

Case No. D26/17

Case stated – profits on sale of property – whether property acquired as a capital asset or a trading stock – whether Taxpayer put forward sufficient evidence to show its intention – whether Taxpayer could claim rebuilding allowance

Panel: Lo Pui Yin (chairman), Corinne Marie D’Almada Remedios and Fong Sui Yi Andrea.

Date of hearing: 25 July 2016.

Date of decision: 20 February 2018.

The Taxpayer was incorporated in Hong Kong with issued share capital of \$2. It entered into a provisional sale and purchase agreement on 23 January 1997 to purchase a property for \$30.8 million, subject to an existing tenancy. According to the minutes of the Taxpayer’s board dated 25 January 1997, the Taxpayer’s director was authorised to sign the formal sale and purchase agreement to purchase the property ‘for investment purpose’. Completion took place on 30 May 1997. The Taxpayer funded the purchase by loans respectively provided by its holding company and its director, and a 15-year mortgage from a finance company. By another provisional sale and purchase agreement dated 10 June 1997, the Taxpayer agreed to sell the property for \$39.5 million, subject to the existing tenancy. Completion took place on 28 July 1997.

For the 1997/98 year of assessment, the Taxpayer included a rebuilding allowance of \$243,836, which was claimable if the property was a capital asset. For 1998/99 year of assessment, the Taxpayer did not include the net profit of \$7,100,930 from the sale of the property as its profits. The Revenue disallowed the rebuilding asset, and included the net profit from the sale of property in raising Profits Tax Assessment against the Taxpayer. The Taxpayer appealed to the Board, which allowed the appeal (in D17/14, (2015-16) IRBRD, vol 30, 58). The Revenue’s appeal to the Court of First Instance was allowed, on the basis that the Board erred in considering allegations from the Taxpayer’s tax representatives without first receiving them as evidence. The Court of First Instance remitted the case back to the Board for the Board to find, as a matter of fact, whether the Taxpayer purchased the property as a capital asset or a trading stock in light of its judgment. The Board decided to reconsider the case without receiving further evidence from the parties.

Held:

1. Upon a holistic consideration of all the circumstances of the case, the Taxpayer failed to put forward sufficient evidence to show that its intention in purchasing the property was to hold it as a capital asset rather

than as a trading stock (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; 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 applied).

2. The reference to ‘investment purpose’ in the Taxpayer’s board minutes showed that the intention of the Taxpayer was to hold the property as a capital asset rather than trading stock. Since the minutes were prima facie genuine and contemporaneous, they should not be considered as being made after the event only because the Taxpayer delayed in providing them upon the Revenue’s request.
3. The fact that the Taxpayer purchased the property with a sitting tenant was not a weighty consideration.
4. It was important that the Taxpayer did not prove the sustainability of its financing of the purchase. It operated at a loss, and the rental income was insufficient to cover the mortgage instalments and the cost of funds. The Board could not take into consideration the assertion that the director had substantial income to support the Taxpayer, because this was only an assertion by the tax representative, and no evidence was ever adduced to substantiate this point. The fact that the sitting tenant was an established company could not improve on the sustainability of the Taxpayer’s finance.
5. The argument that the Taxpayer’s directors and management had experience in holding properties as long term investment was similarly not proved by evidence, as it was only mentioned by the Taxpayer’s director in his submissions during the first appeal hearing before the Board.
6. The Taxpayer did not explain or put forward evidence to justify the reason and need for long completion lead-time for its purchase of the property, to show that this was not adopted in the hope of ‘flipping’ the property for quick profit before completion.
7. The Taxpayer failed to put forward sufficient evidence to show that the stated intention of acquiring the property as an ‘investment property’ was one that was genuinely held, realistic and realizable. Thus, the profits tax assessment raised was neither excessive, nor incorrect.

Appeal dismissed.

Cases referred to:

- D17/14, (2015-16) IRBRD, vol 30, 58
- 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

Ivan Cheung, Counsel, instructed by Messrs K H Lam & Co, for the Appellant.

Paul Leung, Counsel, instructed by the Department of Justice, for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This Appeal was first heard by this Board on 17 February 2014. At that hearing, the Appellant/Taxpayer was represented by its director, Mr A. After hearing submissions from Mr A and from the representative of the Respondent/Revenue, this Board reserved its decision. By a Decision dated 10 October 2014, this Board unanimously allowed the Taxpayer's appeal in part (Decision D17/14).

2. The Revenue applied to this Board to state a case for the purpose of appealing to the Court of First Instance. This Board stated three questions of law for the Court of First Instance in a Case Stated dated 25 March 2015.

3. The Court of First Instance heard the Revenue's Case Stated. In its judgment ('Judgment'), the Court of First Instance held in respect of the first question that this Board erred in law in relying on the Taxpayer's representatives' assertions or representations which were not properly adduced as evidence. The Court of First Instance also answered 'No' to the second question of whether as a matter of law and based on the evidence adduced before this Board, the true and only reasonable conclusion is that the Taxpayer purchased Property B as a trading stock and that this Board erred in law in concluding that Property B was purchased by the Taxpayer as a capital asset; and 'No' to the third question of whether, as a corollary from the answers to the above questions and as a matter of law, the true and only reasonable conclusion in respect of the Taxpayer's claim for rebuilding allowance in respect of Property B is that it should be disallowed.

