

Case No. D11/14

Profits tax – engaging in a trade – whether the Appellant held property as a capital asset or for a trade – section 14(1) of the Inland Revenue Ordinance ('IRO').

Panel: Chow Wai Shun (chairman), Jonathan Lee and Miu Liong Nelson.

Date of hearing: 8 May 2014.

Date of decision: 11 July 2014.

The Appellant was a company incorporated in 1990 and controlled by Mr B. In March 2004, it acquired a property ('the Property') with funds provided by Mr B. The Property was 1 of the 6 flats on a plot of land ('the Site'). The stated intention of the Appellant was to hold the Property for investment purpose, and the Property was treated as a fixed asset in the Appellant's accounts. At around the same time, another company of Mr B acquired another property below the Property. In April 2007, the Appellant accepted a proposal to sell the Property as part of a tender to sell the Site. The Assessor raised profits tax assessment on the gain made by the Appellant from the sale of the Property. The Deputy Commissioner issued a Determination confirming the assessment of profits tax on the gain, but revised the amount of profits made by the Appellant. The Appellant appealed against the Determination.

At the hearing, the Appellant applied for Mr B's younger daughter to be present, intending to assist Mr B with giving instructions to the Appellant's legal representatives. She did not have any official position in the Appellant.

Held:

1. The hearing was required to be conducted in camera. Since the Appellant was represented at the hearing and had 2 officers present, and Mr B's younger daughter did not have any relevant qualification or experience in handling and dealing with tax disputes, she was not allowed to be present when Mr B was giving evidence.
2. In order to consider whether the Appellant engaged in a trade, one had to ask whether the intention to trade existed at the time of the acquisition of the Property. Intention may be changed over time (Lionel Simmons Properties Limited (in liquidation) and others v Commissioners of Inland Revenue (1980) 53 TC 461 applied).

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3. The intention of the Appellant had to be ascertained objectively in light of all the circumstances. Badges of trade included: (i) frequency of engaging in similar transactions; (ii) length of holding the asset; (iii) whether the asset was normally held as the subject of trading rather than investment; (iv) whether a large quantities of the asset was bought; (v) whether the asset was sold for reasons that would not exist if the Appellant had an intention to resell at the time of acquisition; (vi) whether any additions or repairs were done to add the re-sale value; (vii) whether time, money or effort in selling the asset was expended that went beyond what might be expected of a non-trader; (viii) whether the Appellant conceded an actual intention to resell at a profit when the asset was acquired; and (ix) whether the asset was purchased for personal use or pleasure, or for income (All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750; Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51; Marson v Morton [1986] STC 463 applied).
4. The Appellant put forward sufficient evidence to show that it did not acquire the Property for trade. Its expressed intention was to acquire the Property for investment. Mr B's elder daughter did live in the Property for the short time. The Appellant retained agents to help to locate tenant for the Property, and when no tenant was forthcoming, it made improvements to the Property to make it more attractive for tenants. The Appellant did not actively seek out the tender for selling the Site. The unsolicited proposal to sell the Property as part of the tender for the sale of the Site was fortuitous and difficult to resist.
5. The fact that another company of Mr B was similarly assessed for profits tax for the gain obtained from selling the flat below the Property was a neutral factor. First, that profits tax assessment was subject to an appeal which was yet to be heard. Secondly, even though the Appellant and the other company were related companies, they could possibly have different intentions and hence different tax positions. Each case depends on their own facts and circumstances (Marson v Morton [1986] STC 463 at 470-471 referred).

Appeal allowed.

Cases referred to:

Lionel Simmons Properties Limited (in liquidation) and others v Commissioners of Inland Revenue [1980] 53 TC 461
All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750
Marson v Morton [1986] STC 463
Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51
Real Estate Investments (NT) Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 433

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Jones v Leeming [1930] AC 415
D31/87, IRBRD, vol 2, 409
Mok Tsze Fung v CIR (1962) 1 HKTC 166

Lincoln Cheung, Counsel, instructed by Messrs Tung, Ng, Tse & Heung, Solicitors, for the Appellant.
Chow Cheong Po and Lee Shun Shan for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal by the Appellant against the Determination of the Deputy Commissioner of Inland Revenue dated 9 December 2013 in respect of the Profits Tax assessment for 2008/09 on it ('the Determination').

A preliminary issue

2. At the beginning of the hearing, Mr Cheung craved for our leave to allow Ms A, the younger daughter of Mr B (the director of the Appellant and the only witness called to give evidence before us), to be present. In support of this application, we were given a hand-written note signed by both Mr B and Ms C, Secretary of the Appellant, authorizing Ms A to attend as the Appellant's tax representative. The Respondent objected.

3. We asked about Ms A's qualification and the role that she was supposed to play during the hearing if the application was to be allowed. It transpired that although Ms A was said to be the personal assistant of Mr B and had involved in the operation of the Appellant, she held no official position in the Appellant. Ms A did not have any relevant qualification or experience in handling and dealing with tax disputes. She was expected to assist Mr B in giving instructions to the Appellant's legal representatives.

4. The hearing of the Board is required to be conducted in camera. The Appellant was legally represented. Two office holders of the Appellant were present at the hearing. In light of all these, as well as Ms A's lack of proper qualification and experience in dealing with tax appeals, we could not see why Ms A needed to be here. Indeed, we did not see it appropriate to have Ms A here whilst Mr B would be giving his evidence and subject to cross-examination by the Respondent. On the other hand, we raised no objection to her presence during any other time. At the end of the day, Ms A was never present at the hearing.

