | <u>32,640,480</u> | <u>39,852,637</u> |
| Represented by | | | | |
| Equity | | | | |
| Share capital | 100 | 100 | 100 | 100 |
| Retained earnings | <u>(3,481,178)</u> | <u>31,674,884</u> | <u>32,640,380</u> | <u>39,852,537</u> |
| | <u>(3,481,078)</u> | <u>31,674,984</u> | <u>32,640,480</u> | <u>39,852,637</u> |

31. The Assessor did not accept that the gains on disposal of the Sold Parking Spaces were capital in nature. She raised on the Company Profits Tax Assessments for the years of assessment 2015/16 to 2018/19 as follows:

⁴ The amounts due to shareholders / related company were unsecured, interest-free and had no fixed terms of repayment.

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| <u>Year of assessment</u> | <u>2015/16</u> | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|---|------------------|-------------------|------------------|------------------|
| | \$ | \$ | \$ | \$ |
| Profit/(Loss) per return (paragraph 27 above) | (2,063,922) | 2,407,456 | (2,415,638) | 1,117,556 |
| <u>Add: CBA (paragraph 28 above)</u> | <u>3,010,777</u> | <u>1,449,633</u> | <u>1,248,915</u> | <u>981,290</u> |
| Deposit forfeited (paragraph 28 above) | - | 150,500 | - | - |
| Gain on disposal of parking spaces (paragraph 29 above) | - | 34,895,834 | 4,368,029 | 7,357,479 |
| | 946,855 | 38,903,423 | 3,201,306 | 9,456,325 |
| <u>Less: Balancing charge reversed (paragraph 28 above)</u> | <u>-</u> | <u>1,561,144</u> | <u>401,437</u> | <u>802,874</u> |
| Assessable Profits | <u>946,855</u> | <u>37,342,279</u> | <u>2,799,869</u> | <u>8,653,451</u> |
| Tax Payable thereon | <u>136,231</u> | <u>6,141,476</u> | <u>431,978</u> | <u>1,407,819</u> |

32. The Company objected to the above assessments through its accountants/tax representative Vision A. S. Limited (**‘Vision’**), claiming that the gains on disposal of the Sold Parking Spaces were capital in nature and not chargeable to Profits Tax, and that CBA in respect of the Parking Spaces should be granted.

33. Upon consideration of all evidence and documents produced by the Company and the arguments put forward by the Representative, the Commissioner in the Determination confirmed the view of the Assessor that the purchase of the Parking Spaces and sale of the Sold Parking Spaces by the Company amounted to an adventure in the nature of trade. Thus, the gains on disposal/ profits arising therefrom should be chargeable to Profits Tax.

34. Upon the conclusion that the Parking Spaces were the Company’s trading assets, it did not incur any capital expenditure in respect of the Parking Spaces. Hence it was further held that no CBA should be allowed under Section 33A of the IRO.

35. On the other hand, accumulated depreciation should be included and added back to the costs of the Sold Parking Spaces.

36. Regarding costs incurred and paid for the purchase, the Company has adduced evidence of schedules, debit notes and invoices issued by property agents in support of its claim for deduction of commission and bonus expenses in the total sum of \$4,650,000 paid to property agents for the year of assessment 2016/17 (paragraph 29 above). It was noted that of the expenses claimed, cash bonuses in the total sum of \$510,000 were not supported by documentary evidence. Deduction of that sum as part of the costs of purchase was thus not allowed.

37. Following from the above, computation for Profits Tax Assessment for the years of assessment 2016/17, 2017/18 and 2018/19 was revised as follows:

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| <u>Year of assessment</u> | <u>2016/17</u> | <u>2017/18</u> | <u>2018/19</u> |
|--|-------------------|------------------|------------------|
| | \$ | \$ | \$ |
| Profits previously assessed (paragraph 31 above) | 37,342,279 | 2,799,869 | 8,653,451 |
| <u>Add:</u> Cash bonus (paragraph 36 above) | 510,000 | - | - |
| <u>Less:</u> Accumulated depreciation (paragraph 35 above) | <u>2,292,967</u> | <u>589,620</u> | <u>1,179,240</u> |
| Revised Assessable Profits | <u>35,559,312</u> | <u>2,210,249</u> | <u>7,474,211</u> |
| Tax Payable thereon | <u>5,847,286</u> | <u>334,691</u> | <u>1,213,244</u> |

38. It was thus held in the Determination the following:

- (1) Profits Tax Assessment for the year of assessment 2015/16, showing Assessable Profits of \$946,855 with Tax Payable thereon of \$136,231 was confirmed; and
- (2) Assessable Profits for the years of assessment 2016/17, 2017/18 and 2018/19 were reduced as follows:

| | <u>Assessable Profits</u> | <u>Tax Payable thereon</u> |
|---------|---------------------------|----------------------------|
| 2016/17 | \$35,559,312 | \$5,847,286 |
| 2017/18 | \$2,210,249 | \$334,691 |
| 2018/19 | \$7,474,211 | \$1,213,244 |

C. The Grounds of Appeal

39. In its Notice and Statement of Grounds of Appeal dated 4 August 2022, the Company raised the following grounds of appeal against the Commissioner's conclusion made in Determination rejecting the stated intention of the Company to acquire the Parking Spaces as long-term investment for rental income, in that the Commissioner erred in holding:

- (1) that 'the quick sale is a pointer towards trading';
- (2) that there are 'serious doubts over the reliability of the Company's written resolution as a contemporaneous document to support the Company's stated intention' ;
- (3) that the inconsistency in the Company's statements regarding the change of car park operator/ licensee has raised serious doubts about the Company's alleged reasons for selling the properties ;
- (4) that 'the issues relating to the return on rental income and renovation' were not issues that concerned the Company; and

- (5) that the Company did not have ‘the financial capability to hold the Parking Spaces as its long-term investment’.

