

Case No. D16/20

Profits tax – profits on disposal of property – whether original intention as long-term investment – sections 14 and 68(4) of the Inland Revenue Ordinance

Panel: Lo Pui Yin (chairman), Chan Yue Chow and Liu Pak Yin.

Dates of hearing: 20, 21 August and 6 September 2019.

Date of decision: 25 January 2021.

The Taxpayer is a subsidiary of Company D whose principal activities were the operation of a chain of restaurants, property investment and investment holding.

Mr C was a director and shareholder of the Taxpayer at all material times.

At a consideration of \$13,680,000, the Taxpayer purchased and was assigned the Property on 9 October 2009.

At a consideration of \$22,280,000, the Taxpayer disposed of and assigned the Property to Company F on 1 November 2010.

In the Profits Tax Returns for the year of assessment 2010/11, the Taxpayer excluded the gain on disposal of the Property. The Taxpayer claimed that the Property was originally intended as long-term investment for leasing to Company D as premises for a new restaurant.

In the derivation of the gain on disposal of the Property of \$2,983,240, a commission of \$4,456,000 paid to Company G (a related company with Mr C as director) was deducted.

The Assessor is of the view that the disposal of the Property was an adventure in the nature of trade and the alleged commission paid to Company G was not deductible.

The Taxpayer appeals.

Held:

1. Appeal dismissed by Lo Pui Yin (chairman), Chan Yue Chow:
 - 1.1 The Taxpayer's evidence was not entirely consistent with matters of inherent probabilities.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

- 1.2 Mr M's evidence regarding the inspection of the Property has features that impair the reliability of his evidence.
 - 1.3 Mr C's evidence of things said and done at the time, before and after the acquisition of the Property by the Taxpayer do raise real issues on whether the claimed intention of acquiring the Property as long-term investment was genuinely held, realistic and realisable.
 - 1.4 The Property was held for a relatively short period of time and then sold for substantial profits.
 - 1.5 The Taxpayer has not discharged its burden under section 68(4).
2. Appeal allowed by Liu Pak Yin:
- 2.1 The Taxpayer has established its intention of acquiring the Property at the material time was to hold the Property as long term investment, which was supported by contemporaneous documents.
 - 2.2 The Taxpayer's case was supported by Mr M's evidence. Mr M was an independent and reliable witness.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd (in liq) & Ors v Commissioner of Inland Revenue
53 TC 461
Marson (Inspector of Taxes) v Morton & Ors 59 TC 381
All Best Wishes Ltd v Commissioner of Inland Revenue 3 HKTC 750
Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51
Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11
HKCFAR 433
Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140
Tjang Siu Thu v Profield Construction Engineering Ltd & Anor [2015] 2 HKC 22
Jonathan Lu v Paul Chan Mo Po (HCA 370/2012, 7 October 2015, unreported)

Elizabeth Cheung, Counsel, instructed by Messrs Tony Kan & Co, for the Appellant.
Ernest Ng, Counsel, instructed by the Department of Justice, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This Appeal was lodged by the Appellant/Taxpayer, Company A, against the Determination of the Deputy Commissioner of Inland Revenue dated 6 August 2018 rejecting its objection to the assessment of Profits Tax for the year of assessment 2010/11 of assessable profits in the amount of HK\$4,851,086 with tax payable in the amount of HK\$800,429 ('the Determination'). This Appeal is concerned with the issue of whether the profits the Taxpayer obtained from the sale of a property located at Address B ('the Property') should be chargeable to Profits Tax.

2. This Board held the hearing of this Appeal on 20, 21 August and 6 September 2019. The Taxpayer was represented by Ms Elizabeth Cheung of counsel. The Revenue was represented by Mr Ernest Ng of counsel.

3. The Taxpayer called two witnesses and they were cross-examined by the Revenue. The Taxpayer did not call any other witness.

4. The Revenue did not call any oral evidence. The Revenue referred to the documents submitted before this Board.

5. In the sections of this Decision that follow, this Board shall consider the Determination and the evidence placed before it by the parties to this Appeal and make findings of fact. Then this Board shall consider the submissions of the Taxpayer and the Revenue in the light of the facts found and determine this Appeal.

Factual Background

6. The Taxpayer and Revenue have not reached agreement on a set of Agreed Facts for submission to this Board.

7. Notwithstanding the absence of a set of Agreed Facts, this Board is able to understand the factual background of this Appeal from documents placed before it and not disputed by the parties as follows:

- (1) The Taxpayer was incorporated in Hong Kong as a private company in April 2000. At all material times, the issued and paid up capital of the Taxpayer was \$10,000.
- (2) The Taxpayer had at all material times two directors. One of the two directors was at all material times Mr C.
- (3) Related to the Taxpayer was a company named Company D. Company D's principal activities were the operation of a chain of restaurant under the name of 'Restaurant E', property investment and

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

investment holding. Mr C was also a director of Company D at all material times.

- (4) By a provisional agreement for sale and purchase dated 28 July 2009, the Taxpayer agreed to purchase the Property at a consideration of \$13,680,000. The Property was assigned to the Taxpayer on 9 October 2009.
- (5) By a provisional agreement for sale and purchase dated 24 August 2010, the Taxpayer agreed to sell the Property at a consideration of \$22,280,000 to Company F ('the Purchaser'). The Property was assigned to the Purchaser on 1 November 2010.
- (6) In the Profits Tax Return for the year of assessment 2010/11 filed together with the audited financial statements for the year ended 31 December 2010 and a Profits Tax computation, the Taxpayer declared an adjusted loss of \$2,933,824 after excluding the gain on disposal of the Property of \$2,983,240, which was calculated as follows:

	\$
Sale proceeds	22,280,000
<u>Less: Purchase cost –</u>	
Purchase price	13,680,000
Stamp duty	513,000
Legal fee	<u>61,330</u>
	8,025,670
<u>Less: Valuation gain in 2009</u>	345,670
Agency fee	222,800
Legal and professional fee	17,960
Commission and handling charges to Company G (a related company with Mr C as director)	<u>4,456,000</u>
Gain on disposal	<u><u>2,983,240</u></u>

It was claimed on behalf of the Taxpayer that the Property was originally intended to be acquired as long-term investment for leasing to related companies as premises for restaurant and that the gain on disposal was therefore capital in nature and non-taxable.

- (7) The Assessor of the Revenue made enquiries of the Taxpayer's Profits Tax Return for the year of assessment 2010/11. The Taxpayer's representative replied on behalf of the Taxpayer by a letter dated 7 November 2011, which included the following representations:
- (a) The Property was a two-storey house with total gross floor area of about 1,800 square feet. The Property had an estimated age of 44 years at the time of purchase.

- (b) The Property was purchased with vacant possession.
- (c) The Taxpayer's original intention of acquiring the Property was to hold it as a long-term investment, to be let to Company D for generating recurring rental income. Company D had been operating restaurants in various districts of Hong Kong and Kowloon. In 2009, Company D decided to establish a new restaurant in District H and considered that the Property with G/F and 1/F totalling 1,800 square feet at downtown was most suitable for running a restaurant. Hence the Taxpayer acquired the Property which would be let to Company D.
- (d) No feasibility study was conducted on the Property in terms of return on capital. The management of the Taxpayer believed that the rental income from Company D would be sufficient to repay the mortgage loan and interest of slightly over \$50,000 per month.
- (e) The acquisition of the Property was financed partly by bank mortgage and by Company D. Regarding the bank mortgage, the lender was Bank J in the amount of \$7,000,000, repayable by 180 monthly instalments of \$50,039 and guaranteed by Company D. Regarding the financing from Company D, the amount was \$7,254,330 on a rate of interest of 19% per annum with no fixed repayment terms.
- (f) The Property was left vacant during the period of ownership as the application for a restaurant licence by Company D was unsuccessful.
- (g) Company D began to apply for a restaurant licence after the Taxpayer had purchased the Property. A site inspection was conducted by the 'licensing department' and illegal structures attached to the Property were found.
- (h) The Taxpayer had no alternative but to dispose of the Property because there was no hope of obtaining a restaurant licence and the loans were interest-bearing.
- (i) The Taxpayer resolved to sell the Property in mid-2010. The Taxpayer appointed Company K as the estate agent to deal with the sale of the Property. In addition, the Taxpayer engaged Company G to solicit buyers and assist or work jointly with Company K for the sale of the Property.

- (j) The Taxpayer used the sale proceeds to pay off the mortgage loan with Bank J and to settle the amount due to Company D.
- (8) The Assessor of the Revenue was of the view that the disposal of the Property was an adventure in the nature of trade so that the resultant gain should be chargeable to Profits Tax; and that the alleged commission paid to Company G was not deductible. The Assessor therefore raised the following assessment of Profits Tax for the year of assessment 2010/11 on the Taxpayer:

	\$
Less per return	(2,933,824)
<u>Add: Gain on disposal of the Property</u>	2,983,240
Commission to Company G	4,456,000
Valuation gain	<u>345,670</u>
Assessable Profits	<u>4,851,086</u>
Tax payable thereon	<u>800,429</u>

- (9) The Taxpayer objected to the assessment above. The Taxpayer's representative maintained on behalf of the Taxpayer that the intention of the Taxpayer in acquiring the Property was to hold it as a long-term investment, and as such, the gain on disposal of the Property was capital in nature and should not be chargeable to Profits Tax. The Taxpayer's representative made submissions on behalf of the Taxpayer and produced documents in support of the objection by correspondence between 2012 and 2017.
- (10) The Assessor of the Revenue also wrote to the Purchaser, as well as Company L, a company that provided services for applications of a restaurant licence, for information. Both the Purchaser and Company L replied to the Assessor's enquiries.

The Deputy Commissioner's Determination

8. The Deputy Commissioner of Inland Revenue determined that the Property was the Taxpayer's trading stock, the purchase and sale of which amounted to an adventure in the nature of trade, and the resultant profits should be chargeable to Profits Tax under section 14(1) of the Inland Revenue Ordinance (Chapter 112) ('IRO').

9. Section 14(1) of the IRO 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.’

Section 2(1) of the IRO defines ‘trade’ to include every adventure and concern in the nature of trade.

10. The Deputy Commissioner of Inland Revenue stated that in coming to his conclusion in paragraph 8 above, he had regard to the lack of support of ‘solid evidence’ of the claim that Mr C planned to expand the restaurant network of Company D to District H and arranged to have the Property purchased by the Taxpayer for use as a branch restaurant, the questionable genuineness of the ‘study report’ said to have been issued by Company L to the Taxpayer; the fact that the Property was left vacant and sold by the Taxpayer within one year after it was assigned to the Taxpayer; the fact that after the sale, no replacement property in District H or other district was purchased; and the absence of evidence to show that the title defects noted in the provisional agreement for sale and purchase dated 28 July 2009 prevented the Taxpayer from selling the Property to interested buyers.

11. The Deputy Commissioner of Inland Revenue also determined that the commission to Company G was not incurred in the production of the assessable profits of the Taxpayer and therefore disallowed the deduction of the commission. The Deputy Commissioner stated that the Purchaser confirmed with the Revenue that it purchased the Property through Company K and did not directly contact the Taxpayer or its related parties throughout the transaction and that there was no evidence showing that Company G provided the Taxpayer with any services.

12. The Deputy Commissioner of Inland Revenue therefore, by his Determination dated 6 August 2018, confirmed the Profits Tax Assessment for the year of assessment 2010/11 raised against the Taxpayer, showing assessable profits of \$4,851,086, with tax payable thereon of \$800,429.