Facts

5. Parties have agreed on the following facts. As such, we find these facts the

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facts relevant to this appeal:

- (a) (1) The Appellant was incorporated in Hong Kong as a private company in 1990.
- (2) At the relevant times, both the authorized capital and the issued capital of the Appellant were \$10,000. The shareholders of the Appellant were:

	Number of shares held (at \$1 each)
Company D [represented by Mr B]	9,999
Mr B	1

- (3) The directors of the Appellant were Mr B and Ms E.
- (4) In its Profits Tax returns, the Appellant described its principal business activity as follows:

<u>Years of assessment</u>	
2004/05 and 2005/06	Property investment
2006/07 to 2008/09	Investment holding

- (5) The Appellant closed its accounts on 30 April annually.
- (b) (1) By a provisional agreement for sale and purchase dated 2 March 2004, the Appellant agreed to purchase the property situated at Address F1 ('the Property') at a consideration of \$7,180,000. The formal agreement for sale and purchase was executed on 15 March 2004 and the Property was assigned to the Appellant on 2 July 2004.
- (2) By a tripartite legal charge/mortgage of the Property dated 2 July 2004 entered into among the Appellant, Company G and Bank H, Bank H as lender agreed to grant certain banking facilities to Company G as borrower at the request of the Appellant as mortgagor.
- (c) (1) Company J is a company incorporated in Hong Kong. At the relevant times, Mr B was a director and the representative of a shareholder of Company J.
- (2) On 4 March 2004, Company J entered into an agreement to purchase the property situated immediately below the Property, i.e. Address F2 ('the 1/F Property'), which was subsequently sold

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together with the Property as mentioned in paragraph 5(d) below. Company J made a gain from the transaction.

- (d) (1) The properties then situated on Address K and Address F were both of a 3-storey residential building comprising G/F, 1/F and 2/F (collectively referred to as 'the Site') built in around year 1958, each represented 1/6 undivided part or share of section B of Lot L.
- (2) By an instrument dated 1 March 2007, tenders were invited for purchase of the Site with vacant possession subject to existing tenancy of one property. The tender was closed on 28 March 2007. By a letter of acceptance dated 29 March 2007, all owners of the Site accepted to sell the Site to the purchaser at a consideration of \$138,680,000.
- (3) The memorandum of sale was executed by owners of the Site on 20 April 2007. The assignment of the Site was completed on 19 July 2007. The sale price of the Property was \$22,663,333.
- (4) The Appellant became dormant immediately after disposal of the Property.
- (e) The Appellant filed its Profits Tax returns for the years of assessment 2004/05 to 2008/09 together with audited financial statements and tax computations. In the Profits Tax returns, the Appellant declared the following assessable profits or adjusted losses:

	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
Assessable Profits					<u>\$575,693</u>
Adjusted Loss	<u>(\$7,643)</u>	<u>(\$7,644)</u>	<u>(\$219,375)</u>	<u>(\$467,213)</u>	

- (f) In arriving at the above assessable profits or adjusted losses, the Appellant made, among others, the following adjustments in respect of the Property:

	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
	\$	\$	\$	\$	\$
<u>Addition</u>					
Balancing charge ^[1]	-	-	-	-	581,127
<u>Deduction</u>					
Gain on disposal of the Property	-	-	-	-	15,526,739

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	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
	\$	\$	\$	\$	\$
Commercial building allowance ('CBA')- Building	143,600	143,600	143,600	143,600	-
Leasehold improvement ^[2]	-	-	-	<u>6,727</u>	-
				150,327	

Notes:

- Commercial building allowance \$143,600 x 3 + \$150,327 = Balancing charge \$581,127
- Internal re-decoration works \$168,180 x 4%

(g) The Appellant's detailed profit and loss accounts showed the following particulars:

	<u>2004/05</u> <u>& 2005/06</u> <u>(as restated)</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
Period / year ended	<u>30-04-05</u>	<u>30-04-06</u>	<u>30-04-07</u>	<u>30-04-08</u>
	\$	\$	\$	\$
Gain on disposal of the Property	-	-	-	15,526,739 ^[1]
Other revenue	<u>404,810</u>	<u>1,667</u>	-	<u>2,146</u>
	<u>404,810</u>	<u>1,667</u>	-	<u>15,528,885</u>
<u>Less:</u>				
Administrative and operating expenses-				
Depreciation	170,000	170,000	203,636	-
Other expenses	<u>52,324</u>	<u>29,003</u>	<u>29,356</u>	<u>7,230</u>
	<u>222,324</u>	<u>199,003</u>	<u>232,992</u>	<u>7,230</u>
Finance costs-				
Bank charges	430	350	350	350
Interest paid to a related company	<u>80,143</u>	<u>48,089</u>	<u>287,180</u>	-
	<u>80,573</u>	<u>48,439</u>	<u>287,530</u>	<u>350</u>
Profit / (loss) before tax	<u>101,913</u>	<u>(245,775)</u>	<u>(520,522)</u>	<u>15,521,305</u>

Note 1

Selling price	\$	\$
Less: Cost-		
Investment property	7,496,410	
		22,663,333

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	\$	\$
Leasehold improvement	<u>168,180</u>	
	7,664,590	
<u>Less: Accumulated depreciation</u>	<u>543,636</u>	<u>7,120,954</u>
		15,542,379
Legal fee		<u>15,640</u>
Gain on disposal of the Property		<u>15,526,739</u>

(h) The Appellant's balance sheets showed the following particulars:

	2005/06 (as restated)	2006/07	2007/08	2008/09
As at	30-04-05	30-04-06	30-04-07	30-04-08
	\$	\$	\$	\$
Non-current assets-				
Investment property	7,326,410	7,156,410	6,986,410	-
Leasehold improvement	<u>-</u>	<u>-</u>	<u>134,544</u>	-
	<u>7,326,410</u>	<u>7,156,410</u>	<u>7,120,954</u>	-
Current assets-				
Deposits & prepayment	356,500	356,500	400	-
Amount due from a related company	-	-	-	14,879,333
Cash & bank balances	<u>133,019</u>	<u>134,336</u>	<u>70,841</u>	<u>18,997</u>
	<u>489,519</u>	<u>490,836</u>	<u>71,241</u>	<u>14,898,330</u>
<u>Less:</u>				
Current liabilities-				
Accruals	5,000	5,000	10,000	5,153
Deposit received	-	-	2,301,333	-
Amount due to a director	650,032	650,032	233,332	233,332
Amount due to a related company	7,256,059	7,333,151	5,508,990	-
Amount due to ultimate holding company	<u>2,169,925</u>	<u>2,169,925</u>	<u>2,169,924</u>	<u>2,169,924</u>
	<u>10,081,016</u>	<u>10,158,108</u>	<u>10,223,579</u>	<u>2,408,409</u>
Net assets / (liabilities)	<u>(2,265,087)</u>	<u>(2,510,862)</u>	<u>(3,031,384)</u>	<u>12,489,921</u>
Capital and reserves-				
Share capital	10,000	10,000	10,000	10,000
Retained profit	-	-	-	12,479,921
Accumulated losses	<u>(2,275,087)</u>	<u>(2,520,862)</u>	<u>(3,041,384)</u>	<u>-</u>

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	2005/06 (as restated)	2006/07	2007/08	2008/09
As at	30-04-05	30-04-06	30-04-07	30-04-08
	\$	\$	\$	\$
	<u>(2,265,087)</u>	<u>(2,510,862)</u>	<u>(3,031,384)</u>	<u>12,489,921</u>

- (i) In each of the auditors' reports of the Appellant for the period ended 30 April 2005 and years ended 30 April 2006 and 2007, the auditors, Company M ('the Auditors'), expressed their views on the fundamental or significant uncertainty regarding the Appellant's ability to continue as a going concern due to its liabilities position.
- (j) The amounts due to director, related company and ultimate holding company as shown in the balance sheets were unsecured, interest-free and with no fixed terms of repayment.
- (k) The following statements of loss were issued to the Appellant:

	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
	\$	\$	\$	\$	\$
Profits / (Loss) for the year	(7,643)	(7,644)	0	0	575,693
<u>Add: Loss brought forward</u>	<u>(3,814,082)</u>	<u>(3,821,725)</u>	<u>(3,829,369)</u>	<u>(3,829,369)</u>	<u>(3,829,369)</u>
Loss carried forward	<u>(3,821,725)</u>	<u>(3,829,369)</u>	<u>(3,829,369)</u>	<u>(3,829,369)</u>	<u>(3,253,676)</u>

- (l) In response to the Assessor's enquiries, Company N ('the Joint Representative'), as joint tax representatives with the Auditors, stated the following in respect of the Property:

Purchase

- (1) The gross floor area of the Property was about 2,300 square feet and there were three bedrooms. The Property was aged over 40 years.
- (2) The Property was purchased with vacant possession.
- (3) The Appellant intended to purchase the Property for investment purpose as evidenced by the following:
- (i) The directors of the Appellant resolved to purchase the Property for investment purposes in their meeting held on 2 March 2004 [paragraph 5(m)(3)].

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- (ii) The Appellant entered into an agreement on 10 July 2004 to appoint Company P for the purpose of letting out the Property [paragraph 5(m)(4)]. The agreement was renewed on 19 June 2006 [paragraph 5(m)(5)].
- (iii) The Property was labeled as fixed assets in the Appellant's balance sheets [paragraph 5(h)] throughout the period of ownership, which was consistent with the intention to hold the Property for investment purposes.
- (4) The Appellant had requested the estate agent, i.e. Company P, to assess the return on capital. As a result, a report consisting of one page was prepared by Company P [paragraph 5(m)(1)] to supplement another information leaflet also provided by Company P [paragraph 5(m)(2)].
- (5) The Appellant did not demand a formal feasibility report as the report and leaflet provided sufficient information to enable the Appellant to assess the feasibility of the proposed investment.

Finance

- (6) The acquisition of the Property was financed by an advance from a related company, Company Q.

Letting

- (7) Despite the efforts of the estate agent, the Appellant was unable to secure a suitable tenant. According to the estate agent, tenants looking for flats in that area would favour units with car parking space.
- (8) The rent asked by the Appellant was market rent recommended by the estate agent.

Sale

- (9) The Appellant never put up the Property for sale. In early 2007, Company R, a real estate services provider, made a proposal to all owners of the Site to put up the Site jointly for tender. If Company R succeeded in convincing the other owners of the Site to sell their properties jointly, the Appellant would be agonized because the value of the Property would be substantially lower if it were sold individually as shown in paragraph 4.2 of Company R's

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proposal [paragraph 5(m)(6)]. The sale was involuntary and the Appellant played a passive role in the course of sale.

- (10) The Appellant resolved to sell the Property in the directors' meeting held on 2 April 2007 [paragraph 5(m)(7)].
- (11) The Property was sold with vacant possession.
- (12) The selling price was determined by tender. Company R was responsible for all matters related to the tender.
- (13) The sale proceeds were used to repay the advance from Company Q.
- (14) The Appellant became inactive after the sale of the Property.