40. The Company no longer takes issue on the (i) grant of CBA and (ii) deductibility of cash bonuses totalling \$510,000 allegedly paid to the property agents upon acquiring the Parking Spaces.

D. Relevant Legal Principles/ Case Authorities

41. The following provisions in the IRO govern the only issue of this Appeal, ie Whether the profits derived by the Company from the sale of the Sold Parking Spaces should be chargeable to Profits Tax for the years of assessment 2016/17 to 2018/19:

Section 14(1) provides:

‘...profits tax shall be charged for each year of assessment on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets)...’

Section 2(1) defines ‘trade’ as including ‘every trade and manufacture, and every adventure and concern in the nature of trade’.

Section 68(4) provides that ‘the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant’.

42. It is pertinent to bear in mind that in an appeal before this Board, the appellant taxpayer has the burden of proof throughout, and the Commissioner does not have the burden of proving anything.

43. This Board has considered the following case authorities referred to by both parties in their submissions, and the principles stated therein relevant to this Appeal.

44. It is trite that ‘trading’ requires an intention to trade, and the relevant time should be the intention existed at the time of the acquisition of the asset (per Lord Wilberforce in Simmons v IRC [1980] 1 WLR 1196, 119A-D) (‘Simmons’).

45. The Company in this Appeal argues that as opposed to ‘trading’, it had at the time of purchase an intention to acquire the Parking Spaces ‘as capital assets’. The burden of proof lies on the Company.

46. The relevant principles are well-established, as summarised by Fok PJ in Church Body of Hong Kong Sheng Kung Hui v CIR (2016) 19 HKCFAR 54 (‘Church Body’) at paragraphs 43-52 as follows:

- (1) The material issue of fact is whether the taxpayer was carrying on a trade or business when they made the profits sought to be taxed, or whether those profits arose from the sale of a capital asset. This is a question of fact and degree to be answered by the relevant fact-finding body on a consideration of all the circumstances (paragraphs 44-45).
- (2) An intention to trade is essential. The relevant time to consider intention is when the relevant asset is sold, but unless it is contended that there was a change in intention, normally the question to be asked is whether the intention to trade existed at the time of the acquisition of the asset (paragraphs 46-47, citing Simmons at 1199A-D).
- (3) The disposal of land may or may not be in the nature of trade. A landowner may dispose of his land at a higher price than that for which he acquired it and not be liable for profits tax on the gain, since his gain is ‘a mere enhancement of value’ which may simply be the result of market forces. Equally he may act in relation to the sale of his land in such a way that he will be found to have disposed of it in the course of a trade or business, even if the disposal is a one-off transaction (paragraphs 48-49).
- (4) Upon considering all the circumstances, the fact-finding tribunal will have to make a ‘value judgment’ as to whether this constitutes trading and whether the requisite intention to trade can be inferred (paragraph 50).
- (5) Regardless of what is claimed to be the intention subjectively, the question falls to be determined objectively having regard to all the surrounding circumstances (paragraph 50), citing the *dictum* per Mortimer J in All Best Wishes Ltd v CIR (1992) 3 HKTC 750, 771 (‘All Best Wishes’) as follows:

‘...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.’
- (6) For the purpose of ascertaining ‘the intention’, various factors have been identified as constituting ‘badges of trade’, the presence or absence of which may assist in the ultimate determination of whether there is an intention to trade or the carrying on of a trade – these have been listed in Lee Yee Shing v CIR (2008) 11 HKCFAR 6 (‘Lee Yee

Shing’) at paragraph 60 *per* McHugh NPJ. However, the badges of trade are in no sense a comprehensive list of factors. Their purpose is to identify the facts and matters to which a fact-finding tribunal will look holistically in order to determine if the inference of an intention to trade is or is not to be drawn (paragraphs 51-52).

47. Relevant to this Board’s ascertainment of intention, the badges of trade identified by McHugh NPJ in Lee Yee Shing, referred to by both parties in their submissions, are listed as follows:

- (1) Whether the taxpayer has frequently engaged in similar transactions;
- (2) Whether the taxpayer has held the asset or commodity for a lengthy period;
- (3) Whether the taxpayer has acquired an asset or commodity that is normally the subject of trading rather than investment;
- (4) Whether the taxpayer has bought large quantities or numbers of the commodity or asset;
- (5) Whether the taxpayer has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition;
- (6) Whether the taxpayer has sought to add re-sale value to the asset by additions or repair;
- (7) Whether the taxpayer has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class;
- (8) Whether the taxpayer had conceded an actual intention to resell at a profit when the asset or commodity was acquired;
- (9) Whether the taxpayer had purchased the asset or commodity for personal use or pleasure or for income; and
- (10) Source of finance:

48. In the case of a limited company such as the present case, the Company’s intention has to be ascertained through its controlling minds as established in Brand Dragon Limited v CIR [2002] 1 HKC 660 (‘Brand Dragon’) at paragraph 18, *per* Chu J (as she then was).

49. Bearing the applicable legal principles in mind, we turn to the particular facts of this case/ evidence adduced by the Company relevant to this Appeal.

E. Failure to Call Witnesses

50. Much has been said by the Commissioner in criticising the failure of the Company to call any of its shareholders or directors, ie its controlling minds, to give evidence to establish the relevant intention at the time of acquisition of the Parking Spaces.

51. The Commissioner invites this Board to draw adverse inferences from the Company's failure to call key witnesses, in particular (i) Mr M who took a leading role in the discussion and agreement with the other shareholders in the purchase/ alleged joint capital investment, and became the ultimate 99% shareholder of the Company since February 2018 through his holding of Company N; (ii) Ms D, the sole director and shareholder of the Company at the time of purchase of the Parking Spaces, who agreed to use it as a property holding vehicle for the purchase and signed a Resolution dated 27 July 2015 (**'the July 2015 Resolution'**) purportedly recording the intention of the Company at the time of the acquisition of the Parking Spaces; and (iii) Mr L who later became the Company's sole director and signed the relevant board resolutions dated 2 October 2016 (**'the October 2016 Resolution'**) and 1 February 2017 (**'the February 2017 Resolution'**) authorising the subsequent sale.