The Taxpayer’s Grounds of Appeal, Testimonies and Submissions

13. The Taxpayer’s Statement of Grounds of Appeal, which was originally filed in Chinese and has now been translated by the Taxpayer’s legal representatives into English, stated the following matters:

- (1) The Taxpayer was and is a subsidiary of Company D.
- (2) The Taxpayer purchased the Property in 2009 for the purpose of opening a ‘Restaurant E’ restaurant for Company D. This was because Company D once operated a ‘Restaurant E’ restaurant at District H from 2003 to 2005.
- (3) Company D commenced the operation of the ‘Restaurant E’ restaurant chain since 1999. At first, this was done mainly by way of renting premises. Since 2003, Company D began to acquire shop premises for opening branch restaurants in order to reduce the

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

pressure of rental expenses. A list of the shop premises purchased between 2003 and 2010 was provided. It was stated that all these purchases were capital in nature.

- (4) After the Taxpayer had purchased the Property, it was told by a professional restaurant and food licence consultant that the Property could not be used as a restaurant. In order to get back the money for the purposes of operating and development of the restaurant chain, the Property had to be sold.
- (5) None of the properties purchased since Company D's commencement of business in 1999 was for the purpose of speculation. All of them were purchased for operating a restaurant.
- (6) The purpose of the Company D group's acquisition of the Property was also for operating a 'Restaurant E' restaurant. It was for long-term investment purpose.

14. The Taxpayer's case was summarised by Ms Cheung for the Taxpayer. The issue for determination by this Board was whether the acquisition or the subsequent disposal of the Property amounted to a 'trade' for the purpose of section 14 of the IRO. The Taxpayer contended it did not and the evidence of the witnesses of the Taxpayer, together with the contemporaneous documents both before and after the acquisition and the sale was consistent with an intention to hold the Property on a long-term basis so as to allow the Property to be used by Company D to run a restaurant under the name of 'Restaurant E'. At no time did the Taxpayer intend to acquire the Property as trading stock. However, the intention to run a restaurant business at the Property was frustrated after advice was taken from licensing professionals who related that the certain structural characteristics found at the Property would make it very difficult to obtain the relevant 'full restaurant licence' and it would not be cost-effective to modify the premises.

Mr M

15. The Taxpayer called as the first witness Mr M. Mr M was at all material times a shareholder and director of Company L. He stated that Company L's main business was to provide services for companies to obtain food and restaurant licences, to coordinate food licensing and hygiene manager courses for different companies, and to assist entities to establish food safety management standards and to obtain accreditation of ISO 22000 standard. Since the establishment of Company L in 1996, it had successfully applied on behalf of its clients for over 5,000 licences to run food businesses in Hong Kong. Company L was and is the holder of ISO 9001 accreditation.

16. Mr M stated that he had been professionally acquainted with Mr C of Company D for over 10 years. Mr C had instructed Company L to apply for licences for his restaurants.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

17. Mr M stated that when a restaurateur wishes to start running the business of a restaurant from scratch, in the sense that he is not taking over premises which have already been granted the requisite licences, he would need to inspect the premises for the purpose of considering how the relevant licences and approvals from the Government departments would be obtained. Often, a licensing consultant like Company L is engaged to render services. Depending on the circumstances of the premises, several Government departments can be involved, including the Lands Department regarding stipulations in the Government lease, the Buildings Department regarding structures within the property, the Fire Services Department regarding fire fighting facilities, means of fire escape, smoke ducts and stove kitchen, and the Food and Environmental Hygiene Department regarding the overall conditions of the proposed restaurant and the issuing of the restaurant licence. If the premises of the proposed restaurant were affected by unauthorized structures, consideration would have to be given to cure such defects and sometimes it would not be possible and/or financially viable to cure such defects. If unauthorized structures in the premises remain not remedied at the time of the inspection by officer(s) of the Buildings Department for the licence application, the Building Department's surveyor would report the matter to the Food and Environmental Hygiene Department, the application for a restaurant licence is likely to fail. Also, if the premises of the proposed restaurant are found by the Fire Services Department to be not meeting the requirements in the width of the corridors or staircases, the application for a restaurant is likely to fail.

18. Mr M stated that in general, when Company L is engaged, the restaurateur would instruct Company L to inspect the premises of the proposed restaurant and give professional advice on matters that need to be looked into and highlight various areas of concern. Building plans would be obtained if possible and the structures found in the premises would be checked against the building plans.

19. Mr M recalled the circumstances in which Company L was asked by Company D to inspect the Property:

- (a) Ms N, Position P of Company D, instructed Company L to inspect the Property in 2009.
- (b) Company L's file on the engagement relating to the Property had been destroyed due to the lapse of time. Revenue generating and financial/accounting records were normally kept for up to 7 years. Other documents would not be kept for more than 7 years. Documents kept more than 7 years would be destroyed.
- (c) Mr M recalled that he inspected the Property in November 2009. He could not recall whether he had obtained any building plans for the inspection. The Property was a very old two-storey building which was used as a shop (and not a restaurant) at the time. There was a staircase from 1/F to G/F with direct access to the outside but its width was less than the statutory requirement of 1,050 mm for means of escape. The first floor was constructed with timber and cement, which

was not the concrete standard required to meet the standard in the Building Safety Requirements for catering or restaurant premises.

- (d) Mr M came to the conclusion that the Property in the existing state was not recommended for legitimate restaurant use because it was unlikely that the necessary licences could be obtained. Mr M was of the view that if the Property were to be used as restaurant premises and in order for it to successfully obtain the necessary licences, the Property would need to be substantially refurbished.
- (e) Mr M was assisted in recalling the engagement relating to the Property by referring to a letter dated 25 November 2009 entitled 'Feasibility Study on Restaurant Licence Application at Address B' ('the Company L 25 November 2009 Letter'). The Company L 25 November 2009 Letter was shown to Mr M by the Taxpayer's legal representatives. Mr M confirmed that the Company L 25 November 2009 Letter was issued by Company L, the signature on the letter was his signature, and the person named in the letter as 'Mr M' was he himself. Mr M also confirmed that the views expressed in the letter were his own views.
- (f) Mr M also recalled that he decided to waive charges for any fees in respect of his inspection of the Property and his report. This was because the inspection of the Property did not result in any substantial professional work by Company L and since Company D was a long-term and repeated client, Company L had a practice of only charging such a client the professional licences fees when the licences were issued.
- (g) Mr M also recalled that Company L had not prepared any contract, engagement or quotation for the Taxpayer or Company D to sign as the matter did not result in any profit-generating work.

20. Mr M was also shown a letter issued by the Food and Environmental Hygiene Department to Madam Q dated 25 April 2008 to an address that was the registered office of Company L ('the FEHD 25 April 2008 Letter'). Mr M stated that he was not aware of the existence of this letter until he was shown a copy of it by the Taxpayer's legal representatives. Mr M stated that he did not know Madam Q personally and she might be a client of another director of Company L, Mr R, his brother. He had no recollection that Company L had a client of that name in 2008 who instructed Company L to submit an application to the Food and Environmental Hygiene Department for General Restaurant Licence with regard to the Property. Mr M added that Company L might help customers to submit an initial application to the Food and Environmental Hygiene Department to see whether the department might have any objection to an application for General Restaurant Licence and in so doing, the address of Company L might be used as the correspondence address. Mr M stated that he was unable to retrieve any hard copy document relating to Madam Q. However, after Mr M was shown by the Taxpayer's legal representatives the

reply of a Mr S of Company L to the Assessor of the Revenue faxed on 16 April 2018 regarding the Assessor's enquiry on the appointment by the Taxpayer of Company L to inspect the Property for restaurant licence application in 2009, Mr M was able to obtain from the computing record of Company L a Job No. XXXXXXXXX related to the address of the Property with the name of the applicant being Ms Q. Mr M also explained that the Job No. indicated that this was a job in 2007 ('07') and in the month of June ('06'), with the last three digits standing for the accumulated number of clients Company L had back then. By reference to the Job No., Mr M was able to ask his colleague from the computer department to find and retrieve old records, including a 3-page quotation in Chinese dated 26 July 2007 in respect of a General Restaurant Licence at the address of the Property for the contact person named Ms Q1.

21. Mr M also supplemented on the reply of a Mr S of Company L to the Assessor of the Revenue faxed on 16 April 2018. Mr M stated that Mr S was a colleague of the accounting department of Company L who had left Company L for personal reasons. Mr M also stated that he had not seen the letter before he was shown a copy of it by the Taxpayer's legal representatives on 13 August 2019. Mr M further stated that usually the colleagues at the accounting department would have the company chop of Company L. Mr M furthermore stated that he had not seen the letter of the Assessor of the Revenue enquiring Company L of the appointment of Company L by the Taxpayer to inspect the Property before he was shown a copy of it by the Taxpayer's legal representatives. Mr M commented that he found the letter 'very curious'. Firstly, the letter was on white paper and the company chop was upside down. Mr M said that the practice of the company when replying to correspondence with an external party like a Government department would be to use the company chop on paper with the Company L letterhead. Mr M also said that the other details like fax number, email address and the name of Mr S were all correct. Secondly, Mr M checked the computer records and considered that Mr S's reply did not tally with the computer records. While Mr S referred to a client approaching Company L in August 2009 wishing to apply for a restaurant licence in respect of the address of the Property, the computer record showed a record of a client in June 2007. Mr M expressed that he had no idea of the circumstances under which Mr S issued the reply for Company L.

22. Mr M was cross-examined. Mr M had no professional qualification in surveying or engineering. Mr M had been in the business operated under Company L since 1996. Mr M agreed that as a director of Company L, he would be responsible for what the company did and did not do and that he was also quite familiar with the operational side of the company. Mr M stated that he had not looked at the computer records system to see if the file of the engagement by the Taxpayer could be retrieved and agreed that if there was any records, they would be on the computer. Mr M was questioned about the reply letter Mr S faxed on 16 April 2018. Mr M agreed that Mr S was a member of Company L's staff at the time of issuance of the letter and he would have access to the computer system at that time. Mr M disagreed that the contents of Mr S's letter were no Job No. in the case not contradictory or inconsistent with what he later on found out from the computer system. Mr M reiterated that he went back to the computer system and found out that the date was June 2007 and this was a major difference, as Mr S's letter stated the date to be August 2009. As to the remainder of Mr S's letter stating that there was a contact by a Ms Q1 requesting Company L to provide a quotation and there was no follow up action after completing the

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

quotation process, Mr M replied that he was unable to find a physical document or an electronic document to show that this part of Mr S's letter was wrong. Mr M also agreed, when he was later questioned by this Board, that it would have been prudent for Mr S to have asked him or his brother, the directors of Company L, if he was not sure about something stated in the letter from the Assessor of the Revenue, and added that if Mr S had given the letter in reply to him, he would have made corrections before sending it out. Mr M, when he was later asked by this Board whether he could agree that the Ms Q1 stated in Mr S's reply letter was the Madam Q addressed in the FEHD 25 April 2008 Letter, he answered that he was not sure whether both referred to the same case, and he pointed out that the time sequence was 'very curious'. On the other hand, he was unable to answer why Mr S knew that there was a Ms Q1 who asked for quotation when he wrote the reply to the Assessor of the Revenue.

23. Mr M was also cross-examined on the documents he had retrieved from the computer system. Regarding the 3-page quotation in Chinese dated 26 July 2007, Mr M stated that this was a standard pro forma document used by the company, and further stated that this pro forma document was still used in 2008, 2009 and 2010, albeit not necessarily word for word, since such quotations were drawn according to the requirements of the customer, which may differ from customer to customer and so modifications would be made. These could include the structure of collection of payments. For long-term customers, the company may waive the deposit. As to the Taxpayer, by 2010, the company looked at it as a return customer and would skip the intermediate payment. Whatever the payment structure was adopted for a particular customer, that would be listed out in the quotation in writing.