Gain

- (15) The gain on sale of the Property was of capital nature and therefore not taxable. There were sufficient contemporaneous records to show that the Property was intended to be held for investment purpose at the time of acquisition.
- (m) The documents referred to in paragraph 5(l) above are as follows:

- | | |
|--|---|
| | Supporting
statement
at
paragraph
5(1)(4) |
| (1) A proposal (建議書) dated 28 January 2004 in respect of the Property and the 1/F Property made by Company P to Mr B stating, among others, that the total area of the Site was 9,941 square feet with a plot ratio of 1.8, and the Site was then owned by six landlords, and if the Site could be redeveloped jointly, the value of the properties would increase significantly. The proposal also stated that the market rent would be in the range of \$65,000 to \$70,000 per month, with rates of return from 5.5% to 6.5%. | 5(1)(4) |
| (2) An information sheet in respect of the Property and the 1/F Property stating, among others, that the six properties at the Site were offered for sale; the sale prices of the Property and the 1/F Property; and the | 5(1)(4) |

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	Supporting statement at paragraph
contact person and telephone number of Company P.	
(3) Minutes of the directors' meeting dated 2 March 2004 to approve the purchase of the Property for investment purpose by Mr B on behalf of the Appellant.	5(1)(3)(i)
(4) An Estate Agency Agreement for Leasing of Residential Properties in Hong Kong dated 10 July 2004 to appoint Company P as leasing agent during the period from 10 July 2004 to 9 July 2005 to lease the Property at asking rent of \$35,000 per month inclusive of rates and management fee.	5(1)(3)(ii)
(5) An Estate Agency Agreement for Leasing of Residential Properties in Hong Kong dated 19 June 2006 showing that Company P was engaged as leasing agent during the period from 19 June 2006 to 18 October 2006 to lease the Property at asking rent of \$45,000 per month inclusive of rates and management fee.	5(1)(3)(ii)
(6) Proposal for sale of the Site (銷售策略計劃書) dated January 2007 made by Company R to landlords of the Site.	5(1)(9)
(7) Minutes of the directors' meeting dated 2 April 2007 resolving, among others, that the Appellant would sell the Property at the price of \$22,663,333.	5(1)(10)
(n) The Assessor was of the view that the purchase and sale of the Property by the Appellant amounted to an adventure in the nature of trade. Accordingly, she raised on the Appellant the following Profits Tax Assessment for the year of assessment 2008/09:	
	\$
Profits per return [paragraph 5(e)]	575,693
<u>Add: Gain on disposal of the Property [paragraph 5(f)]</u>	<u>15,526,739</u>
Assessable Profits	16,102,432

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	\$
<u>Less: Loss brought forward and set off [paragraph 5(k)]</u>	<u>3,829,369</u>
Net Assessable Profits	<u>12,273,063</u>
Tax Payable thereon	<u>2,025,055</u>

- (o) The Appellant, through the Joint Representative, objected to the above assessment on the grounds that the gain it derived from the sale of the Property was capital in nature.
- (p) By a letter dated 22 February 2013, the Assessor requested the Joint Representative to provide further information concerning the acquisition, the usage put to, and disposal of the Property. Despite reminders, neither the Joint Representative nor the Appellant responded to the Assessor's enquiry.
- (q) The gain on sale of the 1/F Property made by Company J [paragraph 5(c)(2)] was assessed to Profits Tax. The relevant Profits Tax assessment had become final and conclusive in terms of section 70 of the Inland Revenue Ordinance ('IRO').
- (r) The Assessor maintained her view that the gain on disposal of the Property should be chargeable to Profits Tax and considered that the statements of loss for the years of assessment 2004/05 to 2007/08 and Profits Tax Assessment for the year of assessment 2008/09 should be revised as follows:

(1) 2004/05 to 2007/08 statements of loss

	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>
	\$	\$	\$	\$
Loss per return [paragraph 5(e)]	(7,643)	(7,644)	(219,375)	(467,213)
<u>Less: CBA disallowed [paragraph 5(f)]</u>	<u>143,600</u>	<u>143,600</u>	<u>143,600</u>	<u>150,327</u>
Assessable Profits / (Adjusted Loss)	135,957	135,956	(75,775)	(316,886)
<u>Add: Loss brought forward</u>	<u>(3,814,082)</u>	<u>(3,678,125)</u>	<u>(3,542,169)</u>	<u>(3,617,944)</u>
Loss carried forward	<u>(3,678,125)</u>	<u>(3,542,169)</u>	<u>(3,617,944)</u>	<u>(3,934,830)</u>

(2) 2008/09 Profits Tax Assessment

	\$	\$
Profits per return [paragraph 5(e)]		575,693
<u>Add: Gain on disposal of the Property-</u> Amount per accounts [paragraph 5(h)]	15,526,739	
<u>Less: Reversal of accumulated</u> depreciation		

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	\$	\$
[Note 1 to paragraph 5(h)]	<u>543,636</u>	<u>14,983,103</u>
		15,558,796
<u>Less: Reversal of balancing charge</u>		
[paragraph 5(f)]		<u>581,127</u>
Assessable Profits		14,977,669
<u>Less: Loss brought forward and set off</u>		
[paragraph 5(r)(1)]		<u>(3,934,830)</u>
Net Assessable Profits		<u>11,042,839</u>
Tax Payable thereon		<u>1,822,068</u>

- (s) The Determination was so made and handed down. The Appellant lodged an appeal with this Board.

Grounds of appeal

6. The Appellant submitted a five-page notice and statement of its grounds of appeal. As Mr Cheung submitted in his Skeleton Submission, the main ground of appeal was that the profit on the disposal of the Property was capital in nature since the original intention of acquiring the Property was to hold it for long term investment purpose while other grounds purported to set out the disputed parts regarding how the Deputy Commissioner had arrived at his conclusion in the Determination.