4. The Court of First Instance ordered that the Taxpayer's Appeal be remitted to this Board with the opinion of the Court of First Instance on the above questions of law stated by this Board in the case expressed in the Judgment.

5. This Board then held an oral hearing on 22 March 2016 to resolve the questions of whether this Board has power to receive additional evidence (be it oral or documentary evidence) where the appeal is remitted to it with the opinion of the Court of First Instance in general; and whether in the Taxpayer's Appeal, this Board has power to receive additional evidence in light of the particular opinion of the Court of First Instance. In the event that this Board found that it did have such power, this Board would have to consider whether it should be exercised in favour of the Taxpayer.

6. Having considered the written and oral submissions of the Taxpayer (which has been represented by counsel) and of the Revenue (which has also been represented by counsel), this Board issued a Decision dated 15 June 2016 determining that it has no authority to take and consider any additional evidence when it revises the assessment in the Taxpayer's case in accordance with the opinion of the Court of First Instance in the Judgment. In the same Decision, this Board also considered that, even if this Board had the discretion contended for by the Taxpayer to take further evidence, this Board would decline to exercise such a discretion in the circumstances of the Taxpayer's case (Decision D10/16).

7. This Board held the hearing of the Remitted Appeal on 25 July 2016. Both the Taxpayer and the Revenue have continued to be represented by counsel.

8. This Board has heard submissions from counsel of the Taxpayer, Mr Cheung, and counsel of the Revenue, Mr Leung. The essential point in Mr Cheung's submissions is that the declaration of the Taxpayer that Property B was acquired as a capital asset was supported by the circumstantial evidence before this Board and so this Board's determination in this regard in Decision D17/14 should be maintained. The essential point in Mr Leung's submissions is that the Taxpayer has not discharged its burden of proof of proving that the assessment appealed against is excessive or incorrect in respect of the part that was the subject of the Remitted Appeal on the agreed facts and undisputed documents before this Board.

9. In the following sections, this Board shall set out the agreed facts and made reference to the undisputed documents. Then this Board shall state the opinion of the Court of First Instance that it must follow. Lastly, the submissions of the Taxpayer and the Revenue are considered in the light of the evidence before this Board and the opinion of the Court of First Instance.

The Agreed Facts and Undisputed Documents

10. During the original hearing of this Appeal on 17 February 2014, Mr A, then acting for the Taxpayer, confirmed on behalf of the Taxpayer its agreement to Facts (1) to (12) under paragraph 1 of the Deputy Commissioner's Determination. This Board then found those Agreed Facts as facts.

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

11. The Agreed Facts are:
- (1) The Taxpayer was incorporated as a private company in Hong Kong in January 1997. At all relevant times, its authorized and issued share capital were \$10,000 (divided into 10,000 shares of \$1 each) and \$2 respectively. Its shareholders were Mr A (who held 1 share) and Company C (which held 1 share). Its directors were Mr A and his wife.
 - (2) Company C is a company incorporated in the British Virgin Islands and is the Taxpayer's ultimate holding company.
 - (3) In its Profits Tax returns for the relevant years of assessment, the Taxpayer described its principal activity as 'investment in properties for rental purposes'. The Taxpayer closed its annual accounts on 30 June.
 - (4)
 - (a) By a provisional agreement for sale and purchase dated 23 January 1997, the Taxpayer purchased the property known in this Appeal as Property B at a consideration of \$30,800,000. The property was purchased with an existing tenancy, the agreement of which was dated 28 December 1995 covering a rental period of two years commencing on 1 December 1995. The purchase was completed on 30 May 1997.
 - (b) By a provisional agreement for sale and purchase dated 10 June 1997, the Taxpayer sold Property B at a consideration of \$39,500,000. The property was sold with the existing tenancy. The sale was completed on 28 July 1997.
 - (c) Subsequent to the sale of Property B, the Taxpayer has become dormant.
 - (5)
 - (a) The Taxpayer's profit and loss accounts for the period from 10 January 1997 to 30 June 1997 showed a net loss of HK\$1,139,635.
 - (b) The Taxpayer's profit and loss account for the year ended 30 June 1998 showed a net loss of HK\$1,989,932. The gain derived from the sale of Property B of HK\$7,100,930 was recorded as an exceptional item.
 - (6)
 - (a) In the Taxpayer's 1997/98 Tax Returns, the Taxpayer declared adjusted losses of HK\$1,383,471, which was computed after taking account of a rebuilding allowance in respect of Property B in the sum of HK\$243,836.