24. Mr M was questioned by this Board. Mr M was referred to the number beginning with 'LQA' on the 3-page quotation in Chinese dated 26 July 2007 and he stated that in relation to the numbers, the first two referred to the year, the next two referred to the month, and the last three referred to the accumulated number of professional services quotations. Mr M was next referred to a quotation issued by Company L to 'Restaurant E' (which was produced by the Taxpayer's representative to the Revenue) and asked about the Job No. and LQA No. shown on that quotation. Mr M clarified that the Job No. was always a seven-digit number and there was a typographical error on that quotation. Mr M was then referred to another quotation issued by Company L to 'Restaurant E' (which was also produced by the Taxpayer's representative to the Revenue). Having read the quotations, Mr M confirmed that when a client or potential client enquired Company L about a possible restaurant licence application and left the company with details or the address of the proposed restaurant premises, the company would enter the Job No. After negotiations between the company and the client, a quotation number and then a LQA No. would be produced. Mr M was then referred to the Company L 25 November 2009 Letter and it was pointed out to him that this letter did not contain a reference to a Job No. Mr M explained that he prepared and signed on the Company L 25 November 2009 Letter, he did the analysis on the address, which was the Property, and when the Taxpayer's legal representatives contacted him earlier in February 2019 about this letter, he recognized that it was prepared by him and then he went back to the company's computer record and found no record. Mr M stated that he did not really explain why there was no Job No. in the case. Mr M added that in August 2019, after he was shown the letter of Mr S, he went back to the computer

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

system again to retrieve information by date, time or address, and he could find that there was a job and from the Job No., a job in June 2007.

25. Mr M was also questioned by this Board as to why he ‘waived’ the charges for any fees in respect of the inspection and report of the Property when Company L had issued no quotation. Mr M answered that he meant that he did not intend to charge a fee in this case.

26. Mr M confirmed, upon questioning by this Board, that if he had not been shown by the Taxpayer’s legal representative the Company L 25 November 2009 Letter, he would not have any independent recollection about the time he inspected the Property.

27. Mr M was also asked by this Board why there was no addressee on the Company L 25 November 2009 Letter. His answer was that he could not say that this was the practice of Company L, and he agreed that since the letter was prepared after he made the inspection of the Property it would have been quite easy for him to put the addressee in the letter.

Mr C

28. The Taxpayer next called Mr C. Mr C had been in the business of a food importer and a restaurateur. Mr C was a director and shareholder of the Taxpayer at all material times. Mr C referred to the Taxpayer (which was incorporated in Hong Kong in April 2000) and Company D (which was incorporated in Hong Kong in 1993) as Restaurant E Group. Through the Taxpayer and Company D, Restaurant E Group had run a restaurant business in Hong Kong, including a chain of restaurants under the brand name ‘Restaurant E’. Mr C stated that in the early years of business, the ‘Restaurant E’ restaurants were established in the busier parts of Hong Kong with a lot of pedestrian traffic. Later, as ‘Restaurant E’ started to become a more recognized brand and established its reputation, the restaurant network was expanded to some districts in the New Territories. Mr C explained the rapid development of the ‘Restaurant E’ restaurant business by reference to a list of restaurants operated by Restaurant E Group, showing that the restaurants were opened at almost back-to-back dates. When Restaurant E Group first started in September 1999, the group rented premises to operate business and always had to spend a lot of money in the initial decoration/renovation work of the premises including obtaining all the relevant Government food and liquor licences. The normal lease agreement would be for a period of two or three years. At the expiry of each lease agreement, the rental would normally be increased substantially, making business a lot less profitable. And often because of the high rental, Restaurant E Group would vacate and move to new premises. Later on, it was always the intention of Restaurant E Group to purchase the premises whenever possible to open the restaurants in order to make the restaurant business more profitable in the long run and not having to change premises that often, and not having to lose the great amount of renovation/decoration costs of the premises. The practice of Restaurant E Group was always that whenever premises were brought, a restaurant of the group would be opened in the premises. Mr C also stated that the intention of Restaurant E Group (including the Taxpayer) had always been to purchase properties for long-term use so as to allow the restaurants under the trade name of ‘Restaurant E’ to be operated from the premises. There was no intention

for short-term sale. This was the Taxpayer's one and only intention of buying properties, including the Property. The Taxpayer had at all material times been holding its properties as long-term investment. Restaurant E Group may close down restaurants if and when the business was not profitable. Some premises may be sold, but the monies would then be re-invested to acquire another premises or for the continuous running of the 'Restaurant E' restaurant business. The intention of holding the properties for long-term investment had never changed. Another list of properties acquired by Restaurant E Group for the purpose of running restaurants was produced, and by reference to this list that showed the record of purchase and sale, Mr C indicated that none of the profits showing up in the sale of any of these properties were ever taxed and this was because all the properties were purchased for opening a restaurant and as long-term investment, a consistent practice of Restaurant E Group and himself.

29. Mr C then stated the details of the purchase and sale of the Property:
- (a) In or around 2004, Company D was a tenant of shop premises at Address T. Company D rented those shop premises for the purpose of running a restaurant under the brand of 'Restaurant E'. The shop premises in fact consisted of two shops owned by separate owners, each charging a rental of \$22,500 per month. The business of the restaurant initially went well but when it came to the end of the tenancy period, the landlords demanded an exorbitant amount of rental increase for a new lease, which would make the whole business unprofitable. Mr M decided not to renew the tenancy, and the investment on the decoration and renovation of the restaurant and the resources expended for obtaining the licences were wasted.
 - (b) After the end of the tenancy for the previous shop premises at Address T, Mr C kept on searching for another location for restaurant business in the District H area.
 - (c) By 2009, Mr C already had the experience of opening 50 to 51 restaurants. There were 8 among them that were in premises that Mr C bought and turned them for use as restaurants. Mr C stated that he had not done any feasibility study in respect of any of the 50 premises and all of them were successfully opened as restaurants.
 - (d) In 2009, Mr C was shown the Property by a local estate agency, Company K. The Property was vacant at the time. Mr C emphasized to the estate agent that he was looking for premises to run a restaurant. The estate agent emphasized to Mr C that the Property was previously used as a Chinese restaurant. The Property was situated just across the street from the previous shop premises at Address T, and consisted of two floors, with two staircases connecting the G/F to the 1/F. There were two fire escapes, an indication to Mr C that the building had been used for commercial purpose. The estate agent showed him the FEHD 25 April 2008 Letter. Mr C then believed that the Property was

fit to open a restaurant with a suitable size and the necessary licences could be obtained. He thought that the Property was an excellent location for a restaurant which he hoped would be more successful. Mr C made the decision to purchase the Property by himself. The way Mr C made the decision to purchase the Property was consistent with the way other properties were acquired by Restaurant E Group.

- (e) At the time, Company K advised Mr C that there might be title problems with the Property since the Block Crown Lease of the Property was destroyed by fire many years ago. Mr C was advised by lawyers of the risks of the title problems and the impact such risks may have on the arrangement of mortgage or finance. In order to spread the risk, Mr C decided to use the Taxpayer, which did not carry on business, to acquire the Property, as opposed to using Company D, which was the main arm of the 'Restaurant E' business.
- (f) Mr C was aware at the time of the purchase that the Property included a front yard which had a structure of corrugated iron erected thereon at the time. Mr C believed that the restaurant to be opened would be within the building and his plan was to locate the squatter associated with the corrugated iron structure at the front yard and paid him or her some money to make him or her go away.
- (g) Company K helped with the preparation of the provisional agreement for sale and purchase, which was eventually signed on 28 July 2009. When the provisional agreement was signed, Mr C visited the Property with Ms N, the accountant of Restaurant E Group.
- (h) Mr C referred to the minutes of directors' meeting that were prepared by a law firm appointed to act for the Taxpayer in the acquisition of the Property. Mr C stated that the minutes were prepared just for the purpose of the completion of the conveyancing transaction and did not set out the purpose of the transaction was for the Taxpayer's long-term investment. Mr C made the point that while the minutes may not have mentioned the intention of the Taxpayer, it did not change the Taxpayer's purpose and intention.
- (i) Mr C referred to his experience in property transactions and stated his understanding that there was only a very short period of time (such as two hours) between the viewing of the property and the signing of the provisional agreement. It was normally not possible for intended purchasers to do a lot of research and checking by surveyor or other professional on the physical conditions or other matters of the premises, or the premises would be sold to someone else. Mr C stated that he was used to making such snap decisions.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (j) Mr C stated that at the times when visits to the Property were made, he was not aware of any of the unauthorized structures in the Property as no one had mentioned the matter to him. Mr C noted that the unauthorized structures in the Property were a separate matter from the illegal structure made of tin located in the front yard, which he was aware of. Mr C referred to the absence of any notice registered in the Land Registry of any unauthorized building works in the Property.
- (k) Mr C received legal advice that the Taxpayer could purchase the Property without any problem on the title despite the loss of title deeds by fire and that the Taxpayer would be able to obtain a mortgage from a bank for finance.
- (l) Mr C stated that he was influenced by the FEHD 25 April 2008 Letter, which led him to believe that an application for a restaurant licence for the Property could be approved by the Food and Environmental Hygiene Department. Mr C explained that this type of 'renovation letter' was concerned with the address, so if an address itself carried a licence granted by the Food and Environmental Hygiene Department, then anyone who acquired that address would be in a position to open a restaurant.
- (m) Completion of the sale and purchase of the Property took place on 9 October 2009. On the same date, immediately after completion, the Property was mortgaged to Bank J. The Taxpayer arranged for this mortgage, and it appeared that in the course of arranging for the mortgage, Bank J was supplied with a copy of the FEHD 25 April 2008 Letter, which had remained in the file. The monthly instalment for the mortgage repayment was \$50,380. This was considered to be not too heavy a burden when compared with the monthly rental paid for the previous shop premises at Address T of \$45,000. Mr C was of the view that the Taxpayer would be able to run a long-term and sustainable restaurant business, had the Property been granted the relevant restaurant licence.
- (n) Mr C instructed Mr M, the director of Company L, to help with obtaining the relevant licences necessary for running a restaurant in the Property. Restaurant E Group had instructed Company L many times before. Mr M had never advised him that there were any properties which could not be suitably modified to become a restaurant. In relation to the Property, Mr M went to inspect the Property and after the inspection, Mr M informed him that he was of the view that the Property was not suitable to be used for the restaurant business as he could foresee that it would be impossible to obtain the various licences from the different Government departments. Particularly, Mr M informed him that the Property was a very old building, and the staircase from 1/F to G/F and then out of the building

was of insufficient width to meet the revised minimum width of 1,050 mm under the statutory requirement as a means of fire escape. And, Mr M explained that the roof on the G/F was constituted of timber and cement, and not of concrete, and based on this, Mr M formed the view that the Fire Services Department would deem such roof structures to be inferior for fire resistant purposes. Mr M concluded that the Property was not a suitable premises to run a restaurant business unless the two-storey building was to be demolished and rebuilt. Mr C referred to the Company L 25 November 2009 Letter, which he said confirmed Mr M's oral advice to him. Mr C also stated that as Company L could not do any work for obtaining licences and it only charged on successful application, Company L had agreed with the Taxpayer that it would not charge for the work done.

- (o) The Company L 25 November 2009 Letter was entitled 'Feasibility Study on Restaurant Licence at [Address B]' and stated the following:

'The premises was checked and found to be a two-storey detached house. First floor is accessible through 2 external staircases. The width of each staircase is less than 1050 mm which does not comply with minimum building Requirement for Means of Escape.