52. In the present case in which the Commissioner has not called evidence in challenge of the Company's evidence or to establish a positive case, we do not consider it appropriate nor necessary for this Board to draw adverse inferences against the Company as proposed by the Commissioner. The crucial evidential question remains, on the whole of the evidence, whether the Company has sufficiently discharged its burden of proof in establishing the alleged intention of long-term holding or capital investment at the time of the acquisition of the Parking Spaces.

F. The Appellant's Evidence/Arguments

53. Upon enquiries by the Assessor, the Company and its tax representative Vision provided information in documents and correspondence.

54. The Company supplemented its evidence by the oral testimony of Ms B given at the hearing before this Board.

F1. Contemporaneous Documents

55. The Company relies on a Feasibility Study Report dated 24 July 2015 (**'Report'**) prepared upon a study conducted by Mr M, an experienced property investor in Hong Kong and the brother of Mr L, in support of its intention to purchase and hold the Parking Spaces as capital assets at the time of acquisition.

56. The Report was signed by Mr M, recommending purchase of the 204 Parking Spaces for long-term investment. It states *inter alia* that:

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- (1) The Parking Spaces are located in a good location of scarce parking spaces and great demand for parking by vehicles;
- (2) The asking price of the Parking Spaces were relatively low as they were being offered in a bulk;
- (3) The current transaction price of a carparking space in District Z has reached \$1,300,000. In comparison, the average price of the lot of carparking spaces (offered in bulk) appears to be very low;
- (4) The current basic rent (\$3,930,000) yields, on the purchase price of \$126,000,000, a 3.12% annual return which was '*a rather good return*' (「相當不俗的回報」). The current annual rent was still on the low side, and should be potential for increased yield after renovation; and
- (5) On a bank loan of \$50,400,000 for 5 years at current interest rate of 2.2% per annum, monthly mortgage payment including interest would be \$371,000. In other words, the monthly rent receivable at \$327,500 (\$3,930,000/12) would be almost sufficient to cover the mortgage instalment repayment.

57. The shareholders agreed to purchase the Parking Spaces in the name of the Company which Ms D had already incorporated in 2015. Ms D the then sole director and shareholder of the Company executed the July 2015 Resolution, stating that the Company agrees to purchase the Parking Spaces for '*long term investment purpose... subject to an existing Licence in favour of Company W operating a public fee paying car parking lot.*'

58. It is noted in the evidence that a cheque dated 23 July 2015 for the sum of \$12,600,000 ('**the 23 July Cheque**'), confirmed by the Company to be payment of the 10% preliminary deposit to fund the purchase of the Parking Spaces, was prepared for the purchase agreed and signed on 27 July 2015. The 23 July Cheque was dated a day prior to the date of the Report.

59. Vision by its letter dated 31 January 2019 states that the date of the 23 July Cheque was '*only a clerical error*' without explaining the circumstances under which nor the actual date it was drawn.

F2. Financial Viability as a Long-Term Investment/ Financial Capability of the Shareholders

60. The purchase was funded by the Bank X loan of \$50,400,000 (40%) and the rest of the 60% (\$75,600,000) from shareholders' loans.

61. As confirmed by Vision, the shareholders' loans were granted informally without loan agreements, and there was no written record or correspondence regarding the provision of the loans.

62. It was orally agreed between all shareholders that the shareholders' loans would be interest free, unsecured and without fixed terms of repayment.

63. The Company argues that the purchase and long-term holding of the Parking Spaces was financially viable as the aggregate monthly payment to Bank X was \$280,000/month (by 59 monthly instalments and a final payment of \$33,880,000). As such the income from the licence fee of the Parking Spaces (at \$327,500 per month based on an annual base rent of \$3,930,000) was more than sufficient to cover the bank loan, and with a monthly surplus every month. This expected monthly surplus rendered the Parking Spaces a viable long-term investment.

64. As to the financial capability of the shareholders, they are all reputable and substantial businessmen, as evidenced by the upfront payment of 60% of the purchase price by way of substantial shareholders' loans. There is no question on their financial capability. The brothers Mr M and Mr L were well-acquainted with the other shareholders, hence the casual oral agreement and arrangements of the shareholders' loans.

65. The Company argues that it had the financial ability to hold the Parking Spaces as long-term investment.

F3. Unforeseen Shareholders' Disagreements

66. The Company's case is that shortly after purchase of the Parking Spaces, various shareholder disagreements arose in the following circumstances which led to the subsequent sale of the Sold Parking Spaces :

- (1) After purchase of the Parking Spaces, certain shareholders were dissatisfied with the low rental income and the unsatisfactory performance of Company W in not putting in enough effort to promote the Parking Spaces to boost up licence fee income. One of the shareholders proposed that the Company should deal with the leasing directly with end users, but the management of the Company considered that it did not have the manpower and experience to do so.
- (2) In the premises, the Company terminated the original licence with Company W on 31 August 2016 and entered into a new licence agreement with Company Y dated 1 September 2016 (at the same annual licence fee was \$3,930,000 or 72% of annual gross revenue, whichever was the greater, payable every month).
- (3) Company Y had proposed certain programmes to boost the revenue, which involved renovation of the whole car park. Some shareholders disagreed with the scale and the price of the proposed renovation, and indicated their intention to sell their shares in the Company (which they eventually did in February 2018).

67. Thus, in order to resolve the complaints of some of the shareholders and for the best commercial interest of the Company, it was resolved to sell certain parking spaces. On 2 October 2016, Mr L as the sole director executed the October 2016 Resolution, which recorded (i) some shareholders' complaint on the unsatisfactory income from the existing licence of the Parking Spaces; (ii) the lack of manpower and experience of the Company taking over management and direct leasing of the Parking Spaces; and (iii) the resolution to terminate the existing licence arrangement and begin to sell the Parking Spaces.