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) In the Taxpayer's 1998/99 Tax Returns, the Taxpayer declared adjusted losses of HK\$2,136,323. The gain derived from the sale of Property B was not offered for assessment. The gain was computed as follows:

	HK\$	HK\$
Sale proceeds		39,500,000
<u>Less:</u> Purchase cost	30,800,000	
Agency commission on purchase	154,000	
Legal fee on purchase	29,120	
Stamp duty	847,000	
Finance charge on early loan		
Termination	277,200	
Legal expenses on sale	41,750	
Agency commission on sale	<u>250,000</u>	<u>32,399,070</u>
Gain		<u>7,100,930</u>

- (7) The Assessor of the Revenue issued the Taxpayer the following 1997/98 and 1998/99 loss computations in accordance with the Taxpayer's tax returns:

	<u>1997/98</u>	<u>1998/99</u>
	HK\$	HK\$
Loss per return	<u>(1,383,471)</u>	<u>(2,136,323)</u>

- (8) In response to the enquiry of the Assessor of the Revenue, the Taxpayer, through its tax representative made the following claims in respect of Property B:
- (a) The property was purchased with existing tenancy and the Taxpayer's original intention was to hold the property for investment purposes.
- (b) The tenancy agreement was signed between the vendor, Company D, and the tenant, Company E, for a term of two years commencing on 1 December 1995 at a monthly rent of HK\$90,000. The Taxpayer did not have any relationship with the vendor and the tenant.
- (c) The purchase was partly financed by an instalment loan of HK\$18,480,000 granted by Company F. The loan was repayable by 180 monthly instalments of HK\$192,972.80 each. The balance of the purchase cost came from internal funds. Of these internal funds, HK\$10,000,000 was raised from the holding company, Company C, which in turn borrowed the fund from its directors. The remaining balance

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

of HK\$3,350,120 was advanced by the director, Mr A, from his personal assets. Mr A had no problem providing the loan, as his investment income ran into millions annually. For the two years ended 31 March 1997, the loans from Company C and Mr A were without any fixed terms of repayment.

- (d) The property was generating monthly rental income of HK\$90,000 and the tenancy agreement was due to expire on 30 November 1997. The Taxpayer estimated at the time that the monthly rental on a renewal of tenancy or new letting to be between HK\$156,700 and HK\$172,300 (ie HK\$50 and HK\$55 per square foot on 3,314 square feet). Any shortfall would be financed by Mr A, who was also the guarantor on the bank loan, through his substantial investment and other income. The fact that Company F, a very reputable lender, was willing to lend the loan of HK\$18,480,000 to the Taxpayer with a repayment term over 15 years spoke for itself as the Taxpayer's repayment ability.
 - (e) In June 1997, the Taxpayer received an unsolicited offer from a real estate agent for the purchase of the property which was considered to be very generous and worth taking.
 - (f) The Taxpayer resolved to sell the property after receiving this unsolicited offer and considering its merits. The Taxpayer did not offer the property for sale either by appointing an estate agent or any other form of advertisement. The Taxpayer had no idea how the purchasers, who had no relationship with the Taxpayer, were solicited.
 - (g) The selling price was determined by the offer submitted by the estate agent to the Taxpayer which was accepted.
 - (h) The sale proceeds were used to repay the mortgage loan from Company F and the loan from the Taxpayer's holding company, etc.
- (9) In support of the Taxpayer's claims, the Taxpayer's tax representative provided copies of the following documents:
- (a) Minutes of the board of directors' meeting held on 25 January 1997 which recorded the resolution concerning the purchase of Property B as an investment property.
 - (b) Minutes of the directors' meeting held on 25 June 1997 which recorded the resolution concerning the sale of Property B.

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

(10) In response to the Assessor of the Revenue's further enquiry, the Taxpayer's tax representative provided the following responses in relation to Property B:

- (a) 'Mr A's investment income runs into millions of dollars annually. He therefore had no problem providing the loan in question.'
- (b) For the two years ended 31 March 1997, Mr A received dividends from Company G as follows:

<u>Years ended</u>	<u>Dividend</u> HK\$
31 March 1996	5,353,600
31 March 1997	<u>2,868,000</u>
	<u>8,221,600</u>

- (c) '[The Taxpayer did not trade or purchase any property in replacement after the disposal of Property B because] the Asian financial turmoil of 1997 resulted in unreasonably high interest rates and volatility in the financial market, which made new investments extremely difficult.'
- (d) 'The [estate] agent first contacted [the Taxpayer] by phone with an unsolicited verbal offer and then visited [the Taxpayer] to follow up.'
- (e) 'The intention of [the Taxpayer] ... to purchase [Property B] for long-term investment purpose ... was supported by the fact that this property was purchased with an existing tenancy. You must undoubtedly realize that tenants' right of tenancy under residential leases are protected by law in Hong Kong. Tenants can stay for as long as they wish if they pay their rent. Since such properties are not very marketable, it would be foolhardy for [the Taxpayer] to purchase the captioned property for anything other than long term investment purposes. Furthermore, there was a substantial penalty on the early repayment of the bank loan, which also acted as a deterrent to any quick sale.'