Furthermore, the first floor was constructed of timber and cement which is not a proper concrete to meet Building Safety Requirement for restaurant (Minimum 5kPa). Hence this premise is not recommended for legitimate restaurant use.

Prepared by
(signed)
Licence Consultant – [Mr M]
[Company L]'

- (p) Mr C stated that the advice from Company L made it not viable for Restaurant E Group to run a restaurant from the Property. It did not make economic sense for the Taxpayer to demolish the structure and rebuild it completely. As the original intention to run a restaurant in the Property could not be achieved, Restaurant E Group had to consider options, including selling the Property to use the money to buy another property to run the restaurant business. Mr C stated that he did not expect there were the problems stated in (n) above, and since he was not a building developer, he was not sure whether he could renovate the Property to the required standards for running a restaurant and this was a big problem to him. He had to accept that the Property could not be used for the purpose of running a restaurant and the Taxpayer would have to realise its investment and have the money to do something else.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (q) The Taxpayer took steps to sell the Property. Eventually a purchaser was found. Although the sale of the Property generated some profit, that was because the Property was not suitable for the restaurant business and not because the Taxpayer changed its intention to engage in short term property trading.
- (r) Mr C stated that Restaurant E Group continued to search for another property in the District H area at the time but the group was unable to find any premises there of a suitable size and location for the purpose of a restaurant. The houses and buildings in District H were in small sizes. Restaurant E Group looked for suitable premises in other areas and bought up several properties, which were all opened as restaurants.

30. Mr C emphasized that at all material times, the Taxpayer always held the intention that the Property would be purchased and held for long-term use as premises from which a restaurant would be run and there was no intention for short-term sale. Mr C also emphasized that Restaurant E Group did not have any track record of quick-fire sale demonstrating that it regarded properties as stock-in-trade. Mr C further emphasized that the Property was acquired and sold in the peculiar circumstances as Mr M of Company L advised that it would not be feasible to run a restaurant from the Property.

31. Mr C was cross-examined. Mr C stated that he passed to Ms N for handling with the Taxpayer's accountant and auditor the correspondence with the Revenue over the assessment of Profits Tax of gain on the disposal of the Property by the Taxpayer and that Ms N handled the preparation of the Statement of Grounds of Appeal before presenting it for him to sign.

32. Mr C was asked about the purchase of the Property. Mr C was asked to compare the version of the provisional agreement for sale and purchase on the occasion of the purchase of the Property by the Taxpayer provided to the Revenue by the Taxpayer's representative (i.e. its accountant) and the version of the same exhibited with his witness statement (which appeared to be the version retrieved from the Land Registry) and provide explanations on the discrepancies apparent from the comparison. Mr C made the point that for the provisional agreement there were occasionally corrections that the parties would need to initial. Mr C also made the point that the version retrieved from the Land Registry was the final version. Next, Mr C was taken to the land search of the Property which suggested that there was no final agreement for sale and purchase related to the Taxpayer's purchase of the Property. Mr C responded that he was not a lawyer and all he did was to buy and sell a property, and he could not recall whether he had signed a formal or final agreement for sale and purchase for the Taxpayer's purchase of the Property. He also could not recall whether he received any advice that he did not need to sign a formal or final agreement for sale and purchase. He also responded that it was up to the lawyers to handle.

33. Mr C was asked about the inspection he made of the Property. Mr C recalled two inspections. While he could not recall whether he went alone or with Ms N on the first inspection, he was sure that he was with Ms N on the second time, because there were

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

documents to sign. He would go with Ms N when he thought that a deal would be made, since it would be Ms N who would look into the contract, and contact the bank to arrange the loan. Mr C recalled that there was nothing in the building of the Property except some garbage. Then, Mr C was taken to the correspondence the Taxpayer's accountant/representative sent to the Revenue which described the Property as well decorated with suspended/painted ceilings, painted/tilted walls, carpet flooring and aluminium framed windows. In reply, Mr C disagreed with the description and expressed that he did not know how such description came up in the correspondence. Mr C stated that in fact there was no decoration at all, the building was vacant.

34. Mr C was asked about Company K, the estate agent. Mr C stated that he had not tried to contact Company K for the purpose of this Appeal, such as giving evidence for the Taxpayer. He also stated that all along the correspondence with the Revenue was handled by Ms N and the Taxpayer's accountant/representative and he was not involved. Going back to the time in 2009 when Company K contacted Mr C regarding the Property, Mr C recalled, in addition to the terms in his witness statement, that he was busy at that time and District H was a remote place, and it would take some time to arrange a site visit, but that the estate agent was rushing him over the Property, claiming to him that the Property was quite special, the seller was eager to dispose of it, and there were many people who had their eyes on it.

35. Mr C was asked about the inspection of the Property after the Taxpayer had made the purchase. Mr C stated that after the acquisition, he called Mr M of Company L to take a look at the Property for the purpose of doing the licence applications. Mr C was not certain whether Mr M inspected the Property in person. Mr C was also shown the correspondence of the Taxpayer's accountant/representative with the Revenue that suggested that there was an inspection by 'the licensing department' which concluded that there were illegal structures that did not fulfil the licensing requirement for a restaurant. Mr C replied that it was possible that he and the accountant understood matters differently, and he disagreed with the description. Mr C was also shown the Company L 25 November 2009 Letter. It was suggested to him that the said letter did not state that it was impossible to get a restaurant licence. Mr C replied that from what he read of the said letter and his experience, the said letter was saying that it was impossible to get a restaurant licence. It was also suggested to Mr C that the said letter did not say what had to be done in order to get the restaurant licence, such as demolishing and rebuilding the whole building. Mr C replied that Mr M did not say that the licences could be obtained and he had never received a letter like this in his experience of running 50-plus restaurants. Mr C was then shown the conclusion of Mr M in his witness statement and asked to comment. His response was that it was generally correct as some kind of work needed to be done before licences could be obtained.

36. Mr C was asked about the loans used to finance the purchase of the Property. Mr C indicated that the Taxpayer did not have a bank account and it was Company D that issued the cheque that paid the deposit under the provisional sale and purchase agreement. Mr C was shown correspondence by the Taxpayer's accountant/representative to the Revenue which stated that a sum of \$3,602,133 was borrowed from Company U for purchasing the Property. Mr C agreed that there was such loan and added that this loan did not involve a signed loan agreement and no security was required. It was pointed out to Mr

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

C that this was different from his evidence. Mr C explained that it was possible that Ms N made the arrangement. He did not know who borrowed the money from Company U and for whom. Mr C underlined that Ms N followed up on the purchase of the Property he made and was responsible for liaison with the banks.

37. Mr C was asked about the sale of the Property by the Taxpayer. Mr C stated that he had thought about renting the Property out for the short term but given the messy tin houses in the front yard, he could not rent the Property out as a shop front. Mr C had also thought about renting the Property as a warehouse but the amount of rent this could generate was at most \$7,000 per month and Mr C was not that tight with cash. Mr C had no personal knowledge of any efforts made to rent out the Property for the short term. Mr C remembered that the Property was put on the market for 4 to 5 months because at that time, Restaurant E Group hesitated and debated internally on what to do with the Property. He also remembered that a complaint was made against Company K and Company K proposed to Restaurant E Group that the Property be sold and came up with a buyer. He believed that it took maybe about one month for Restaurant E Group to consider. He explained that Restaurant E Group had spent a lot acquiring the Property but was unable to open a restaurant to create cash flow and meanwhile, funds were tied up and the cash flow kept on flowing out because of the commitment to pay the mortgage. This amounted to great pressure. Mr C was taken to the correspondence the Taxpayer's accountant/representative made to the Revenue which made the point that Company G had solicited a potential buyer who finally agreed to purchase the Property from the Taxpayer and asked which version was correct, and his responses were that he was probably representing Company G in the deal since he also worked for Company G; and that he did not know why as he did not write the correspondence himself and had never read the said letter.

38. Mr C was shown the ledger of the current account of the Taxpayer around the time of the sale of the Property and asked about payments recorded there of a total of about \$6 million odd to Company U after the sale of the Property. Mr C replied that he was not able to answer why there were those payments. On re-examination, Mr C was shown the correspondence the Taxpayer's accountant/representative to the Revenue that enclosed the said ledger. Mr C was then able to say that the payments to Company U was probably to pay back a loan that Company D arranged from Company U.

39. Mr C was shown the audited financial statements of Company D. It was pointed out to him that between 1 January 2009 and 31 December 2010 the net current liability of Restaurant E Group was over \$100 million and bank facilities utilisation percentage was very high (i.e. between 91.6 to 94.98 per cent). It was suggested to him that in fact it was not feasible at those times for Restaurant E Group to maintain another restaurant in District H. Mr C disagreed, since he had been granted bank facilities, there were unutilised facilities, he could raise loans, many of the properties of the group were mortgage-free. There was no need for him to worry about the financial implications of opening another restaurant.

40. Mr C was asked about the expression 'quick fire sale' used in his witness statement. He replied: 'speculative buy and sell'. He explained that Restaurant E Group was not engaged in sale and purchase of properties in quick turnaround because had the group

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

done so, the bankers would not have given the group the financing to carry out the business. Rather, Restaurant E Group's policy was for long-term investment and Mr C gave two examples of a property that the group had held from the time of purchase to the date of the hearing of this Appeal. The main thing, according to Mr C, was that where the property concerned was not suitable for restaurants, the group would see whether rental income could be derived from it or whether it had become a burden to the group. The property must generate rent because the group had to service the mortgage. And, in the latter case, the group would dispose of the property and then try to find another property for the restaurants.

41. Mr C was asked about Ms N. He confirmed that she was the person who knew the best about the transactions related to the Property, the correspondence with the Revenue and the correspondence with the bank. He was asked why she was not giving evidence for the Taxpayer in this Appeal. His reply was that he entrusted the case to the Taxpayer's legal representatives and they asked Mr M and himself to stand as witnesses in this Appeal. If Ms N was requested to stand witness, he thought this was possible.

42. It was put to Mr C that the Taxpayer purchased the Property not as a capital investment but as a trading stock. Mr C disagreed and explained that since the Property did not have the title deed and would have been difficult to dispose of, it would have been the last choice he would get for use as trading stock. Rather, he liked the open yard in the front of the Property which could be used as an open ground for smoking restaurant patrons.

43. It was put to Mr C that it was unreasonable for him to make such a quick decision to buy the Property for operation as a restaurant given the old age of the Property, the title defects and illegal structure. Mr C disagreed. He emphasized that the location of the premises of the Property was a very good one in District H.

44. This Board questioned Mr C on the way Restaurant E Group expanded its restaurants into the newly developed areas in the New Territories, as well as the restaurant at Address T. Mr C explained that he wished to cover the District H area with one of his restaurants and Address T restaurant was 1,400 square feet comprising of two adjoining units. Although the business was good initially, there were problems afterwards, namely the remoteness of the location, the difficulty with recruiting Chinese staff, patrons getting tired of the food, and the less than good economy of scale due to the small size of the premises. Mr C commented that the Property was better in that it had a front yard, two storeys, and an independent location, making eating outdoors possible. Mr C also explained that the negotiations for renewal of Address T restaurant broke down because one of the two landlords wanted to renew at a reasonable rental but the other landlord did not want to renew and asked for a much higher rental.

45. This Board also questioned Mr C as to the efforts Restaurant E Group took to look for new locations in District H. Mr C stated that he gave word to the estate agents to find and show properties for him but properties in District H were relatively small and an operation like a 'Restaurant E' restaurant needed location of a bigger size. Then Company K approached him with the Property, which was about 20 paces across the road from Address T.