68. On 1 February 2017, Mr L executed the February 2017 Resolution, stating the Company's resolution to sell further the Parking Spaces in order to reduce the mortgage loan gearing ratio of the Company and to combat the commercial risks of an imminent global trend of rising interest rates.

F4. Nil Effort/Cost in Selling the Parking Spaces/ Unsolicited Offer

69. The Company argues that its conduct of not taking active steps to market or put the Parking Spaces on sale was entirely inconsistent with that of a trader. Despite the Company's decision to sell pursuant to the October 2016 Resolution and the February 2017 Resolution, it had never expended any time, money or effort in selling the Parking Spaces. It had not specified any parking spaces for sale but had simply indicated that all were available. All sales were solicited by the property agents.

70. The Company relies on cases of D76/94 IRBRD Vol. 9, 934 (14-3-1995) and D11/14 IRBRD Vol. 29, 602 (11-7-2014) to argue that its initial intention was to hold the Parking Spaces as capital assets even though some of them were later disposed of upon the unsolicited good offers. It also relies on the judgment of Beautiland Company Limited v CIR [1991] 2 HKLR 511, where the Privy Council found that shares were acquired by Beautiland as part of its capital structure. The company sold the shares because of the appearance of a fortuitous offer at a very good price. The acquisition and disposal of the shares was held not an adventure in the nature of trade.

71. It also argues that the overall pattern of sale in an orderly and systematic manner (ie after the first sale in 2016/17, the sale in 2017/18 and 2018/19 were significantly scaled down) is distinctively different from that of a speculator who trades in properties would seize the opportunity to sell all in one go. Also, the 86 bicycle parking spaces were never made available for sale.

F5. Continuous Holding of Unsold Spaces

72. After the sale of some parking spaces, the Company had renewed its licence agreements with Company Y on 1 February 2018 and 1 January 2019 (at progressively reduced licence fees). The Company argues that the renewal supports its intention at the time of acquisition to hold the Parking Spaces for long-term investment and for generating rental income, and the sale of the Sold Parking Spaces was due to unforeseen circumstances.

73. The Company also argues that its intention of acquiring the Parking Spaces as long-term investment or capital assets is supported by the fact that it is to this date still

holding onto 112 out of the originally purchased 204 Parking Spaces.

F6. Ms B's Evidence

74. Ms B states in her witness statement dated 21 February 2023 that she is the Position AA of the Company.

75. She clarified in her testimony given at the hearing that her employer is in fact Company AB which has 4 employees including herself. The Company was on the other hand a property holding company which has no employee.

76. In relation to this Appeal, she was responsible for overseeing and handling the transactions of purchase of the Parking Spaces and the sale of the Sold Parking Spaces, and preparing related documents and keeping records for the Company.

77. In her witness statement and testimony given at the hearing, Ms B claims to have knowledge of the agreement and intention of the shareholders in purchasing and holding the Parking Spaces for long-term investment. She basically confirms all the facts stated in the Notice of Appeal.

78. Her evidence is that she did not know any of the shareholders personally, other than Mr M and Mr L, both being her bosses. She worked closely with Mr M, and obtained most of the information through Mr M regarding the shareholders' intention of holding the Parking Spaces for long-term investment and later disagreements leading to the sale of the Sold Parking Spaces. She obtained the information when Mr M mentioned such matters to her, when she overheard his conversations with the shareholders over the phone, and when she chatted on the phone with the office people or secretaries of some of the shareholders. She insisted time and again that she knew the shareholders' direction of thinking and was certain of their intention to purchase and hold the Parking Spaces for long-term investment at the time of acquisition.

79. She did not have any personal knowledge of the preparation of the 23 July Cheque or the signing of the preliminary sale and purchase agreement on 27 July 2015, she not being present at the signing. On re-examination, she added that as the market conditions were changing fast, the Company had to prepare the 23 July Cheque in advance pending the shareholders' agreement to purchase (and before preparation of the Report). This way they could get everything ready and proceed with purchase quickly once decision was made.

80. In relation to the 3 Resolutions executed by the Company (ie the July 2015 Resolution, the October 2016 Resolution and the February 2017 Resolution) authorising the purchase and subsequent re-sale, Ms B's evidence is that she had simply typed them up upon the instructions of Mr M. She passed the Resolutions to the accountants after typing.

81. She agrees that there was no meeting of the shareholders regarding the purchase or sale of the Parking Spaces. She was instructed by Mr M to prepare the documents including the July 2015, October 2016 and February 2017 Resolutions for signing. She heard from Mr M that the shareholders had reached oral agreements on the

purchase and the subsequent re-sale.

82. In relation to the Report relied upon by the Company to show the intention of the shareholders to purchase and hold the Parking Spaces for long-term investment, Ms B's evidence is that on the morning of 24 July 2015 (the date of the Report), Mr M dictated the contents of the Report for her to type up. She did not take part in the site visit which she knew or was told by Mr M that the latter had conducted alone a few days earlier. She then made copies of the typed Report and arranged on the same day for messengers to deliver them by hand to the shareholders' offices.

83. When asked whether the shareholders had decided upon the purchase based on the contents of the Report, Ms B replied that she did not know, but added that she believed their decision had not been based on the Report only.

84. When cross-examined on the different circumstances under which the Report was said to have been given personally to some of the shareholders at a social dinner gathering per Vision's letter, Ms B simply affirmed Vision's reply, but added that she had arranged delivery by messengers to some of the shareholders' offices. When Mr M's immigration record (showing his absence from Hong Kong during the relevant period indicating the impossibility for him to have given the Report to some shareholders at a social dinner gathering) was put to her, Ms B had a long pause and did not give any answer.