The Taxpayer's tax representative provided the following responses in relation to Company C:

- (f) The Taxpayer was unable to supply copies of the balance sheets and accounts of Company C for the period from 1 July 1996 to 30 June 1998 as it did not have access to the financial statements of the holding company.

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

(g) Company C had two other subsidiaries in Hong Kong with their registered offices at an address at Address H. One of them was Company J, which was a property investment company. The other was Company K, which was a dormant company.

(11) The Assessor of the Revenue was of the view that Property B of the Taxpayer's trading stock and, hence, no rebuilding allowance should be granted in respect of it and the profit derived from its sale should be chargeable to tax. Accordingly the Assessor issued to the Taxpayer the following revised loss computation for the year of assessment 1997/98 and Profits Tax Assessment for the year of assessment 1998/99:

(a) Year of assessment 1997/98

	HK\$
Loss per return	(1,383,471)
<u>Add: Rebuilding allowance</u>	<u>243,836</u>
Adjusted loss carried forward	<u>(1,139,635)</u>

(b) Year of assessment 1998/99

	HK\$
Loss per return	(2,136,323)
<u>Add: Gain on sale of Property B</u>	<u>7,100,930</u>
Assessable Profits	4,964,607
<u>Less: Loss set-off</u>	<u>1,139,635</u>
Net Assessable Profits	<u>3,824,972</u>
Tax Payable thereon	<u>611,995</u>

(12) The Taxpayer disagreed with the 1997/98 loss computation and objected to the 1998/98 Profits Tax Assessment on the grounds that the rebuilding allowance should be granted and that the assessable profits were excessive. The Taxpayer's representative put forward the following contentions:

Year of assessment 1997/98

(a) '[Property B] is an investment property and classified under Fixed Assets. At the same time, the property was receiving rent during the period. Rebuilding allowance should be allowed under section 36 of the Inland Revenue Ordinance.'

Year of assessment 1998/99

- (b) '[Property B] was purchased as long-term investment with an existing rental agreement. Through numerous previous correspondence with [the Revenue], [the Taxpayer] has affirmed repeatedly that their original intention regarding the purchase of this property was to hold it for long-term rental income.'
- (c) 'Up to the time the unsolicited purchase offer was received, [the Taxpayer] had no intention of selling this property. Their intention to hold this property for long term was clearly demonstrated by the following facts:
 - (i) They have arranged for long term financing for the property which involved the payment of a hefty early repayment penalty if the loan was repaid within a short period of time;
 - (ii) The subject property, with an existing tenant at the time, was not really a marketable commodity for sale when compared with a property with vacant possession because the tenant's right to renew the tenancy was protected by law. This would be a major deterrent to any potential purchaser who may consider acquiring the property for self use and these are the overwhelming majority of the potential purchasers in the market and
 - (iii) They had not taken any decision to sell this property nor had they taken any steps to market this property.'
- (d) 'If [the Taxpayer's] intention was otherwise, they could reasonably be expected to have taken the following steps:
 - (i) They should have arranged for some financing arrangement with minimal repayment penalty on early repayment,
 - (ii) They should have purchased a property with vacant possession which would have a much greater marketability and
 - (iii) They should have taken active steps to market their property such as advertising and appointing sales agent etc to increase the property's exposure to the market in order to enhance the chance of selling the property quickly and obtaining a good selling price.

[The Taxpayer] did none of the above because they did not have any intention of selling their property at the time.’

- (e) ‘Between the time [the Taxpayer] purchased [Property B] and the time they received the unsolicited purchase offer in June 1997 the property market in Hong Kong had gone through a period of explosive and unusual activities and this explained why such a generous unsolicited offer was received. This unsolicited offer was the REASON that persuaded [the Taxpayer] to change their intention regarding this property because the offer was simply too generous to be passed over. As a result, the property was only held for a relatively short period of time but this was not intended.’
- (f) ‘Whether a business project is commercially viable would be best left to the judgments of the enterprise involved and its bankers. ... [The Taxpayer’s] judgment was obviously agreed to by their lender, [Company F], one of the most respectable financial institutions in Hong Kong, as it was satisfied with the repayment ability and the staying power of the Taxpayer and was willing to lend to [the Taxpayer] more than \$18 million over a term of fifteen years. We believe this attested to the “long term” viability of the project.’

12. Apart from the documents referred to in paragraph 11(9) above, the Revenue has also provided the following documents before this Board in this Appeal:

- (1) Acceptance of appointment as director of the Taxpayer by Mr A as from 23 January 1997.
- (2) Acceptance of appointment as director of the Taxpayer by Mrs L as from 23 January 1997.
- (3) Annual return of the Taxpayer for the year ended 10 January 1998.
- (4) Annual return of the Taxpayer for the year ended 10 January 1999.
- (5) Profits Tax return, audited financial statements and tax computation for the year of assessment 1997/98.
- (6) Profits Tax return, audited financial statements and tax computation for the year of assessment 1998/99.
- (7) Profits Tax return, audited financial statements and tax computation for the year of assessment 1999/2000.