The law

7. It is common ground that the following provisions of the IRO apply.

- (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 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.’

8. It is also common ground that the following cases and the legal principles arisen therefrom apply.

- (a) Lionel Simmons Properties Limited (in liquidation) and others v Commissioners of Inland Revenue (1980) 53 TC 461;
- (b) All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750;
- (c) Marson v Morton [1986] STC 463;
- (d) Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51; and
- (e) Real Estate Investments (NT) Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 433.

9. 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? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa.’ (per Lord Wilberforce at page 491).

10. Mortimer J in All Best Wishes at page 771 stated that ‘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.’

11. This was indeed echoed by the Court of Final Appeal decision in Lee Yee Shing where Bokhary and Chan PJJ ruled that the question whether something amounts to the carrying of a trade (or business) ‘is a question of fact and degree to be determined by the fact-finding body upon a consideration of all the circumstances.’ In the words of McHugh NPJ, the intention to trade to which Lord Wilberforce referred in Simmons is not subjective,

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but objective and it requires an examination of all the circumstances to see whether the ‘badges of trade’ are present. Specifically, they are 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 and 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.

12. McHugh NPJ also said that *‘in some cases, the source of finance for the purchase may also be a badge of trade, particularly where the asset or commodity is sold shortly after purchase’* but *‘borrowing to acquire an asset or commodity is usually a neutral factor.’*

13. This list of badges coincides much with the one in Marson v Morton [1986] STC 463 in which Sir Nicolas Browne-Wilkinson V-C held that *‘a single, one-off transaction can be an adventure in the nature of trade’* and that *‘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 depends on the interaction between the various factors that are present in any given case.’* Nonetheless, the list of factors was in no sense comprehensive, nor was any one of those decisive in all cases. They would provide common sense guidance to an appropriate conclusion. The matters which are apparently treated as a badge of trade consists of:

- (a) That the transaction was a one-off transaction which is in law capable of being an adventure in the nature of trade (but the lack of repetition is a pointer which indicates there might be something other than trade);

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- (b) Is the transaction in some way related to the trade which the taxpayer otherwise carries on?
- (c) Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realization?
- (d) Was the transaction carried through in a way typical of the trade in a commodity of that nature?
- (e) What was the source of finance of the transaction?
- (f) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale?
- (g) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots?
- (h) What were the purchasers' intentions as to resale at the time of purchase?
- (i) Did the item purchased either provide enjoyment for the purchaser or pride of possession or produce income pending resale?

In his words, *'in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade?'* Alternatively, one may ask, *'was the taxpayer investing the money or was he doing a deal?'*

14. In Real Estate Investments (NT) Limited, Bokhary and Chan PJJ opined that the list offered in Marson v Morton is no less helpful in Hong Kong than it is in the United Kingdom and held that the question of whether property is trading stock or capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case. Regarding the taxpayer's burden of proof, *'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 position is X [which is the footing on which the tax assessment is made]. And it would likewise fail if the Board merely determines that he has not proved his contention.'* This means that no appeal by the taxpayer could succeed unless the Board is of the view that the true and only reasonable conclusion is that the position is what the taxpayer contends.

15. In his submission, Mr Cheung also referred us to Jones v Leeming [1930] AC 415. In particular, he stressed that the case supported the following propositions: (a) that a

one-off transaction is indeed less likely to be a trading transaction than a realization of capital investment; (b) that the acquisition of property with the contemplation of ultimately realizing it for more than its purchase price does not, of itself, constitute an intention to trade; and (c) that the fact that a property is sold for a higher consideration than its purchase price does not, of itself, constitute trading. While we find no basis to disagree, we do not find it adding much value to the Appellant's case.

Evidence from the witness and other documentary evidence

16. Mr B was the only witness called. In total, three written statements were filed before the hearing.

17. In his first statement which we find as his main statement, Mr B explained the intention of and the circumstances leading to the acquisition of the Property. He said that in or about early 2004, the Appellant was looking for a suitable residential property to generate steady rental income while there was also an intention to acquire a property for his family's use as his elder daughter had come back from Country S after finishing her studies. During cross-examination, Mr B was asked about his family and their residence at Address T1 ('Property T'), which was slightly more than 1,000 square feet with three bedrooms, one of which was a cloakroom, and a car parking space. Since he had three cars in total, he rented two additional car parking spaces. He had never had any plan to sell his Property T.

18. Mr B stated in his main statement that he targeted flats in District U for a number of reasons. He mentioned at the hearing that he had dreamed for a long time to reside in District U. He also indicated his wish to have the extended families of his two daughters living in the same block.

19. According to Mr B's main statement, a Mr V of Company P was introduced to him. Mr V subsequently contacted him and asked if he would be interested in acquiring the Property and the 1/F Property. Mr B then went to inspect the Property with Mr V and found the Property renovated internally and was ready for moving in. While he realized that the Property did not come with a car parking space, he was reassured by Mr V that cars could be parked on the lane adjacent to Address F3 ('the G/F Property'). Mr B further requested Mr V to assess the return of the Property. At cross-examination, Mr B stressed that he did not ask about how much the value of the Property might increase. He had no clue why Mr V in one of the paragraphs in the proposal referred to possible future redevelopment which would increase the value of the Property.

20. We were told by Mr B that the projected return looked promising and attractive to him. As he relied on the expertise and reputation of Company P, Mr B did not require or go further for a more detailed feasibility report but proceeded with the purchase after discussing further with Ms E, his cohabited ex-wife and the other director of the Appellant. At cross-examination, when he was asked about the minutes of the Appellant in which the purchase was approved, he recalled that those minutes had to have been prepared by the solicitors acting for the Appellant in the transaction.