85. Questions were put to Ms B why disagreements had arisen after purchase of the Parking Spaces among the shareholders regarding '*unsatisfactory*' rental income, when the evidence (paragraph 26 above) shows that in fact the Company received every month rental income in excess of the monthly base rent of \$327,500, totalling in excess of \$4.8 million during the 12 months (December 2015 to November 2016) after purchase. This is much higher than the annual base rent of \$3,930,000 stated in the Report which was already described to be '*a rather good return*' when Mr M recommended bulk purchase of the Parking Spaces to the shareholders.

86. Ms B did not explain why the rental income actually received, at sums higher than the stated yield based on the guaranteed base rent in the Report, had suddenly become '*unsatisfactory*', when it was described to be '*a rather good return*' in the Report. She simply stuck to the Company's case that some shareholders were dissatisfied, as she had heard from Mr M, adding that some shareholders had expected that they could earn much higher income in practice.

87. Ms B was cross-examined on the shareholders' decision not to use the sale proceeds to repay the Bank X loan in full but repay all shareholders' loans upon sale of the 1st Lot and the 2nd Lot. This the Commissioner challenges to be inconsistent with Vision's statement that the shareholders had declared they would financially support the Company and would not demand repayment until it was in sound financial position to do so. The Commissioner also challenges that Ms B did not know the reasons behind the repayment decision, nor the shareholders' discussions on the same.

88. The Commissioner also queries that the Company's alleged concerns of the

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high gearing ratio and interest rates exposure risks were not genuine nor were the reasons for the sale.

89. When it was put to Ms B that in the interests of the Company, the Bank X loan should have been repaid first to reduce interest costs before repaying the shareholders' loans which were interest-free, Ms B rejected the suggestion and said that there was *no conflict between the two* (「冇抵觸」). Upon further questions and after acknowledging that the Company was reliant on the shareholders' ongoing capital injections, she said that the Bank X loan was not paid off because Bank X did not request for repayment, and she thought that *'it was better for the shareholders to have more money in hand'*.

90. When challenged that she had no personal knowledge as to why the Bank X loan was not paid off nor of the thinking of Mr M and Mr L, she took a long pause before finally sticking to her answer and insisting that she knew their direction of thinking.

91. When asked about the continuous holding by the Company of the unsold parking spaces and the Bicycle Spaces, Ms B replied that the 86 Bicycle Spaces never generated any rental income and were used by residents and cyclists in the area free of charge. They are not of much value, and there had not been any interested purchaser.

92. She agreed and supported the Company's case that when disagreements among the shareholders on the unsatisfactory rental income arose after purchase of the Parking Spaces, the Company had at one point thought of taking over the management and operation of the car parks and renovating to boost rental income, but the Company did not have sufficient manpower to do so. She agreed that there was no written record or written communications such as emails or WhatsApp messages recording such complaints, nor on discussions on taking over management or renovation.

93. When cross-examined on the proposed renovation and cost estimates to boost rental income, Ms B said that Mr M did make enquiries with the renovation contractor who orally gave an estimate of renovation costs of \$3-4 million. Again there was no written record or correspondence on the proposed renovation and cost estimates

94. The Company's case, as supported by Ms B, is that the idea of renovating the Parking Spaces to boost rental income was abandoned due to the high costs and lack of management manpower of the Company.

95. When asked why the same guaranteed licence fees arrangements were made with Company Y when the Company had considered Company W's income performance not satisfactory and which would be improved with replacement by Company Y, Ms B replied that the Company had kept the same licence fees terms initially in order to allow Company Y to gradually pick up on operation.

G. Analysis

96. In ascertaining the intention of the Company at the time of purchase of the Parking Spaces for the purposes of the IRO, this Board has considered all relevant evidence,

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the legal principles and the parties' submissions. We consider the evidence of the Company on the background and events leading to the sale of the Sold Parking Spaces, starting from about a year after purchase, important.

97. We have considered the Company's case alongside the Commissioner's arguments in light of the evidence, objectively viewed, and come to the conclusions hereinbelow.

GI. Ms B's Evidence

98. Ms B claims to have knowledge of the direction of thinking of the shareholders of the Company, and that they together had the intention of purchasing and holding the Parking Spaces for long-term investment.

99. She did not know any of the shareholders apart from the brothers Mr M and Mr L. She had no personal knowledge or direct involvement in the pre-purchase discussions, if any, of the shareholders. There is no evidence in this regard, and indeed, Ms B confirmed that no meeting was held by the shareholders, nor was there any written record of discussions, regarding acquisition of the Parking Spaces.

100. She purported to confirm all the facts stated in the Notice of Appeal and the correspondence from the Company and Vision to IRD, claiming that she believes they were true and correct. However, her evidence does not show a reliable basis for that belief.

101. Her evidence shows that her knowledge was at best based primarily on what she had heard from Mr M, maybe Mr L as well, or from the office staff or secretaries of some of the shareholders over their casual chats on the phone. Her purported knowledge of the thinking of the shareholders is mainly hearsay, or double-hearsay, and is unreliable.

102. She did not know how the shareholders funded the purchase of the Parking Spaces.

103. She did not have personal knowledge of the preparation of the 23 July Cheque for the preliminary deposit or the signing of the preliminary sale and purchase agreement, she not being present at the signing.

104. Her evidence regarding preparation of the 23 July Cheque in advance, contradicted by Vision's reply, is not reliable. It was in our view a reason conveniently added by her when giving testimony at the hearing.

105. She did not have personal knowledge of the disagreements among the shareholders, nor the reasons for/intention behind the disposal of the Sold Parking Spaces and the use of proceeds. She simply adhered to and repeated the Company's case set out in the Notice of Appeal.

106. In relation to the key contemporaneous documents relied upon by the Company, ie the Report and the 3 board resolutions, namely the July 2015 Resolution, the

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October 2016 Resolution and the February 2017 Resolution authorizing the purchase of the Parking Spaces and the subsequent sale of the Sold Parking Spaces, Ms B was simply instructed by the boss to type them up and had no personal knowledge of their contents.