- (8) Land Register entry of Property B.
- (9) Provisional purchase agreement dated 23 January 1997.
- (10) Formal purchase agreement dated 5 February 1997.
- (11) Provisional sale agreement dated 10 June 1997.
- (12) Formal sale agreement dated 25 June 1997.
- (13) Correspondence between the Revenue and the tax representative of the Taxpayer, including the tax representative's letter dated 29 November 1999 (which enclosed, inter alia, the instalment loan facility letter dated 30 April 1997 from Company F and the minutes of the Taxpayer's board of directors' meeting held on 25 January 1997 concerning the appointment of a fellow subsidiary of the Taxpayer, Company M to manage the Taxpayer's business) and the tax representative's letter dated 25 September 2002 (which enclosed, inter alia, the minutes of the Taxpayer's board of director's meeting held on 25 January 1997 concerning the purchase of Property B and the minutes of the Taxpayer's board of directors' meeting held on 25 June 1997 concerning the sale of Property B).
- (14) Hong Kong Property Review 1997 (Rating and Valuation Department) (extracts).
- (15) Hong Kong Property Review 1998 (Rating and Valuation Department) (extracts).

The Court of First Instance's Opinion

13. The Court of First Instance observed in its Judgment that the representations made on behalf of the Taxpayer by its tax representative were not agreed facts and what was agreed was the fact that the Taxpayer's tax representative made those representations or 'claims' to the Revenue. There was no agreement that the contents of the representations were in fact true and correct. The representations made by the tax representative themselves, without more, did not constitute evidence to support the truth of their contents. The Court of First Instance considered in paragraph 18 that this Board erred in treating the representations that had been made by the tax representatives in letters to the Revenue as agreed facts or effectively unchallenged evidence, when those matters were in fact contentious.

14. The Court of First Instance also noted in paragraph 19 of its Judgment that Mr N, counsel for the Revenue, 'accepted that the contemporaneous documents submitted by the tax representative, at any rate those documents whose authenticity is not in dispute, may be considered by the Board as admissible documentary evidence. But the assertions

and submissions that are not supported by the undisputed contemporaneous documents stand on a different footing and ought not, without more, to be treated as evidence.’

15. The Court of First Instance considered in paragraph 20 of its Judgment that in essence, what had happened in this Appeal was that this Board erred in law where it had relied, to a material extent, on matters which were not properly adduced as evidence.

16. The Court of First Instance dealt with Question 2 and Question 3 by answering them in the negative. These two questions asked the Court of First Instance to consider whether the true and only reasonable conclusion as a matter of law and based on the evidence before this Board was that the Taxpayer purchased Property B as trading stock and therefore the gain from its disposal was subject to profits tax (with the ancillary consequence that the Taxpayer’s claim for rebuilding allowance should be disallowed). In coming to the answer ‘No’ to Question 2, the Court of First Instance reasoned as follows:

- ‘23. In any event, having considered the documentary evidence, it seems to me the question of the taxpayer’s intention has to be one for the Board. So far as circumstantial evidence is concerned, Mr Cheung pointed to the fact, among others, that (i) [Property B] was purchased subject to tenancy; (ii) under the law applicable at the time there was protection of the tenure of the tenant, subject to payment of market rent; (iii) the taxpayer obtained a mortgage loan on terms which penalised and discouraged early repayment; and (iv) the taxpayer actually took the assignment of the property and paid all stamp duty and legal costs before entering into an agreement to sell the property. These matters, he submitted, tend to show an intention to hold the property on a long-term basis as investment, rather than as trading stock.
24. But not only was there circumstantial evidence of the taxpayer’s intention, there was actually a copy of the minutes of the meeting of the board of directors of the taxpayer dated 25 January 1997 which stated it was resolved that the company “shall purchase the property ... as an investment property ...”. This was included in the material before the Board as Appendix E to the Deputy Commissioner’s determination and was, as I understand Mr Leung’s submission, a document properly to be treated as admissible documentary evidence. As far as I understand the Commissioner’s position, there is no suggestion that it was anything other than a genuine document created at the time. It is arguable – and I need put it no higher than that – that the phrase “investment property” would suggest that the property was purchased as capital asset rather than trading stock. As such, the document, albeit created by the taxpayer’s own directors, could, in my view, be regarded as evidence of the intention of the taxpayer at the time. What weight should be put on it is a question open to debate, but within the

bounds of rationality, weight is of course a question for the Board as the tribunal of fact.

25. On the basis of the evidence properly adduced before the Board, I am unable to say that no reasonable Board of Review properly directing itself could possibly come to the conclusion that [Property B] was purchased and then held by the taxpayer as a capital asset rather than trading stock. I shall accordingly answer Question 2 in the negative.'