46. This Board further questioned Mr C on the scale of costs for renovating the Property to the standards appropriate for restaurant licences after he received the advice of Mr M of Company L. Mr C replied that he held Mr M's opinion in high regard since Mr M was a very respected figure in the licensing business, having served as a director of four associations concerned with restaurants, catering and beverages. Once Mr M said that the Property was not suitable, Mr C realized that if he were to obtain the licences it would not be enough for him to renovate the floor slab or do something with the fire escapes as the building was so old that renovation to one part would lead to damage to other parts. Redevelopment of the building might take two or three years or maybe longer, and this was a business he was not familiar with. So finding another location to open a restaurant was a better idea. Indeed, after he disposed of the Property, he bought four additional premises and opened a restaurant in each of them.

The Taxpayer's Submissions

47. Ms Cheung for the Taxpayer submitted that the ascertainment of the Taxpayer's intention was to be an objective exercise; the narrative evidence would have to be assessed in light of inherent probabilities and against the backdrop of contemporaneous documents. In a case where there had been no change of intention throughout, it must be legitimate to look at all the facts and happening over the years to find out the intention of the Taxpayer; that was the approach of the 'badges of trade'. Among them, the happening on the date of acquisition was important; there must have been a reason to prompt the Taxpayer to acquire the asset in the first place. Hence the emphasis on the Taxpayer's intention at the time of acquisition in some of the authorities that did not adopt the 'badges of trade' approach. Such an emphasis required looking at all the circumstances of the case, including those happening before and those happening subsequently. Things that happened subsequently would help throwing light on what the intention of the Taxpayer as they happened, which could help corroborate or contradict an intention said to have been held by the Taxpayer at the time of the acquisition. In this Appeal, Ms Cheung submitted that the Taxpayer's intention had never changed and the intention was to acquire the Property for the purpose of opening a restaurant.

48. Ms Cheung submitted that the Taxpayer's two witnesses had stood by their evidence in spite of the cross-examination and their testimonies, which had been thoroughly tested, should be accepted by this Board. Ms Cheung provided this Board with thorough closing submissions in written form on the evidence of the witnesses of the Taxpayer and what their evidence would establish, and she supplemented with oral submissions.

49. Ms Cheung highlighted the following aspects of the testimony of Mr M: (1) Mr M was an independent witness; (2) Mr M's evidence was entirely corroborated by the report of his inspection of the Property, i.e. the Company L 25 November 2009 Letter; (3) The Revenue had not suggested that Mr M did not attend the Property in November 2009. Nor had the Revenue suggested that the report of the inspection was not issued by Mr M or the views stated in that report were not held by him; (4) None of the matters of so-called inadequacies of the Company L 25 November 2009 Letter, whether individually or cumulatively, contradicted Mr M's evidence that he had visited the Property and advised Mr C that it would not be possible for the Property to obtain a restaurant licence in its current

structural state. Mr M was not cross-examined about the inspection and this letter and he had answered the questions of this Board about aspects of this letter; (5) Mr M had explained in his evidence the need for him to correct his witness statement in light of him reading the letter of Mr S of Company L to the Assessor of the Revenue faxed on 16 April 2018 and having conducted a search of the computer records of Company L. Mr S had responded to the letter of the Revenue without enquiring with Mr M. It would be wrong to prefer this letter of Mr S over the sworn evidence of Mr M; (6) The shortcomings in Company L's record keeping did not make Mr M unreliable as a witness; (7) The Revenue should have retracted the allegation that Mr M was not familiar with the restaurant licensing guidelines, a serious accusation against a restaurant licensing professional, since there was cross-examination on this point; (8) The Revenue was wrong to make an issue of the fact that Mr M did not charge Mr C for the inspection and the report of the inspection. The submission that this part of Mr M's evidence on charging or waiving of fees should not be believed should not have been made since Mr M was not cross-examined on the point. On the other hand, Mr M had explained in his evidence why he did not charge Mr C any fees for the inspection.

50. Ms Cheung highlighted the following aspects of the testimony of Mr C: (1) Mr C was the decision-maker of the Taxpayer and Restaurant E Group, the person who made the decision to acquire the Property and the sole person who signed the provisional sale and purchase agreement for purchasing the Property, and thus the most appropriate witness to give evidence as to the Taxpayer's intention in acquiring the Property; (2) Mr C's evidence was in fact consistent with someone in his position, the 'boss' of Restaurant E Group and other companies doing substantial business in Hong Kong. There were minor points of detail that Mr C could not recall or that he would not have known and it would be incredible to think that the boss would be cognizant of minor and inconsequential details. It would actually be incredible for someone in Mr C's position to be able to remember minute details that would obviously be within the scope of duties of his assistant or lawyer; (3) The contemporaneous documentary evidence wholly supported and corroborated the Taxpayer's narrative evidence of its sole intention in acquiring the Property of holding it on a long-term basis as a capital asset; (4) The Taxpayer's evidence was entirely consistent with matters of inherent probability; (5) The history of the transactions of Restaurant E Group's sales and purchases of premises for operating restaurant (including properties that were held for about one year) had hitherto not been subject to a charge of Profits Tax. This was supportive of the Taxpayer's case of the mode of operation and business model of Restaurant E Group of running restaurants, and not property speculation. It was noteworthy that in spite of the short length of holding of the properties at Address V and at Address W, the sales of each of them was not assessed for Profits Tax; (6) Restaurant E Group had operated a restaurant at Address T in District H and the group did not renew the lease because the landlords were raising rentals to a very high level. Mr C thought that the restaurant business in District H was promising and did look for premises for operating a restaurant. The track record and experience of running a restaurant in District H meant that Restaurant E Group had actual figures of monthly income and outgoings of running a restaurant there and would therefore know the likely cash flow situation, and thus the sensible amount of monthly mortgage payments that would make the restaurant viable; (7) It was not to be expected of Restaurant E Group to have proposals or written 'Expansion Plans' of the 'Restaurant E' restaurant chain; (8) The Revenue's submission that the 'Restaurant E' restaurant chain was 'in

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

recession' since 2007 should not have been made as the submission had not been put to the witness; (9) The Revenue's submission that the presence of the squatter made the alleged intention to open a restaurant at the Property not being able to withstand examination should not have been made as the submission had not been put to the witness; (10) The future finances of Company D and the opinion of the auditors over them were a red herring in this Appeal since the Property was successfully acquired with funding that was made available to the Taxpayer at the material time. Rather, the income from the Property was at the time considered to be sufficient to discharge the outgoings, including the mortgage payment, so Company D's finances would play no part in the sustainability of the restaurant; (11) Mr C's evidence that he was provided with the FEHD 25 April 2008 Letter by the estate agent when he went to view the Property was unchallenged; (12) The FEHD 25 April 2008 Letter was a piece of contemporaneous documentary evidence that wholly supported the Taxpayer's case of its belief, at the time of acquisition, that the Property could be used as a restaurant. It was not open to the Revenue to submit that this letter could not have led to Mr C having the intention of running a restaurant at the Property; (13) Mr C's evidence that the estate agent told him there were many buyers 'eyeing on' the Property was not unbelievable. Mr C's own experience, stated in evidence, of property transactions in fact accorded with the real life experience of agents being 'pushy' in making a sale with 'sales talk'. Whether or not there were such representations, Mr C did decide to purchase the Property in a short amount of time and this was in line with his personal habit and experience; (14) The Taxpayer's accountant/representative had, through an unfortunate use of wording, possibly led the Revenue to misunderstand what was referred to as 'unauthorized building work' related to the Property; the accountant/representative wrote about the structural defect in the Property that made the Property not suitable for running a restaurant. There was no discrepancy between this point and Mr C's evidence. Also there was no inherent contradiction between the accountant/representative's description of the decoration of the Property and Mr C's description of the Property being vacant with some garbage; (15) The minutes of the Taxpayer's directors' meeting were for the conveyancing formalities and would not have stated the intention of the Taxpayer in acquiring the Property; (16) The matter over the financing of the purchase of the Property by the loan from and/or arranged by Company D had been answered in the letters of the Taxpayers' accountant/representative without ambiguity. From the Taxpayer's point of view, there was a loan from Company D and that was still the same where Company D may have got a loan from another party like Company U. It may simply have been a matter of convenience or accounting that repayment was made directly to Company U; (17) Mr C did not see a need to conduct a feasibility study as to the rental income because he was not a new comer in the business of running a restaurant in the District H area and knew what Company D was paying in 2005 as rental at the Address T premises. It would be entirely artificial for the Taxpayer and Company D to make agreements as to an intended business plan as they were companies of Restaurant E Group with Mr C acting as their directing mind and will. Also, Mr C's experience of property transactions being concluded in a very short amount of time was that it was usually not possible for an intended purchaser to do a lot of research and consult professionals as this was time consuming and might result in the property being sold to someone else. Further, Mr C was given the FEHD 25 April 2008 Letter by the estate agent that led him to believe that an application for restaurant licences for the Property could be approved by the FEHD. So, a licensing professional was not asked to survey the Property before the provisional agreement was signed; (18) The Taxpayer's intention to acquire the Property to

rent out the premises to Company D to run a restaurant was consistent with the fact that there was filed with the Land Registry an assignment of rental provision in the agreement between the Taxpayer and Bank J (which would indicate that the Taxpayer must have represented to the bank at the time of applying for the mortgage that it intended to rent the Property out), and that the Property was not rented out to another party after the Taxpayer had discovered that the Property was not suitable for operating a restaurant by Company D and left vacant; (19) It was not open for the Revenue to make any suggestion on the reliability of the Company L 25 November 2009 Letter as Mr Ng had not tested any of the proposed suggestions with either Mr M who made the inspection report or Mr C who received it; (20) Mr C's evidence was that Mr M's advice meant that it was not viable for Restaurant E Group to run a restaurant from the Property and it did not make economic sense for the Taxpayer to incur a lot of expenses to demolish the structure and to completely rebuild it. Mr C and Restaurant E Group had never been a property developer. The Taxpayer's accountant/representative had already explained why re-building the structure would not be suitable for the Taxpayer, given Mr C and Restaurant E Group's experience in running restaurants. There was no inconsistency in Mr C's use of the word 'impossible' in his evidence, since he was concerned with the impossibility of obtaining a licence to run a restaurant with the Property in the form, structurally, it was then in. The Revenue's submission that the Company L 25 November 2009 Letter did not support Mr C's understanding was to misunderstand Mr C's evidence; and (21) How the buyer of the Property was solicited was irrelevant to the issue of this Appeal.

51. Ms Cheung referred to the 'badges of trade' in relation to the evidence in this Appeal, and showed that there was no such intention to trade: (1) Whether the Taxpayer had frequently engaged in similar transactions: No; (2) Whether the Taxpayer held the asset or commodity for lengthy period: No, it had to be sold as it was not being used; (3) Whether the Taxpayer had acquired an asset or commodity that was normally the subject of trading rather than investment: No. It could not be said that landed properties were normally the subject of trading. The intention here was for long-term investment which was frustrated. Given the lack of title deeds, the Property was not the typical property one would acquire as trading stock; (4) Whether the Taxpayer had bought large quantities or number of the commodity or asset: No; (5) Whether the Taxpayer had sold the commodity or asset for reasons that would not exist if the Taxpayer had an intention to resell at the time of acquisition: No; (6) Whether the Taxpayer had sought to add resale value to the asset by additions or repair: No; (7) Whether the Taxpayer had expended time, money or effort in selling the asset or commodity that went beyond what might be expected of a non-trader seeking to sell an asset of that class: No; (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 purchased the asset or commodity for personal use or pleasure or for income: The Property was purchased with the intention of running a 'Restaurant E' restaurant there.