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21. Mr B also explained in his main statement the source of funding for the purchase. He said that at all material times he was operating a catering business named 'Company W' which provided a variety of dining experiences and entertainment in one-go. He regarded the business quite successful. The business has been his main source of income. At this juncture, we were also referred to various bank statements of his. In one single bank account, we note the following average account balances in various months just before and after the provisional agreement for sale and purchase of the Property was signed:

February 2004	HK\$750,886.85
March 2004	HK\$1,198,328.16
April 2004	HK\$1,272,721.06
May 2004	HK\$230,782.18
June 2004	HK\$970,875.54
July 2004	HK\$800,875.68
August 2004	HK\$224,273.28
September 2004	HK\$2,291,967.28
October 2004	HK\$1,659,129.10
November 2004	HK\$1,023,264.79
December 2004	HK\$1,088,302.18
January 2005	HK\$2,359,453.73
February 2005	HK\$2,434,556.18
March 2005	HK\$1,145,113.59
April 2005	HK\$1,965,708.65
June 2005	HK\$968,382.89
July 2005	HK\$1,093,196.17
August 2005	HK\$403,733.21
October 2005	HK\$3,282,720.49
November 2005	HK\$717,025.71
December 2005	HK\$593,911.45
January 2006	HK\$459,289.86
February 2006	HK\$1,381,106.91
March 2006	HK\$997,084.87
April 2006	HK\$2,027,502.69

The quarterly averages during the period had been, for most of the time, over HK\$1 million.

22. The financial capability of the Appellant was one of the key aspects of cross-examination, and indeed, in the Respondent's submission. In particular, Mr Chow referred to the Auditor's comment on 'the possible financial effects on the financial statements with the inherent uncertainty as to the continuation of the financial support by the ultimate holding company and a related company' in the financial report of the Appellant for the period from 1 May 2003 to 30 April 2005. The Auditor considered that fundamental uncertainty and opined that if such financial support was to be withdrawn the Appellant

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might not be able to continue its operation. In reply, Mr B reiterated that the Appellant relied on himself as the major source of finance. He provided financial support to his companies, including the Appellant, typically by reallocating resources among those companies even though he had not considered increasing his capital injection, in this particular case, to the Appellant. Mr B also said that, in addition to director's fees, he received dividends and gain from purchase and sale of stocks. He said that satisfactory return from his catering business would be much more than sufficient to finance repayment of any loan.

23. In re-examination, Mr B confirmed the sources of his income from director's fees in years of assessment from 2002/03 to 2005/06. The level of those fees was rather low. However, from Mr B's notices of assessment in respect of years of assessment from 2006/07 (which was the year before the disposal of the Property) to 2011/12, we note that he had been paying significant amount of taxes in each of those years.

24. In his main witness statement, Mr B then explained the reasons for failing to let the Property. We were referred to two Form 5 agreements between the Appellant and Company P covering the following respective periods at the respective asking rents:

(a) 10 July 2004 – 9 July 2005	HK\$35,000
(b) 19 June 2006 – 19 October 2006	HK\$45,000

On both occasions, the Appellant (i) agreed to allow viewing of the Property by Company P / tenant(s) at a mutually agreeable time; (ii) agreed to pass the keys of the Property to Company P for safe custody and for the viewing of the Property; (iii) authorized Company P to sub-list the Property and pass relevant information about the Appellant and the Property supplied to other estate agents for sub-listing purposes; and (iv) authorized Company P to issue advertisement in respect of the Property.

25. Mr B explained that those asking rents were proposed by Mr V of Company P which, he was told, reflected the prevailing market rent at those times but eventually the Property failed to be rented out because it did not come with a car parking space. Mr B supplemented during cross-examination that he could recall at least an offer which the prospective tenant asked for a car parking space nearby rented at the expense of the Appellant.

26. According to Mr B, the prospect of letting the Property out had not improved despite the renovation, as suggested by Mr V, carried out during May to August 2006. With regard to the cost of such renovation (HK\$168,180), Mr B acknowledged that it was not huge but explained that otherwise it would be too large a sum which in turn would have inevitably increased the asking rent significantly. In his view, that might not be a wise move. A detailed list of work done was also handed in at the hearing.

27. Mr B was asked about whether the Appellant had kept any record of inspection of prospective tenants. His answer was no. He supplemented by saying that he was

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extremely busy during 2005 and those leasing matters were left to his colleagues, including but mainly Ms C, to handle. So far as he could recall, he was given to know that the monthly average number of prospective tenants inspecting the Property was just about one to two.

28. In his main statement, Mr B also explained the non-suitability of the possible alternative use of the Property as his family residence. He indicated that his elder daughter had moved into and resided in the Property (and the 1/F Property) with her friends in late 2004 for a short while. It was supported by utilities bills. Mr B said that it was only by then he had noticed that he was not even allowed to drive into the lane adjacent to the G/F Property. Mr B further indicated that they were even stopped by the owner of the G/F property to drive into and park along the said lane. Mr B also said that those metered parking spaces outside the Site turned people away from any long-term parking. He attempted to show to us how inconvenient it was in terms of using public transportation including the MTR and taxis in the area.

29. Concerning the circumstances for the disposal of the Property, Mr B said that the Appellant only played a passive role. He said in his evidence that he asked Company R, the real estate service provider which made the proposal to all owners of the Site to tender for a joint sale, to assist in acquiring the G/F Property for him. In this regard, Mr B put forward a letter from Mr X, Senior Director of Company R dated 7 May 2014, the content of which is consistent with what Mr B had just said.