17. The Court of First Instance heard and determined the appeal by way of case stated in respect of this Board's conclusion that Property B was purchased by the Taxpayer as a capital asset. The remitting of this Appeal to this Board with the opinion of the Court of First Instance expressed in its Judgment therefore concerned this finding of this Board in this Appeal, which affects the following aspects of the Taxpayer's liability for profits tax:

- (a) Whether the loss computation for the year of assessment 1997/98 should be revised to allow the deduction of the rebuilding allowance; and
- (b) Whether assessment for the year of assessment 1998/99 should be revised to exclude the gain on the sale of Property B.

18. There was no appeal against this Board's upholding of the Deputy Commissioner's rejection of Taxpayer's claim that the items of 'consulting fee' and 'rental expenses', said to have been paid to Company M, were deductible expenses in its Decision of 10 October 2014. The Remitted Appeal does not purport to question this Board's finding in respect of the deductibility of these two items. There was no submission on them by the parties on these two items at the hearing of the Remitted Appeal on 25 July 2016.

The Submissions

19. In the light of the opinion of the Court of First Instance stated above, both Mr Cheung, counsel for the Taxpayer and Mr Leung, counsel for the Revenue, directed their written and oral submissions on the evidential value of the minutes of the meeting of the board of directors of the Taxpayer dated 25 January 1997 as evidence of the intention of the Taxpayer at the time of the acquisition of Property B and on the various matters that may serve as circumstantial evidence of the intention of the Taxpayer at the time of the acquisition of Property B.

20. In relation to the minutes of the meeting of the board of directors of the Taxpayer dated 25 January 1997 -

- (a) Mr Cheung for the Taxpayer adopted what the Court of First Instance had said in paragraph 24 of its Judgment and contended

that from the plain reading of the phrase ‘investment property’ on the minutes, it would be understood that Property B would be a capital asset. As to the matter that the minutes were produced four years after the initial request by the Revenue, Mr Cheung referred to the terms of the initial request and the subsequent requests. Although Mr Cheung acknowledged that the initial request did refer to ‘director’s resolution’ (which would be understood as in the form of minutes), he stressed that the Taxpayer produced the minutes upon the specific request of the Revenue in 2002 and that there was a lack of efficient communication between the Taxpayer (and its representative) and the Revenue in those four years. As to the matter that the minutes could be regarded as an ‘after the event’ document, Mr Cheung drew attention to the terms of the provisional sale and purchase agreement and suggested that at the time when it was signed on 23 January 1997, both parties had not yet committed to completion of the sale and purchase with the remedy of specific performance. Mr Cheung also emphasized that the date of the minutes of 25 January 1997 showed that the resolution was genuinely made on that date as opposed to being made up to satisfy the Revenue about the intention of the Taxpayer in purchasing Property B.

- (b) Mr Leung for the Revenue submitted that this Board should not rely on the minutes. Although the minutes arguably is the only document that directly suggests the intention of the Taxpayer at the time of the purchase was to acquire Property B as an ‘investment’ property, this document was produced in 2002, some four years after the Revenue’s initial request for production of documentary evidence in support of the Taxpayer’s intention in the purchase of Property B and there was no explanation from the Taxpayer on why it should take four years to produce it. Also, the minutes were an ‘after the event’ document, since the provisional sale and purchase agreement for Property B was signed on 23 January 1997 and there was no explanation why the minutes came to be dated 25 January 1997 when the provisional sale and purchase agreement had been signed two days earlier. Mr Leung pointed to the company registry filings that Mr A consented to become a director of the Taxpayer on 23 January 1997 and that his wife also consented to become a director of the Taxpayer on the same date. And the Taxpayer entered into the provisional sale and purchase agreement on 23 January 1997. Mr Leung suggested there could be no valid reason why the resolution to acquire Property B and to authorize Mr A to sign the sale and purchase agreement should be passed on a date other than 23 January 1997. Mr Leung also sought to rebut the claim that the minutes were for the formal sale and purchase agreement, since it was unlikely that the terms of the formal agreement could be sorted out a few days after the provisional sale and purchase agreement.

Thus Mr Leung essentially submitted that the Taxpayer had ‘messed up the minutes’. Additionally, Mr Leung noted that the Assessor of the Revenue had asked the Taxpayer to produce a copy of the minute book showing details of the meetings of the board of directors for the period from incorporation to 30 June 1998, or if the minute book was unavailable, to provide copies of all the resolutions during that period of time, but the Taxpayer had not produced the requested documents. Therefore, Mr Leung suggested that from the production of the minutes with an inappropriate date four years after the initial request of the Revenue, the gap of 4 months between the Revenue’s request for the supposedly readily available minutes and the actual production by the Taxpayer’s tax representative of the minutes, and in the absence of the minute book and oral evidence, there is at least a reasonable doubt over the genuineness and contemporaneous nature of the minutes. Mr Leung stressed in this respect that it was for the Taxpayer to show that the minutes are reliable minutes and they assist the Taxpayer’s Appeal, and it is not for the Revenue to prove that the minutes are in any way un contemporaneous. As to the contents of the minutes, Mr Leung suggested that they should not be taken at face value. The resolution to purchase Property B as an ‘investment’ could be interpreted equally as purchasing a capital asset and as purchasing trading stock since ‘investment’ in the context of a business can be short term or long term. Accordingly, Mr Leung urged this Board not to place any weight to the minutes, or to hold that the minutes have no probative value whatsoever.