52. Ms Cheung submitted that the Taxpayer had come up to proof of its case, supported by contemporaneous documentary evidence, that the Property was not acquired as trading stock and the Taxpayer had never held an intention to trade. To the contrary, the Taxpayer intended to hold the Property on a long-term basis as capital investment.

The Revenue's Submissions

53. Mr Ng for the Revenue underlined that this Board shall determine the issue of intention of the Taxpayer in the acquisition of the Property objectively by examining all the circumstances of the case. Mr Ng submitted that this Board shall start from the objective evidence and view the objective evidence in the context of the Taxpayer's case. Mr Ng pointed to 7 documents that he said were contemporaneous with the purchase and disposal of the Property by the Taxpayer and from which this Board may consider whether inferences could be drawn. They were: (1) The provisional sale and purchase agreement of dated 28 July 2009; (2) The minute of the meeting of the board of directors of the Taxpayer held on 8 August 2009; (3) The mortgage facility letter from Bank J; (4) The audited accounts of Company D for the years ended 2009 and 2010; (5) The FEHD 25 April 2008 Letter; (6) The Company L 25 November 2009 Letter; and (7) The current account ledger between the Taxpayer and Company D.

54. With respect to each of these 7 documents, Mr Ng submitted that: As to the first document, there was nothing on the provisional sale and purchase agreement of dated 28 July 2009, which Mr Ng said to be the most contemporaneous document, that showed anything about the intention of the purchaser, the Taxpayer. As to the second document, there was mention on the board minute of the purpose for which the Property was purchased. As to the third document, there was nothing in the mortgage facility letter that allowed an inference to be drawn that the Property was to be used as a restaurant, and, in this connection, Mr Ng made the point that the Taxpayer's reference or reliance on an 'assignment of rentals' printed on the land search record of the Property was unsatisfactory. As to the fourth document, the audited accounts of Company D, there was nothing to infer that there was an intention to purchase the Property for opening a restaurant or for capital investment. As to the fifth document, the FEHD 25 April 2008 Letter, Mr Ng submitted that this letter did not support the Taxpayer's case since it was only an application for a general restaurant licence with steps that still had to be followed and works to be done; it did not provide for a factual foundation for an inference to be drawn. At best, it only showed the fact that an application had been made. As to the sixth document, the Company L 25 November 2009 Letter, it had several deficiencies in itself and more than that, it did not say what the Taxpayer wanted to say, which was that upon receiving the letter, the Taxpayer's intention of opening a restaurant in the Property or investing in the Property, was frustrated. Mr Ng submitted that Mr C's evidence that the letter showed that it was impossible to open a restaurant in the Property was a classic exaggeration of the matter. Additionally, the letter did not say what was to be done. As to the seventh document, Mr Ng referred to the payments out to Company U of \$6 million odd, a third party having no relationship with Restaurant E Group, which he submitted was inconsistent with the Taxpayer's case that all the sale proceeds of the Property as capital investment were furthered to other capital investments.

55. Having made observations on these 7 documents, Mr Ng submitted that the Taxpayer's case was clearly not supported by objective evidence permitting inference to be drawn. Mr Ng also submitted that in the absence of objective documentary evidence to demonstrate the intention on the part of the Taxpayer, what was said and what was done

before and after were important matters for this Board to consider whether the claimed intention existed or not.

56. Mr Ng provided this Board with extensive analyses or commentaries of the testimonies of Mr M and Mr C for the purpose of his submission that the testimonies of Mr M and Mr C were both incredible and unreliable and should be rejected by this Board.

57. Regarding the evidence of Mr C, Mr Ng made the a number of observations, which this Board summarizes in brief terms: (1) Whilst Mr C was able to recall details of events dating back to the operation of the first 'Restaurant E' restaurant and the 'Restaurant E' restaurant at Address T, he was less than able to recall particulars of critical events related to the purchase and sale of the Property and at the same time, put the matter in question behind either Ms N or Company K or his legal representatives; (2) The Taxpayer's claim of a plan to expand the 'Restaurant E' chain of restaurants was contradicted by the objective business outlook shown in the number of restaurants opening and the number of restaurants closing in 2007, 2008, 2009 and 2010. There was also no contemporaneous documentary evidence supporting this claim; (3) Mr C had emphasized the importance of location in the restaurant business. In this connection, Mr C had stated in his evidence that Address T restaurant was in a remote location and not an economical operation and that the Property was about 20 paces from Address T premises. The Taxpayer had produced no evidence of actual figures of monthly income and outgoings of running a restaurant in District H to show that it was viable to run a restaurant there; (4) Although Mr C suggested in his evidence that one of the attractive features of the Property was the front yard, which he believed could allow customers to enjoy outdoors dining and to smoke, the fact was that there was a corrugated metal structure there with a squatter and there was no explanation as to how Mr C could open a restaurant without clearing the squatter, no budgeting of the costs to evict the squatter, and no guarantee that the squatter would leave upon being offered money; (5) Company D had a negative cash flow of more than \$10 million in 2009 and 2010 and its auditor took a relatively 'grim' view of Company D as a going concern. While Mr C explained in evidence that he would be able to obtain financing by loans and related companies, there was no budgeting related to any plan of expansion of the restaurant chain in the circumstances. The declared intention must be tested against the financial arrangement or plan for financial arrangement made to carry out the intention, including the sustainability of any such plan; (6) Mr C's claim that Restaurant E Group's record had all along been to invest in properties for long-term use was inaccurate. This was illustrated by two examples: the property at Address V and the property at Address W; (7) Mr C's claim that he had to make a quick decision to acquire the Property because he was told that there were many potential buyers was unbelievable; (8) Mr C's claim that he was used to making quick decisions in buying properties showed 'total recklessness', which, it was said, reinforced the inference that he planned to buy the Property for making a quick profit when opportunities arose or at least with no intention of using the Property as long-term investment; (9) The Taxpayer had provided an inconsistent and contradictory account in respect of the pre-purchase inspection of the Property. Mr C's claim that he was unable to find any unauthorized building works at the Property was contradicted by the presence of a corrugated metal structure at the front yard of the Property with a 'live-in' squatter. Mr C's description of the Property as 'vacant with some garbage' during the inspection was contradicted by the representations made on behalf of the Taxpayer by its

representative/accountant to the Revenue that the Property was ‘well decorated’ with various features; (10) The Taxpayer’s purchase of the Property in such a short period of time without any effort in due diligence before the purchase supported the submission that there was never any intention of purchasing the Property for opening a restaurant; (11) The evidence on the financing of the purchase of the Property by a mortgage from Bank J and a loan from Company D was at best dubious. The application documents for the mortgage with Bank J were not submitted to this Board. The claim of a loan from Company D was revealed to include a loan from Company U, an unrelated third party, which in itself was doubtful. Mr C was unable to explain the loan from Company U. Also, there was no budgeting of funds to meet the initial capital outlay of opening a restaurant. Thus the financing for the purchase of the Property did not sit well with the claim of a capital investment for long-term to expand the restaurant chain; (12) Mr C’s testimony on the execution of the provisional sale and purchase agreement for the purchase of the Property and the subsequent document(s) was doubtful; (13) Mr C’s claim that the Taxpayer’s intention of running a restaurant business at the Property was frustrated following the reading of the Company L 25 November 2009 Letter was unbelievable and no weight should be placed on Mr C’s evidence that he relied on that letter. The Company L 25 November 2009 Letter was sparse in particulars and did not state that it would be ‘impossible’ to obtain a restaurant licence. In this relation, there was a stark and irreconcilable contrast between Mr C’s evidence and Mr M’s evidence. And the Company L 25 November 2009 Letter did not clear any doubt between the evidence of Mr C and the Taxpayer’s accountant’s correspondence with the Revenue; (14) Mr C’s claim in his testimony that he had thought about renting out the Property in the short-term should not be believed; (15) Mr C’s testimony of the sale of the Property went against the version of events on the sale of the Property the Taxpayer’s representative/accountant had stated to the Revenue in correspondence. Mr C’s evidence before this Board clearly conflicted with the representations made on behalf of the Taxpayer in the correspondence with the Revenue and there was no evidence suggesting that the accountant of the Taxpayer made up the facts or the instructions from the Taxpayer were made up; and (16) Mr C’s claim in his testimony that the proceeds of sale of the Property were invested to purchase additional properties for the purpose of opening a restaurant was incapable of reconciliation with the documentary evidence.¹

58. Regarding the evidence of Mr M, Mr Ng also made a number of observations, which this Board summarizes in brief terms: (1) Mr M had submitted two witness statements before the Hearing of this Board. At the beginning of the Hearing, Mr M altered his witness statement in a material way to clarify that he meant that he was unable to find a paper-based document at the time. This alteration was to ‘insulate himself’ from

¹ Ms Cheung for the Taxpayer submitted that Mr Ng for the Revenue had made in submission various points that he had not tested them with the witnesses. It was a matter of fairness that if submissions were to be made, either to say that a witness was not telling the truth or to allege that a witness should have done things in a certain way or was unreasonable to not have done things in a certain way, then as a matter of fairness, the witness should be given an opportunity to answer. Ms Cheung submitted that where Mr Ng had chosen not to conduct his case by cross-examination on particular matters, it was not open to him to make submissions on those matters by asking this Board to look at the evidence as a whole. It was a matter of fundamental fairness that the witness be given a chance to answer. See also Ms Cheung’s submissions summarized in paragraph 50 above.

the letter of Mr S of Company L to the Assessor of the Revenue faxed on 16 April 2018; (2) Company L's files appeared to be 'chaotically managed' notwithstanding that it was ISO 9001 certified; (3) Mr M did not appear to be familiar with the requirements and criteria in obtaining a restaurant licence when he was asked about the 1,050 mm requirement regarding means of escape. This was said to be going against the claim that Mr M was an experienced person in restaurant licensing and could offer reliable professional advice on meeting licensing requirements; (4) The Company L 25 November 2009 Letter was on its face full of deficiencies and Mr M was unable to provide a satisfactory answer as to why those deficiencies existed. This letter should not be regarded as reliable or be given weight; (5) The letter of Mr S of Company L to the Assessor of the Revenue faxed on 16 April 2018 should be given considerable weight notwithstanding that Mr M had sought to downplay its value. The Revenue received this letter in reply to its enquiry with Company L and the Deputy Commissioner took it into consideration when he made the Determination; (6) Mr M's claims that Company L decided to waive the fees for the inspection and the report in respect of the Property and that Company L had not prepared any contract, engagement or quotation for the Taxpayer to sign because Restaurant E Group was a long-term regular and repeated client could not be believed. An engagement letter and/or a quotation should be the documents that would normally be prepared before inspection. Mr M's witness statement suggested that an engagement letter once existed in relation to the Property and the file was subsequently destroyed. While Mr M's evidence was that Restaurant E Group was a long-term regular and repeated client and Company L was prepared to dispense with the formalities for engagement in relation to the Property in 2009, Company L required Restaurant E Group to pay an advance deposit prior to any inspection in the quotation dated 3 May 2010.²