107. It is evident that during cross-examination, Ms B would add to her evidence and say whatever she thought would assist the Company's case. She appeared to be adding conveniently during her testimony the following alleged knowledge: (i) her belief that the shareholders' decision to purchase the Parking Spaces had not been based on the Report only; (ii) that Mr M had conducted a site visit alone before dictating to her the Report recommending bulk purchase of the Parking Spaces; and (iii) that Mr M had made enquiries on renovation cost of the car parks and was orally informed by the contractor the estimate of \$3-4 million.

108. Such evidence has never featured in any of the documents or correspondence placed before this Board. It would be most unreasonable that other evidence, had there been any, in support of the Company's decision on or intention of long-term investment is not referred to in this Appeal.

109. We also consider it unreasonable and most unlikely that there would be nil written record in support of the other information or materials based on which the shareholders came to the decision to purchase the Parking Spaces, the alleged site visit by Mr M, the proposed renovation and cost estimates of a magnitude of \$3-4 million.

110. Ms B's evidence on the delivery of the Report and her knowledge as to the reasons why the Bank X loan was not repaid before repayment of the shareholders' loans was unsatisfactory and unreliable.

111. She could not explain why the shareholders had disagreements on the '*unsatisfactory*' rental income, despite the fact that the rental income received was much higher than the annual base rent (which was described to be '*a rather good return*') during the whole 12 months after purchase. She could only say that some shareholders had expected higher income.

112. Her evidence on the alleged proposal by some of the shareholders of the Company taking over management of the car parks to boost rental income is wholly unreasonable and not credible. The evidence reveals that the Company was an investment holding vehicle which did not have any employee whilst Company AB had only 4 employees (including Ms B). Neither the Company nor Company AB had ever engaged in the business or work of property management.

113. Ms B simply adhered to the Company's case and claimed at the outset and insisted all along that she had personal knowledge of the thinking of the shareholders and directors of the Company – the basis of this alleged personal knowledge is flimsy and not established on the evidence.

114. We found Ms B's evidence of little value and not supportive of the shareholders' alleged intention to purchase and hold the Parking Spaces for long-term

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investment, nor the unforeseen shareholders' disagreements arising primarily from the *unsatisfactory* rental income, which disagreements had allegedly led to the subsequent sale of the Sold Parking Spaces.

115. It remains for this Board to conduct an objective assessment of the documentary evidence and correspondence to ascertain the intention of the Company at the time of acquisition of the Parking Spaces.

G2. Contemporaneous Documents

116. Vision confirmed, and as testified by Ms B, the shareholders' loans were granted informally without loan agreements, and there was no correspondence or any written record of discussions.

117. We consider it most unreasonable for the reputable and experienced businessmen to agree to provide substantial loans interest free and without security, not even proper documentation, yet allegedly committed to a long-term investment of holding the Parking Spaces after acquisition.

118. The Company relies on the Report and the July 2015 Resolution, stating the long-term investment purpose of acquiring the Parking Spaces, and the October 2016 and February 2017 Resolutions, recording some shareholders' complaint on *unsatisfactory* current licensing arrangement of the Parking Spaces, concerns of high gearing ratio and imminent global trend of rising interest rates in support of the proposed sale.

119. They are self-serving documents and in our view not conclusive or decisive of the alleged intention of long-term investment, and must be assessed against all the surrounding circumstances: see Brand Dragon at paragraph 21 per Chu J (as she then was) (in respect of board minutes).

120. The 2-page Report contains scanty information and a flimsy analysis which we consider disproportionate to the size of a \$126,000,000 investment. There is no analysis of expenses or net profits. The sole basis of the purchase being a good long-term investment is the annual base rent of \$3,930,000, equivalent to a yield of 3.12%, which was described to be '*a rather good return*' in the Report. On a proposed bank loan of \$50,400,000 at interest rate of 2.2% repayable by 5 years, monthly repayment would be \$371,000. This would be almost covered by the monthly base rent (of \$327,500) under the current licence agreement. It also states that the sale price of \$126,000,000 (with the Company W) was attractive, given that individual car parking space price in the area was about \$1,300,000.

121. Even if taken at face value, it makes no commercial sense and the Report does not support a good long-term investment for acquiring the Parking Spaces: The monthly licence fee of \$327,500, not taking into account property holding expenses such as management and maintenance, was not sufficient to pay the monthly bank mortgage, let alone repaying the shareholders' loans which were interest-free, unsecured and for unspecified loan periods. The shareholders would likely have to continue to inject funds in order to keep the investment.

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122. On the proposed financial arrangements, the longer the Company held the Parking Spaces, the more the shareholders would stand to lose by having their substantial capital contributions locked up without interest income by the purchase. They would suffer opportunity cost as they could have deployed the funds in other profit-making businesses or investments.

123. On the other hand, it became immediately apparent that there would be a huge profit to gain by individual re-sale of parking spaces after bulk purchase at \$126 million, as the 118 CP Spaces and LV Spaces would roughly worth no less than \$153 million (\$1.3 million x 118) on the current individual parking space price reference at \$1,300,000 as suggested in the Report, even not taking into account the higher value of LV Spaces.

124. The contents of the Report therefore do not in our view genuinely support the alleged long-term holding intention.

125. Also the evidence raises doubts whether the Report dated 24 July 2015 was delivered to the shareholders, considered by them and formed the basis of the agreed decision to purchase the Parking Spaces within the short time until the signing of the preliminary sale and purchase agreement on 27 July 2015.

126. The date of the 23 July Cheque could not be a mere '*clerical error*' as suggested by Vision given the amount drawn and its importance. Ms B's explanation that it had been prepared to get ready for quick actions in view of the rapidly changing market conditions is unreasonable particularly when the shareholders had not even by then had sufficient information (as set out in the Report) on the proposed purchase. It would have been most unreasonable for Mr M to give instructions to the Company to draw the 23 July Cheque for such a large amount without first confirming the agreement of the shareholders.