30. During cross-examination, Mr B recapped the sequence of events leading up to the disposal of the Property. Mr B said that he was first approached over the phone by Company R in January 2007. When he met the said Mr X of Company R subsequently, he asked about the possibility of acquiring the G/F Property so that he would by then own the whole block for his family members. The Company R's proposal was accepted in February 2007. During the course of events, he did not liaise with any co-owner of the Site but he was requested by other co-owners to accept Company R's proposal. The invitation to tender was publicized on 1 March 2007 in which the expected offer price for the Property was HK\$22 million. The Appellant resolved to dispose of the Property in early April 2007.

31. In the event, Mr B made cross-references to a letter from Company P dated 20 December 2011 in response to the assessor's enquiry. That Company P letter referred to its appointment by Company J (but not the Appellant) and showed the following asking prices on different dates:

5/11/2004	HK\$23,000,000
16/12/2004	HK\$11,200,000
07/03/2007	HK\$15,000,000
22/05/2007	HK\$14,000,000

Mr B, and the Appellant, cast serious doubt on the reliability of such record. In particular, the second last entry (7 March 2007) was post invitation to tender and the last one (22 May 2007) was even after the Appellant had signed preliminary agreement for sale. In both

entries, the alleged asking prices were far below the expected offer price and the final price for sale. It is the Appellant's submission that it simply could not have happened that way.

32. In his main statement, Mr B also attempted to explain why the Appellant did not purchase another property for long term investment until 2010 and why a subsequent property purchased to generate rental income had been held for just about a year. He reiterated during cross-examination that he considered the price too high during that period. Although subsequently the Appellant managed to acquire another property for rental purposes, the investment return would not possibly be doubled without first incurring a substantial amount of expenses for repair and renovation. Mr B considered that too costly and given the ever increasing property price the Appellant did not acquire any other property since then.

Our analysis

33. It would have been better if we could have heard testimonies from Mr B's elder daughter, Mr V, Mr X and even Ms C and seen how they might react and respond to cross-examination. Mr B in his main statement explained why Mr V could not be called. We were not told, however, why the other potential witnesses, in particular Mr B's elder daughter and Ms C, did not come forward to give any oral evidence.

34. Nonetheless, we find Mr B a credible witness. He has given us the impression that he came forth with complete honesty. Even though his evidence is not corroborated by oral evidence of others, we find support from other documentary evidence submitted. In our view, the cross-examination fails to attack fundamentally Mr B's character or quality of his evidence.

35. It may be convenient to first deal with the following submission of the Respondent. Mr Chow submitted that the Appellant's alternative claim that it was also its intention to acquire the Property for Mr B's family use was a new one and was inconsistent with the original claim that it was acquired for rental income. We do not agree. Profits tax was assessed because the assessor considered the purchase and sale of the Property an adventure in the nature of trade. The Appellant's objection was turned down because the Deputy Commissioner was also of the view that the Appellant acquired the Property for trading purposes. The Appellant's main ground of appeal to this Board was that the Property was capital in nature. In our view, both self-use and letting for rental income are consistent with the ground that the Property was a capital asset. The Property of course could not have been factually for self-use and letting out for rental income at the same time. However, these are not the facts found here.

36. Now we turn to apply the well-established badges of trade to the facts of this case.

37. In our view, the intention of the Appellant at the time of acquisition of the Property has been quite clearly stated. The evidence of Mr B and all the company

documents of the Appellant, including its business registration, its minutes of directors' meeting regarding the acquisition, as well as the classification of the Property in its financial statements, point towards investment. The Appellant has not conceded an actual intention to resell at a profit when the Property was acquired. However, such stated intention of the Appellant is not decisive and must be measured against the whole of the surrounding circumstances of the case, including things said and things done at the time, before and after.

38. Mr Chow argued that the minutes were not prepared to record the intention as to the use of the Property because Mr B also claimed that those minutes were prepared 'as required by the law'. Furthermore, it is Mr Chow's submission that the minutes only stated that the intention of acquiring the Property was 'for investment purpose' but did not state whether it was a long-term investment or a short-term investment or it was to be let out for long-term rental income. We cannot see why those minutes prepared to satisfy the legal requirement cannot be also prepared to record the intention of acquiring the Property. Equally, we do not accept that the intention as stated in the minutes must have been as precise and concise as suggested by Mr Chow. To us, 'for investment purpose' is sufficiently indicative of the stated intention of the Appellant.

39. As to the Appellant's intention to let the Property, Mr Chow submitted that, apart from Mr B's claims and the two Form 5 agreements submitted, there was no evidence of any property viewing by prospective tenants, rent negotiation, feedbacks given by estate agents, discussions with estate agents and instructions given to estate agents. Section 68(4) of the IRO puts the burden of proof on the Appellant and as such requires the Appellant to substantiate its case: D31/87, IRBRD, vol 2, 409 at 410; see also Mok Tsze-fung v CIR (1962) 1 HKTC 166 at 182. However, the burden would have been too onerous for the Appellant to discharge if such records had to have been kept and made available to the Board, particularly when, as in this case, the first enquiry by the assessor was only made more than 7 years after the Appellant's acquisition of the Property and about 5 years after its formal appointment of Company P as agent to let out the Property. Even in the assessor's subsequent enquiry to Company P, the latter could not provide such information. Indeed, Company P only provided information, the accuracy of which was also challenged laudably by Mr B in his evidence, relating to Company J rather than the Appellant.