59. Mr Ng invited this Board to draw an adverse inference against the Taxpayer where the Taxpayer had failed, without explanation, to call a witness whom he might reasonably be expected to call. In this connection, Mr Ng pointed to the absence of a reasonable explanation why the estate agent of Company K was not called to give evidence, particularly when Mr C seemed to have no first-hand knowledge of the market of the sale and purchase of the Property. Mr Ng also pointed to the absence of a reasonable explanation why Ms N was not called to give evidence as she is in the best position to testify as to the oral discussion with Bank J and to speak to the transactions involving the purchase and sale of the Property. Mr Ng suggested that this Board could draw the following adverse inferences: (1) there was no need to make a snap purchase of the Property due to the representation that there were many buyers 'eyeing' on the Property; (2) the alleged intention to use the Property for the purpose of opening a restaurant was not communicated

² Ms Cheung for the Taxpayer made the similar submission that Mr Ng for the Revenue had to put to Mr M the matters he was going to suggest in closing submissions that went to Mr M's professional standing, his reputation and his competence as an experienced licensing professional. Otherwise, Mr Ng could not make such submissions in closing. Ms Cheung stated that Mr Ng could not escape criticism in this regard by saying that those submissions were the Revenue's 'observations'. See also Ms Cheung's submissions summarized in paragraph 49 above.

to Bank J; (3) the alleged loan from Company D and/or from Company U were not intended for acquisition of the Property for the purpose of opening a restaurant.³

60. Mr Ng submitted that there was no concrete objective evidence to show that the Property was purchased for long-term capital investment and that the evidence of Mr C and Mr M, and any representations made by the Taxpayer's accountant/representative to the Revenue that the Property was purchased for long-term capital investment must be rejected. Mr Ng also submitted that this Board should assess the facts holistically on the totality of the evidence before it, with particular regard to the following matters: (1) The purchase of the Property was inconsistent with the Taxpayers' allegation of a plan of expansion of the restaurant chain into District H; the objective evidence would suggest that it was not and could not have been a considered decision to purchase the Property to seriously operate a restaurant in the Property; (2) The purchase of the Property was carried out in a manner at variance with the usual practice of purchase for a property to operation as a restaurant; (3) The purchase of the Property, if intended for a restaurant, was financially unsustainable and not feasible; (4) The financing of the purchase of the Property and the disposal of the sale proceeds of the Property were in ways inconsistent with the Taxpayer's own case of capital investment and re-investment into another capital asset; and (5) The Property was held for a short period of time and then sold for substantial profits. Mr Ng ultimately submitted that the intention of the Taxpayer was not to invest in the Property but in trade, and in any event, the Taxpayer had not discharged its burden it had under this Appeal against the Profits Tax Assessment in dispute.

Discussion

61. The Taxpayer has the burden of proof under section 68(4) of the IRO to show that the Profits Tax Assessment in dispute in this Appeal was excessive or incorrect. The issue that the Taxpayer seeks to establish in this Appeal has been stated in paragraph 14 above, which is that the Taxpayer's acquisition of the Property did not amount to a 'trade' for the purpose of section 14 of the IRO and that its acquisition and the sale of the Property was consistent with an intention to hold the Property on a long-term basis for the running of a restaurant in the Property.

62. The case law on the determination of whether an asset is a trading or capital asset for the purpose of section 14(1) of the IRO is well known. This Board has been referred to the following cases, namely, Lionel Simmons Properties Ltd (in liq) & Ors v Commissioner of Inland Revenue 53 TC 461, Eng CA and HL; Marson (Inspector of Taxes)

³ Ms Cheung for the Taxpayer submitted that before an inference can be drawn, the evidence must give rise to a reasonable and definite inference that is more probable than the other conflicting inferences and there has to be a lack of reasonable explanation for not giving evidence, and the facts proved must provide a reasonable basis for a definite conclusion before one enters the realm of inference. And in respect of the two matters that Mr Ng for the Revenue asked this Board to draw an adverse inference, Mr Ng had failed to show that the evidence gave rise to a reasonable and definite inference that was more probable than the other conflicting inferences. Particularly, Ms Cheung made the point that given the issue that has to be decided, namely the intention of the Taxpayer at the time of acquiring the Property, Ms N would not be able to shed light on the Taxpayer's intention. Also, in relation to the estate agent, there was nothing to suggest that it was more probable than not that she did not make the representations about there being many other buyers.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

v Morton & Ors 59 TC 381, Ch D; All Best Wishes Ltd v Commissioner of Inland Revenue 3 HKTC 750, HC; Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51, CFA; and Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433, CFA. It is not necessary for the purpose of determining this Appeal to set out at length the relevant portions of the judgments in these cases. Highlighting the following points will suffice:

- (a) The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case. It is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances.
- (b) The question is one of the intention of the Taxpayer 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?
- (c) The stated intention of the Taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. 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. 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 such an intention to invest is established.
- (d) A sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention.
- (e) A single, one-off transaction can be an adventure in the nature of trade.
- (f) Matters of enquiry related to the determination of the question include the nature of the subject matter, the way in which the transaction was carried through, whether the Taxpayer has frequently engaged in similar transactions, whether the item was purchased for personal use or pleasure or income, the source of finance of the transaction, the length of the period in which the item was held, whether the item was resold as it stood or after work had been done on it or relating to it for the purposes of resale, and whether the item was resold in one lot or in several broken down lots, the time, money or effort expended in selling the item. No single matter is in any way decisive and it is always necessary to look at the whole picture.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (g) An asset cannot be both trading stock and permanent investment at the same time, nor to possess an indeterminate status of neither trading stock nor permanent asset.

63. This Board's finding of the intention of the Taxpayer at the time of the acquisition of the Property is a finding of fact that is to be determined upon the whole of the evidence validly before this Board, including evidence of things said and done both before and after the acquisition. An intention stated at the time of acquisition has to be tested against such evidence to see if the intention can properly be regarded as genuinely held, realistic and realizable. As stated above, an intention to invest is established only if all the circumstances show that at the time of the acquisition of the asset, the Taxpayer was investing in it.

64. Given that this Board has to consider the 'whole picture' of evidence that is validly before this Board, the first task that this Board has to perform is to identify the evidence that is validly before it. First, this Board has no difficulty to regard as evidence before it the witness statement(s) verified and adopted by the witnesses, their testimonies before this Board, and the documents that each of them acknowledged and adopted as part of his evidence either in the witness statement(s) or in the course of the testimony. Second, this Board may regard as evidence before it the contemporaneous documents that were submitted by the Taxpayer's accountant/representative, where the authenticity of the documents is not in dispute. Third, and this is a matter of specific judicial guidance, assertions, representations and submissions made by the Taxpayer's accountant/representative, not supported by any undisputed contemporaneous documents, ought not, without more, to be treated as evidence; see Commissioner of Inland Revenue v Crown Brilliance Ltd [2016] 3 HKC 140, CFI (at paragraph 19). This point is of some significance in this Appeal since the parties have not agreed on a set of agreed facts, the witness statement of Mr C does not adopt as true and correct the representations said to have been made on behalf of the Taxpayer in the correspondence of the Taxpayer's accountant/representative to the Revenue, and this Board may not rely on matters which were not properly adduced as evidence. Hence, for example, this Board is not entitled to find as facts the representations made by the Taxpayer's representative in the reply dated 7 November 2011 referred to in paragraph 7(7)(a) to (j) above.

65. This Board finds, having regard to the submissions of the parties to this Appeal, that the matters referred to in paragraph 7(1) to (6) and (8) to (10) are undisputed and this Board finds them as facts. In so far as the matters referred to in paragraph 7(7) are concerned, this Board finds as fact that the Assessor of the Revenue made enquiries of the Taxpayer's Profits Tax Return for the year of assessment 2010/11 and the Taxpayer's representative replied on behalf of the Taxpayer by a letter dated 7 November 2011.

66. Next, this Board considers the contemporaneous documents that are properly before it in this Appeal. This Board accepts that the following are contemporaneous documents: (1) The provisional sale and purchase agreement of dated 28 July 2009; (2) The minute of the meeting of the board of directors of the Taxpayer held on 8 August 2009; (3) The mortgage facility letter from Bank J dated 6 October 2009; (4) The FEHD 25 April

2008 Letter; and (5) The Company L 25 November 2009 Letter.⁴ Having read the above contemporaneous documents, this Board finds that none of document (1), document (2) and document (3) expresses or states on its terms an intention or the purpose on the part of the Taxpayer regarding the purchase of the Property. As to document (4) and document (5), they are relied on by Mr C in his evidence on how he made decisions for the Taxpayer and this Board will consider each of them below together with Mr C's evidence.

67. This Board turns to the evidence of the Taxpayer's witnesses. This Board has considered and debated upon the merits of the submissions of the parties in respect of the evidence of each of the Taxpayer's witnesses. This Board does not wish to prolong this Decision with repeated reproduction of the submissions.

68. This Board, in assessing the evidence of the witnesses, has tested and weighed the evidence of each witness against the totality of the materials, and in particular any available contemporaneous documents, as well as taking into account inherent probabilities. This Board has to consider all matters whenever they occurred before drawing any conclusions. The reason is based on practical experience: Where a witness has been discredited over one or more matters on which he or she has testified, that fact may be relevant to the assessment of his or her overall credibility. On the other hand, where a witness' evidence is found unreliable or even untruthful in some respect does not automatically mean that the totality of that witness' evidence is unreliable or untruthful.

69. This Board first examines the evidence of Mr M. This Board acknowledges that Mr M is a witness who is not concerned with the sale and purchase of the Property and he is therefore in this sense an independent witness. Having examined Mr M's evidence, this Board is unable to regard his evidence as reliable and so is unable to give his evidence full weight for the purpose of making findings of fact in this Appeal. This Board considers that Mr M's evidence regarding the inspection of the Property has features that impair the reliability of his evidence. Mr M accepted that he was unable to produce any physical document and computer record reproduction correlated to the inspection. Mr M also accepted that he would not have any independent recollection of the time of the inspection of the Property had he not been shown the Company L 25 November 2009. Mr M's evidence of deciding to 'waive charges for any fees' in respect of the inspection and the report had to be clarified upon questioning of this Board since Company L had not issued a quotation, but Mr M's clarification that he did not intend to charge was inconsistent with his evidence that he made the decision because the inspection did not result in any profitable work for Company L. The Revenue's enquiry with Company L led to the reply signed by Mr S of Company L (which was faxed on 16 April 2018) containing information that Mr M had to disagree with in his evidence, but at the same time had to accept that he was unable to find a physical document and computer record reproduction to show that information in Mr S's letter about a contact by a Ms Q related to the Property was wrong. In the event, this Board does not find that Mr M's evidence was 'corroborated' by the Company L 25 November 2009 Letter, as that document was adopted by Mr M as having been authored and signed by

⁴ Mr Ng for the Revenue had also referred to the audited accounts of Company D and the current account ledger between the Taxpayer and Company D. This Board does not accept these two documents as contemporaneous documents.

him upon a copy of it having shown to him by the Taxpayer's legal representatives, and Mr M was unable to provide a hard copy of that document from the files of his company. The Company L 25 November 2009 Letter itself, in addition, does not make reference to an addressee, a job number and a LQA number, with the latter two items being references that Company L would assign to each piece of work or business engagement.⁵ In the circumstances, this Board is unable to rely on Mr M's evidence to make any finding of facts.

70. This Board next examines the evidence of Mr C. This Board accepts and finds that Mr C was the decision-maker of the Taxpayer and Restaurant E Group and that it was Mr C who made the decision to acquire the Property and he who signed the provisional sale and purchase agreement for purchasing the Property. This Board also accepts and finds that Restaurant E Group had operated a restaurant from shop premises at Address T in District H between 2003 and 2005 and from this experience the group had certain business information about the running of a restaurant in District H. This Board further accepts and finds that Mr C was able to obtain the financing for the acquisition of the Property by the Taxpayer through a bank facility secured by mortgaging the Property and from Company D.