127. We consider Ms B's evidence on her belief that the shareholders' decision to purchase had not been based on the Report only to be vague and evasive. We found it more likely than not that the shareholders' agreement for the purchase had been reached and decision made prior to the commission of the Report.

128. The alleged reasons for sale stated in the October 2016 Resolution and the February 2017 Resolution, namely some shareholders' complaint on *unsatisfactory* current licensing arrangement and the concerns of high gearing ratio and imminent global trend of rising interest rates are not supported by any contemporaneous evidence or records of discussions. We also consider these could not be the genuine reasons for the sale as discussed under section G4 below.

G3. *Financial Viability as a Long-Term Investment/ Financial Capability of the Shareholders*

129. The purchase was funded by the Bank X loan of \$50,400,000 (40%) and the rest of the 60% (\$75,600,000) from shareholders' loans.

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130. As set out in the Report, the guaranteed monthly rent receivable (\$327,500) was not even sufficient to cover the mortgage instalment (\$371,000). The stated yield on investment of 3.12% was unrealistic and superficial in that it had not taken into account expenses incidental to ownership such as management and maintenance, etc.

131. The Company's case, as advanced by its counsel, is that the monthly mortgage payment of \$280,000 would be wholly covered by the licence fee with surplus every month. This analysis is misleading and has not taken into account the element of bank interest payable every month, which brought total monthly mortgage payment to \$371,000 (as stated in the Report). The monthly base licence fee income of \$327,500 would not be sufficient to pay the mortgage.

132. The proposed long-term investment holding plan would not allow any positive cashflow at least during the term of the mortgage of 5 years, and made no mention at all as to recoupment of shareholders funding, let alone earning profits.

133. On the present evidence, the intention to acquire the Parking Spaces and financial viability as a long-term investment is not made out.

134. We consider the Company's argument regarding financial capability of the shareholders quite beside the point and not convincing. Being reputable businessmen themselves, the shareholders would be apt to see that the proposed long-term investment holding would not make commercial sense. It would entail a significant economic cost of providing substantial shareholders' loans and requiring continuous injection of funds. The shareholders would suffer the opportunity cost of not being able to deploy those funds elsewhere or in other profitable ventures, their loans being interest free, unsecured and with no fixed terms of repayment. It was unreasonable and most unlikely that the long-term investment holding plan would have any appeal to the shareholders.

135. We accept the Commissioner's argument that comparing the tenuous case of a long-term investment to the significant profit that would be obtained simply by selling the parking spaces individually, it would have been obvious that the better strategy would be for a quick resale rather than holding the Car Parking Spaces long-term. The immediate substantial profit upon quick individual resales was obvious by comparing the bulk purchase price and the individual car parking space price reference discussed in paragraph 123 above; this is simple arithmetic. On a balance of probabilities, we found that to be the true purpose for the purchase.

136. Indeed as the evidence shows, what happened in reality was that the shareholders' loans were fully repaid by October 2017 upon sale of some of the Parking Spaces, with surpluses. It would be most unreasonable that the shareholders, all reputable and experienced businessmen, would allow their funds to be locked up interest-free in some long-term investment of no financial viability.

G4. *Unforeseen Shareholders' Disagreements*

137. The shareholders' disagreements which allegedly arose shortly after

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purchase of the Parking Spaces, apart from being briefly mentioned in the October 2016 and February 2017 Resolutions which are self-serving documents, are not supported by any contemporaneous record of complaints or discussions amongst the shareholders.

138. The reasons for sale based allegedly on the complaints of certain shareholders being dissatisfied with the low rental income and the unsatisfactory performance of Company W are wholly unreasonable, and are contradicted by the evidence.

139. The rental income actually received from the Parking Spaces after purchase had all along exceeded the base rent which was described in the Report to be '*a rather good return*' (「相當不俗」). There was no discernible basis for the sudden dissatisfaction and why the '*rather good return*' described in the Report would suddenly considered to be '*low rental income*' rendering some shareholders dissatisfied.

140. The alleged dissatisfaction with the performance of Company W was tenuous, bearing in mind neither the Company nor Company AB had any management personnel who would be in a position to assess it. Also, one would imagine the assessment of the performance of a car park operator should primarily be based on revenue generated, which had all along met and in fact exceeded the guaranteed income targets.

141. The alleged ideas of the Company taking over management of the Parking Spaces or renovation to boost rental income do not make any commercial sense when neither the Company nor Company AB had the manpower or relevant property management experience.

142. The licence agreement with Company W was terminated, and Company Y became the new licensee as from September 2016, curiously on identical licensing/guaranteed rental income terms. Ms B's explanation that Company Y was allowed time to gradually pick up on operation does not make commercial sense.

143. The alleged dissatisfaction is contradicted by the evidence of good and steady rental income generated during the term of operation up to August 2016 by Company W. It could not be the genuine reason for the subsequent sale. We consider it more likely that the change of car park operator was to pave way for the subsequent sale resulting in a much reduced scale of car parking operation.

144. The high gearing ratio and interest rates risks reasons are also not convincing. There is no evidence of interest rates hikes in the 2 or 3 years after completion of purchase of the Parking Spaces. There was also no change of circumstances such as change of the Bank X loan size that could explain why the mortgage loan gearing ratio had suddenly become a concern.

145. The alleged concerns of high gearing ratio and interest rates risks were inconsistent with the prompt repayment of the shareholders' loans. Should those be the Company's genuine concerns, it should have arranged to repay the Bank X loan with proceeds from sale of the Sold Parking Spaces, instead of repaying the shareholders' loans in full.