21. In relation to the circumstantial evidence on the intention of the Taxpayer at the time of the acquisition of Property B and the findings of this Board in the previous Decision (which are the italicized text in each of the sub-paragraphs below), the parties made the following submissions

- (a) *The Taxpayer purchased Property B with a sitting tenant at a time when there was protection of the tenure of tenancy subject to the payment of market rent.* Mr Cheung submitted that this was an agreed fact and helpful to the Taxpayer’s case on the basis that if there was a sitting tenant, it was logical to say that it would be more difficult to dispose of the property in the market. If the Taxpayer had wished to purchase trading stock for quick disposal, it would have been natural to pick a property with no sitting tenant. Having a sitting tenant in the property would have restricted the pool of potential buyers. Mr Leung pointed out that there was no evidence before this Board as to the choices the Taxpayer had at the time when it decided to buy Property B, such as properties with vacant possession. He referred to the fact that Property B was purchased by the Taxpayer with a sitting tenant and then sold by the Taxpayer with the same sitting tenant to indicate that it cannot be fairly said

that all properties purchased with a sitting tenant at the time when there was protection to the tenant must be for long term investment. The fact that a property had a tenant did not mean that it was not a suitable investment on a short term basis for a trader. A property with a yield should be as marketable as a property that does not yield any income. He regarded this matter to be a neutral factor.

- (b) *The purchase of Property B was financed partly by funding from Company C (which in turn borrowed from its directors), partly by personal funding from Mr A, and partly by a 15 year mortgage from Company F. The terms of the mortgage discouraged early repayments of the mortgage loan by imposing monetary charges.* Mr Cheung indicated that the above matters were supported by the balance sheet of the Taxpayer (which shows the advance for purchasing Property B came from three sources) and the facility letter of Company F. Mr Leung submitted that these matters were not borne out by the documents. Mr Leung also made the point that there was no evidence to show that the Taxpayer would be able to sustain the project since it had not shown that it had the fund to do so. As a matter of fact, even before the first loan instalment was due and payable, which is usually one month after drawdown, Property B was already sold. The ability of repaying the loan was shown by selling the property rather than servicing the instalment loan. Such actions of the Taxpayer should speak for itself; they were all clearly indicative of a purchaser intending to buy a property as a trading asset. Mr Leung further invited this Board to consider what he regarded as common knowledge that banks and finance companies would charge prepayment penalty for early repayment, and here, the Taxpayer had no other financing choices but to pay the prepayment penalty. Mr Leung furthermore asked this Board to consider the situation back in 1997 of banks commonly lending very much on security without ensuring repayment ability of the borrower. Hence, Mr Leung submitted that this Board should consider the primary pieces of evidence as to whether the Taxpayer or Mr A was in a position to maintain or sustain the project of Property B beyond the first month and probably in the long term. If they could not, then the project must be regarded as not feasible and the chance or probability of the Taxpayer originally intending to keep it as a long term investment would not have been established. After all, one of the key points of investigation in the Board's determination on whether or not the intention as alleged held had any truth in it was to ask whether the project was a feasible and realizable project or investment.
- (c) *The purchase of Property B was completed in May 1997 with the Taxpayer paying all the stamp duties and legal costs.* The parties do not dispute these matters.

- (d) *Although the Taxpayer had signed the formal agreement for sale and purchase on 5 February 1997, it had not put Property B in the market by appointing estate agents, publishing advertisements or using other means that would make it known that the property was on sale. The parties do not dispute these matters. But Mr Leung added that there was no evidence before this Board of the unsolicited offer from the estate agent or of the estate agent approaching the Taxpayer or of its representation unsolicited. And even if there was such evidence, the Revenue's position would be that the period of holding of the property was very short and that would be inconsistent with the Taxpayer's declared intention of purchasing it for investment purpose.*
- (e) *Those in the management of the Taxpayer, including Mr A, were clearly experienced in the buying and selling of properties in Hong Kong both as long term investment and as trading stock. This is illustrated by the portfolio of properties held by Company C and its subsidiary companies, including the Taxpayer and Company K, and the different approach taken by those in control of Company K to actively market the purchased property before the taking of the assignment, resulting in a confirmor sale, and to book the gain as a trading profit subject to taxation. Mr Cheung submitted that the above matters were supported in the facts referred to in the Deputy Commissioner of Inland Revenue's Determination of 27 September 2013 and in the financial statements of Company M. Mr Cheung also relied on the point that while the Revenue's representative at the hearing of this Board on 17 February 2014 was not in a position to confirm or agree to any of the claims made in respect of Company C on behalf of the Taxpayer, the Revenue's representative did refer to and confirm that Company K had purchased and sold a property. Mr Leung submitted that the facts referred to in the Deputy Commissioner's Determination went only as far as stating that Company C was the Taxpayer's ultimate holding company and the other parts of the Determination referred to were recitation of the representations made by the Taxpayer's representative in response to the enquiry of the Revenue's Assessor and such representations should not be treated as established facts or evidence. Mr Leung reminded this Board that the Revenue's representative was not giving evidence on 17 February 2014; and that what the Revenue's representative did say did not tell very much and was certainly not evidence from the Revenue on what actually happened in relation to Company K. In response to the question from the Chairman of this Board, Mr Leung stated that the transaction that Company K was involved had no relevance to the determination concerning the transaction that the Taxpayer was involved.*