71. Mr C stated in his evidence that he emphasized to the estate agent from Company K that he was looking for premises to run a restaurant and that when he was shown the FEHD 25 April 2008 Letter, he then believed that the Property was fit to open a restaurant as the necessary licences could be obtained. Having regard to Mr C's experience of opening 50 restaurants (including 8 in premises that he had bought on behalf of Restaurant E Group and turned into restaurant use), Mr C's awareness of the physical situation and condition of the Property following the inspection he stated he had undertaken with the estate agent, and the FEHD 25 April 2008 Letter, this Board is of the view that in light of the FEHD 25 April 2008 Letter being only the first page of a multi-page letter, a restaurateur of experience would have to enquire beyond the 'no objection' to the application for General Restaurant Licence on the part of the Food and Environmental Hygiene Department and into the requirements in Appendix A that the Department proposed to impose and the conditions to be observed after the issue of licence in Appendix B, as well as the need for certification that the premises are free of unauthorized building works and compliance with the fire services requirements issued by the Fire Services Department. A verified suggestion that a restaurant licence could be approved, objectively considered, is only the beginning of the enquiry, since one needs to know of all the requirements of all the relevant departments as well as all the conditions for running the restaurant in order to evaluate the likely costs to be expended and works to be done before all relevant licences, permissions and approvals would be issued or granted.⁶ And, in the particular circumstances of the inspections, where Mr C stated that he came to know of the two storey building of

⁵ Mr M was shown two quotations of Company L before he confirmed that when a client or potential client enquired Company L about a possible restaurant licence application and left Company L with details or the address of the proposed restaurant premises, Company L would enter the Job No.. A quotation and a LQA No. would be produced after negotiations between Company L and the client.

⁶ This Board has considered the assertion from the evidence from the Taxpayer of an email exchange between Ms N and Bank J that the FEHD 25 April 2008 Letter was probably submitted to Bank J. This Board considers that the said evidence supports the Taxpayer's evidence that Mr C was provided with the FEHD 25 April 2008 Letter by the estate agent in the course of the acquisition of the Property.

the Property having nothing inside (except some garbage) and no decoration in mid-2009 (more than 1 year after the date of the FEHD 25 April 2008 Letter) and of the ‘unauthorized structure’ at the front yard of the Property,⁷ this Board considers that notwithstanding Mr C’s stated approach and experience of closing purchase of properties within a short time frame, there were real issues that should reasonably have led to train of enquiry on the viability of Mr C’s stated intention to open a restaurant at the Property, which, after all, was not shop premises in a multi-storey building with building management but a self-contained two-storey building of considerable age, unknown state of repair. As Mr C stated, he was presented with a record of an attempt to turn the Property into a restaurant. But what Mr C related to this Board about the inspections reasonably suggests that the outcome of that attempt to turn the Property into a restaurant was at best unknown and possibly a failure, since Mr C stated that he saw an empty building with no decoration inside, with some garbage left behind, and a front yard that was occupied by a squatter who might have built or taken over a corrugated iron structure there. This Board therefore comes to the view that the circumstances of what was said and done at the time and before the acquisition of the Property by the Taxpayer do raise real issues on the whether the claimed intention of acquiring the Property as long-term investment for opening and running a restaurant there was genuinely held, realistic and realisable. This Board does not accept the Taxpayer’s submission that its narrative evidence was entirely consistent with matters of inherent probabilities. The said issues should have been addressed by positive evidence from the Taxpayer. No such positive evidence was before this Board.

72. Also, this Board finds that Mr C’s claim that Restaurant E Group’s practice of purchasing property as investment for opening and running a restaurant and re-investing the monies after sale to acquire another premises for opening and running of a restaurant or for the continuous running of the ‘Restaurant E’ restaurant business did not appear to hold in the case of the sale and purchase of the Property. The documentary records brought before this Board suggest that the monies received following the sale were applied to repay and discharge the bank facility and mortgage of Bank J, to repay Company D for the financing (which included a substantial loan of about \$3.6 million odd Company D arranged from Company U,⁸ apparently at an annual rate of interest much higher than that charged by Bank J), and to pay Company G, a company unrelated to Restaurant E Group, a sum of \$4 million odd, albeit that Company G was a company in which Mr C was a director at the material time. The Taxpayer had only one property transaction thereafter, which was the purchase of a car parking space in 2011, and that car parking space was held by the Taxpayer till January 2016 when it was assigned to a purchaser. The evidence before this Board does not reasonably suggest re-investment after sale for acquiring another premises for opening and running of a restaurant or for the continuous running of the ‘Restaurant E’ restaurant business in line with the ‘consistent practice’ that Mr C has claimed before this Board.

⁷ Mr C is taken to be well aware of this corrugated metal (or ‘tin’) structure at the front yard since an additional clause was inserted in the provisional sale and purchase agreement for the acquisition of the Property to cover that structure.

⁸ This Board notes that the Taxpayer had not explained how the amount of this loan from Digital Finance was ascertained and asserted. The reconciliation from accounting documents of the Taxpayer disclosed to the Revenue was unsuccessful.

73. Further, whilst Mr M's evidence would have been objective support of Mr C's evidence as manifestation of his/Taxpayer/Restaurant E Group's claimed intention, this is not forthcoming since this Board has, for the reasons stated in paragraph 69 above, held Mr M's evidence to be unreliable for purpose of making findings of fact. As a result, this Board is unable to place any significant weight on Mr C's reliance of the Company L 25 November 2009 Letter as a contemporaneous document of what was said and done after the acquisition of the Property that is supportive of his claimed intention.

74. Furthermore, this Board finds that there are matters of concern in Mr C's evidence that have also prevented this Board from giving full weight to his evidence. They are as follows:

- (a) Mr C stated at the beginning of his evidence that he could open the restaurant in the building of the Property without the front yard with the corrugated metal structure and squatter living in it. Towards the end of the evidence, when questioned by this Board, he expressed that the Property was more advantageous than the Address T premises because it had the front yard that would attract customers of foreign nationalities who liked to dine outdoors. The picture of the Property provided to this Board appears to show that the front yard of the Property to be occupying a relatively wide area with the corrugated metal structure of approximately human height extending along the whole front of the building. How one could reasonably open a restaurant attractive to customers in the circumstances of the front yard covered by a corrugated metal structure of such height is a rather open question. And it seemed that Mr C acknowledged this matter when he sought to explain why he did not rent out the Property; he stated that the corrugated structure at the front yard looked like a mess and this meant that he could not rent out the Property as a shop front.
- (b) Mr C stated when he was cross-examined that the estate agent from Company K told him that the Property was special, the seller was eager to dispose of it, the price was attractive and competitive, and there were other people eyeing for it. He also stated that he complained to Company K and the estate agent came up with the idea of selling the Property and then a buyer. None of these matters were stated in Mr C's witness statement.
- (c) Mr C stated in his evidence that it was he who telephoned Mr M of Company L to inspect the Property. On the other hand, Mr M's signed witness statement, which he verified and adopted as part of his evidence before this Board, stated that it was Ms N who instructed him to inspect the Property.

All the matters above concern things said and done at the time, before and after the acquisition of the Property by the Taxpayer. This Board finds that

they do cast unfavourably against the veracity and reliability of Mr C's evidence.

75. Finally, this Board attaches weight to the fact that the Property was held for a relatively short period of time and then sold for substantial profits.

76. The Revenue had invited this Board to draw adverse inferences against the Taxpayer on the basis that a specified person who could have been made available to give relevant evidence before this Board was not before this Board to give evidence. This Board notes from the authorities cited by the parties (which included Tjang Siu Thu v Profield Construction Engineering Ltd & Anor [2015] 2 HKC 22 and Jonathan Lu v Paul Chan Mo Po (HCA 370/2012, 7 October 2015, unreported)) that for an adverse inference to be drawn, the primary facts proved must provide a reasonable basis for a definite conclusion, or putting it in different words, the inference would logically flow from the primary facts. Having considered the relevant evidence and the facts that this Board proposes to find therefrom, and the inferences that the Revenue had suggested this Board to draw, the invitation is declined.

77. By reason of the matters aforesaid, this Board finds that on the evidence before this Board, the Taxpayer has not established that the claimed intention of acquiring the Property as long-term investment for opening and running a restaurant there was genuinely held, realistic and realisable.

78. Having examined the evidence before this Board and considered the submissions of the parties before it, this Board made the findings set out above. In light of the findings, this Board holds that the Taxpayer has not discharged its burden under section 68(4) of the IRO to show that the Profits Tax Assessment in dispute in this Appeal was excessive or incorrect.

Dissenting views of Mr Liu Pak-yin

79. With the greatest respect to my learned colleagues and their reasoning, I have come to a different conclusion than that of my learned colleagues. I accept that the facts set out above are accurate and comprehensive. However, I wish to emphasize some of those facts in a manner different from that of my learned colleagues.

80. Upon my examination of the evidence in front of this Board, I found that the intention of the Taxpayer was to buy the Property as a long term investment, which was supported by contemporaneous documents, in particular, the FEHD 25 April 2008 Letter and the Company L 25 November 2009 Letter.

81. The former was a contemporaneous document which supported the Taxpayer's case as it supported its belief at the time of acquisition that the Property could be used as a restaurant and the necessary licences could be obtained. The latter showed the instruction of Company L by Company D to conduct inspection of the Property, which was

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

consistent with the claimed intention of the Taxpayer to acquire the Property for running a restaurant.

82. Also, as Company L's main business was to provide services for companies to obtain food and restaurant licenses and to assist entities to establish food safety management standards and obtain accreditation, there was no reason for Company D to instruct Company L to inspect the Property if it was not the Taxpayer's intention to invest the Property for opening and running a restaurant.

83. Moreover, the Property was arranged by the Taxpayer to be mortgaged to Bank J. In the course of arranging the mortgage, Bank J was supplied with a copy of the FEHD 25 April 2008 Letter, which stated that an application for restaurant licence had been made for the Property. If the Property is not intended to be used as a restaurant, I see no reason why such a letter was provided to Bank J.

84. Furthermore, the Taxpayer's case was supported by Mr M's evidence. In my view, Mr M was an independent and reliable witness and his evidence was corroborated by the Company L 25 November 2009 Letter.

85. I have considered matters which may cast the Taxpayer in an unfavourable light, including but not limited to, (i) the Company L 25 November 2009 Letter had several inadequacies such as the lack of a job number and addressee, (ii) the discrepancy in Mr C's and Mr M's evidence as to who instructed Company L to inspect the Property and (iii) the shortcomings in Company L's record-keeping and that physical documents and computer records correlated to the inspection could not be produced.

86. However, the above deficiencies were insufficient to render Mr M an unreliable or incredible witness. Also, I do not see any incentive for Mr M, an independent witness who would have a reputation to maintain as a professional consultant, to give untrue evidence in front of this Board.

87. Having considered all the evidence and facts before us, I have regrettably reached a different conclusion to that of my learned colleagues. In my view, the Taxpayer has established that the intention of acquiring the Property at the material time was to hold the Property as long term investment so as to allow the Property to be used by Company D for running a restaurant.

88. For all the reasons above, I would allow the appeal.

(2021-22) VOLUME 36 INLAND REVENUE BOARD OF REVIEW DECISIONS

Decision

89. This Board, by a majority of 2 to 1, dismisses the Taxpayer's appeal. This Board, by a majority of 2 to 1, confirms the assessment of Profits Tax that the Deputy Commissioner of Inland Revenue confirmed in his Determination dated 6 August 2018, which is particularised in paragraph 12 above.

90. There has been delay on the part of this Board in rendering this Decision. This Board apologizes for the delay.