40. Mr Chow also challenged the Appellant's case on the basis of the documents prepared by Mr V, the first being the information sheet which included: (a) the asking selling price of the Property (and the 1/F Property), (b) the site plot ratio and (c) a statement that six property units were at the time offered for sale together and the second was the one-page long proposal which, in addition to the possible rates of return of rental income in simple form, mentioned that the value of the Property (and the 1/F Property) would increase substantially in case of re-development of the Site. As said, Mr V could not be cross-examined. It is undisputed that the first document was prepared before the Appellant's acquisition of the Property. As a result, it could not be prepared in accordance with any instruction from the Appellant or Mr B. The proposal was prepared pursuant to the request of Mr B. However, Mr B denied to have requested for any indication of short-term appreciation in value. Indeed, the proposal only stated that it would possibly be so if the Site

was to be re-developed (emphasis added).

41. We move on to apply the other badges of trade.

42. The fact that the Property, being an interest in land, can be the subject of either trading or investment is a neutral factor.

43. Although there is no evidence suggesting that the Appellant has frequently engaged in similar transactions, this incident may still amount to an adventure in the nature of trade.

44. Clearly, the Appellant has not bought large quantities or number of such properties. It had held the Property for slightly more than three years which, although is not too long, is not too short either. Although the fact is that the Property had never been rented out throughout the period of Appellant's ownership, it had been for personal use, albeit for a short span of time. Such use is evidenced by the utilities bills covering the relevant period.

45. The Appellant offered reasons for the subsequent disposal. On the one hand, it was difficult to let out the Property and it was not fit for self-use, mainly because of the lack of car-parking space. On the other hand, the unsolicited proposal from Company R was fortuitous and difficult to resist.

46. Although Mr B should have known, and indeed he knew, before the acquisition that no designated car parking space would be available, we accept his evidence that he believed, which however turned out to be mistaken, what Mr V assured him and under-estimated the difficulty of car parking either on the Site or nearby. He only came to realize it after the purchase had already completed.

47. Concerning the unsolicited, fortuitous and irresistible proposal by Company R, Mr B categorically indicated that he came to know about it first in January 2007, more than 2 ½ years after the acquisition of the Property. In our view, the Appellant or Mr B could not have anticipated such an opportunity at the time of acquiring the Property. Furthermore, the Company R's proposal also supported that the Appellant had not spent time, money or effort in selling the Property.

48. Mr Chow drew to our attention evidence submitted by Company P that they were appointed by Company J to sell the 1/F Property. Given the relationship between Company J and the Appellant, Mr Chow submitted that it would be logical to deduce or it is possible that the Property was offered for sale at more or less the same time. We do not agree. As seen above, such evidence was reasonably and forcefully challenged. In this regard, we accept Mr B's denial of any instructions given to Company P by the Appellant to sell the Property.

49. The Appellant did spend some money on renovating the Property. It was, however, a relatively small sum. Mr Chow submitted that it was hardly believable that the

sum was spent to improve the attractiveness of the Property to potential tenants. He also cited Mr B's claim that it would be unwise to spend a huge sum on decoration which in turn would unavoidably increase the asking rent. He concluded that the Appellant did not seem to be keen on letting out the Property. We cannot accept this deduction and analysis. In our view, a huge, or at least a large enough, sum spent on renovation would have sought to add re-sale value to the Property, which could then be seen as a badge of trade against the Appellant instead. We accept Mr B's evidence that, as suggested by Mr V, he spent a modest sum on renovation to increase the chance of renting out the Property. At that time, his elder daughter had once resided in the Property (and the 1/F Property) and personally found it not convenient to stay on.

50. The source of finance for the acquisition may be a badge of trade, particularly if the holding period is short. In any event, however, the case authorities tend to suggest that borrowing for acquisition is usually a neutral factor. More importantly, in our view, is whether the stated intention is genuinely held, realistic and realizable. In this regard, we are satisfied that the Appellant had the necessary financial capability through Mr B, its shareholder and director, to hold the Property as a capital asset. Despite all those reservations, uncertainties and remarks given by the Auditors on the face of the Appellant's financial statements, this has shown to be so, at least during the three-year holding period which we tend to say not too short.

51. There remain two other points which we think we should deal with, at least for the sake of completeness if not anything more than that.

52. The first is the Appellant's activities after the disposal of the Property. Mr B's explanation can be seen in our account of his evidence above. On the other hand, Mr Chow called for evidence to show that the Appellant had considered any property to purchase as substitute for the Property, the reasons for not doing so and the levels of the market rates of return that had been considered but not been accepted by the Appellant. We find the approach taken similar to that set out in paragraph 39 above. Our response is equally similar to what we have said in that paragraph. Indeed, the way how the Appellant dealt with the proceeds of sale is neither here nor there. This is not among the typical badges of trade and in no event it would be determinative, one way or the other.

53. The last point is about the profits tax assessment on Company J for gain derived from its sale of the 1/F Property, the late appeal by Company J against which is yet to be heard. We see no need to dwell on this. Suffice to say, as Sir Nicolas Browne-Wilkinson VC said in Marson v Morton, at pages 470-471, '*it is clear that 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 depends on the interaction between the various factors that are present in any given case.*' Although the Appellant and Company J were related companies and Company J was one of the co-owners of the Site, Company J was not a co-owner of the Property. In short, the Appellant and Company J could possibly have different intentions and hence different tax positions.

Conclusion

54. By applying the relevant legal principles together with the badges of trade to all the facts and circumstances of this case as found, we accept the Appellant's case that it did not acquire the Property for trading purposes and hence the gain derived from the subsequent disposal of the Property is capital in nature and not chargeable to tax. Accordingly, we hold in favour of the Appellant and allow its appeal.