G5. Nil Effort/Cost in Selling the Parking Spaces/ Unsolicited Offer

146. For reasons stated above, this Board found that the Company did not have the intention to hold the Parking Spaces long-term but had a trading intention. We consider it not of significance that the Company did not take active steps to market or put the Parking Spaces on sale, given it was a property holding company with nil employee and no manpower to do so.

147. It had engaged reputable and sizeable property agents including Company AC and Company AD to sell the Parking Spaces and did pay bonuses to agents for successful resale.

148. As stated in Vision's letter dated 26 July 2019, '(the Company) *left the estate agents to do their own way of advertisement*'; *'purchasers were solicited through estate agents'*.

149. We consider that the amount of effort that the Company expended is consistent with a property trader who would not need to do much to sell the Parking Spaces at all. As Fok PJ explained in *Church Body* at paragraph 54, whether *'time, effort or money expended on an asset to enhance its sale price is or is not such as to justify a finding of intention to trade must be a matter of fact and degree and depend on the extent of such expenditure.'*

150. We also accept the Commissioner's argument that the licence-back arrangements (ie the new purchaser would upon purchase licence the car parking space back to the Company for a licence fee) in respect of a majority of the Sold Parking Spaces were incentive arrangements to facilitate or boost the sale.

G6. Continuous Holding of Unsold Spaces

151. The Company sold the 1st Lot, the 2nd Lot and the 3rd Lot commencing on 7 October 2016 and during years of assessment 2016/17, 2017/18 and 2018/19. The remaining parking spaces after sale comprised of 30 CP Spaces, 6 LV Spaces and 86 Bicycle Spaces.

152. Evidence shows that the Company has ever since continued to sell more CP Spaces at total price of \$22.3 millions during year of assessment 2019/20 and in 2022.

153. The Company's case is that it has been holding for 8 years until now 112 out of the 204 Parking Spaces purchased in 2015 - this supports the intention to hold them as long-term capital assets at the time of acquisition.

154. The unsold parking spaces being held comprise mainly of 86 Bicycle Spaces. As confirmed by Ms B, the Bicycle Spaces never generated any rental income and are of little worth. There was never any interested purchaser.

155. The pattern of sale is in our view not inconsistent with the Company never

having the intention to hold the Parking Spaces long-term, but to sell them individually when it had the good opportunity to do so. The speed of sale would depend on the market conditions and whether the right buyers appear. The intention to trade is also consistent with the fact that there is no evidence of the Company sourcing in the market or using the sale proceeds to acquire other investment properties for long-term holding.

156. For the sake of completeness, we consider it to be peripheral and not necessary for this Board to make a finding on the alleged inconsistency in Vision's reference to Company W and Company Y, referred to in the Determination and stated as ground (3) in the Notice of Appeal.

H. Badges of Trade

157. Both parties conclude their submissions with reference to the 10 badges of trade identified by McHugh NPJ in Lee Yee Shing arguing in support of their respective cases.

158. We have considered and analysed the evidence set out above, applying the legal principles stated in the cases of Simmons, Church Body and All Best Wishes. We conclude that the evidence gives a neutral indication under some criteria, but collectively the badges of trade indicate a trading intention of the Company at the time of acquisition as follows (adopting the numbering in paragraph 47 hereinabove):

(1) *Whether the taxpayer has frequently engaged in similar transactions*

- The Company is a special purpose vehicle with its only business activity being purchase and holding and sale of the parking spaces in question.
- The previous activities of the shareholders may shed light on the issue but there is no such evidence before this Board.

(2) *Whether the taxpayer has held the asset or commodity for a lengthy period*

- No – sale commenced in October 2016, about a year after completion of purchase. A substantial portfolio of 63 CP and LV Spaces (out of a total of 118) was sold in the First Lot (assignments dates between February and March 2017) at total consideration of \$109,210,000 which was equivalent to a high 86% recoupment of the purchase price. Upon sale of the 2nd Lot and the 3rd Lot in the following 2 years, total sale proceeds had reached \$142,530,000, which represents a 13% gain on the purchase price of \$126,000,000.

(3) *Whether the taxpayer has acquired an asset or commodity that is normally the subject of trading rather than investment*

- Neutral

(4) *Whether the taxpayer has bought large quantities or numbers of the commodity or asset*

- Neutral

(5) *Whether the taxpayer 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*

- The alleged shareholders' disagreements and unforeseen circumstances raised by the Company that had led to in the subsequent re-sale are not credible and not accepted.

(6) *Whether the taxpayer has sought to add re-sale value to the asset by additions or repair*

- No evidence. There is also no indication whether the change of licensee to Company Y had any impact on the re-sale value.

(7) *Whether the taxpayer 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*

- Yes, re-sale was done through property agents and payments of commissions/bonuses. Also the licence-back arrangements were expenditures indicative of an intention to boost re-sale.

(8) *Whether the taxpayer had conceded an actual intention to resell at a profit when the asset or commodity was acquired*

- No

(9) *Whether the taxpayer had purchased the asset or commodity for personal use or pleasure or for income*

- The Company's alleged intention to hold the Parking Spaces for income and as long-term capital investment at the time of acquisition is not made out. A reasonable inference from the overall evidence is for trading.

(10) *Source of finance*

- The substantial financing by shareholders' loans, unsecured and interest-free with no repayment dates, and the financially not

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viable plan of rental income being not sufficient to cover even bank mortgage payment, contradicts long-term holding and is indicative of trading.

I. Conclusion

159. We conclude that the Company had an intention to trade rather than to hold long-term as capital assets at the time of acquisition of the Parking Spaces. The profits derived by the Company from the sale of the Sold Parking Spaces should be chargeable to Profits Tax for years of assessment 2016/17, 2017/18 and 2018/19.

160. The Appeal is dismissed. This Board confirms the Profits Tax Assessments for the years of assessment 2015/16, 2016/17, 2017/18 and 2018/19 set out in 2(1), (2), (3) and (4) of the Determination dated 8 July 2022.

161. We order the Appellant/ Company to pay costs of \$20,000.