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (f) *Mr A was the personal guarantor of the mortgage loan.* Mr Cheung referred to the facility letter of Company F as supportive of this matter. Mr Leung accepted that the facility letter supports this statement but considered that this was not helpful to the Taxpayer's case since nearly all bank facilities and loan extended to private companies require personal guarantees from directors or at least active directors.
- (g) *The shareholder's and director's advances to the Taxpayer in the total of HK\$4.3 million had no fixed terms of repayment.* Mr Cheung suggested that the balance sheet of the Taxpayer as at 30 June 1997 would show this matter and sought to illustrate the relevant calculations, as well as to rebut Mr Leung's claim that this matter appears to be inconsistent with the assertions previously made on behalf of the Taxpayer by its representative on financing of the purchase price of Property B. Mr Cheung also seeks to rebut Mr Leung's contestation of the matter that the advances had no fixed terms of repayment, stating that there was no evidence. Mr Cheung submits that since the terms of repayment of the loan materially affects the financial status of the Taxpayer and a prudent concept of accounting standards would require disclosure, the absence of any such disclosure in the financial statement was a matter that this Board could take from the face value of the financial statement. Mr Cheung then made a reference to the disclosure in the Taxpayer's audited accounts in respect of 'Amount Due from Holding Company', which was 'amount due from the Holding Company is unsecured, interest free and has no fixed term of repayment'. Mr Leung responded to say that financial statements could be a self-serving document and in the Taxpayer's case the audited accounts were prepared and signed in June 1998, about one year after the sale of Property B. He urged this Board to look more at the objective factors and evidence (such as oral evidence) than the audited accounts. Separately, Mr Leung submitted that the reference in the Taxpayer's audited accounts in respect of 'Amount Due from Holding Company' should be distinguished from the case where the holding company was advancing money to the Taxpayer at the time of acquisition of Property B because that would be an amount due to the holding company. The statement in the audited accounts had no bearing on the other way around at the time when Property B was acquired. This should be regarded as not an important piece of evidence.
- (h) *Mr A had substantial annual income from his investments in the order of millions.* Mr Cheung submitted that this Board could draw such an inference from the lack of any further enquiry on this matter by the Revenue following the assertion by the Taxpayer's representative on 20 September 2002 that Mr A received dividends

of HK\$8 million odd from one company in the year 1996/97, and from the fact that he was the personal guarantor of the mortgage. That Mr A was the guarantor of the mortgage loan had significance because, according to Mr Cheung, the lender would not have approved the loan without looking into the ability of the guarantor or the borrower to meet the payment obligation, bearing in mind that the lender here was well aware of the fact that the rental income was not sufficient to meet the monthly mortgage repayment. Mr Cheung referred to the power of the Revenue to investigate the company in question, and contended that if the matter were regarded as disputed, the Revenue should have covered it when it had exchanges of correspondence with the Taxpayer and also exercised its power of investigation. Mr Cheung also referred to the ‘style’ of the Deputy Commissioner’s Determination, such as whether the assertion was franked by quotation marks, to suggest that the matter was uncontroversial. Mr Cheung thus submitted that this Board could find that Mr A could meet the financial obligation in making repayments of the loan to finance the purchase of Property B. On the other hand, Mr Leung submitted that there was no proper evidence at all to substantiate this matter. The representations made on behalf of the Taxpayer were mere representations. The Taxpayer must adduce proper evidence – evidence that is cogent and reliable – to support its case and all the elements of its case. If the Taxpayer wished its director to prove that he had substantial income from investments, it must produce evidence and not just ask this Board to read assertions in correspondence with the Revenue, or read into the Determination’s use of quotation marks. Further, Mr Leung submitted that the matter that Mr A was the guarantor of the mortgage was not capable of giving rise to an inference that he was good for his guarantee or that he was financially sound in the eyes of the bank for several reasons. Firstly, it was banking practice to require an individual to guarantee the loan. Secondly, the loan was secured on a mortgage of the property. Thirdly, the loan was obtained from a finance company which lent more liberally. Fourthly, it should not have been difficult for the Taxpayer and its directors to produce evidence of the financial ability of itself, its shareholders and its directors. But, when the Revenue asked for financial information about the Taxpayer’s holding company for the purpose of verifying its provision of HK\$10 million loan to the Taxpayer, its representative replied that the Taxpayer was unable to supply the requested information as it did not have access to the financial statements of its holding company. Furthermore, Mr Leung contended that the main point in the present Appeal was not the past source of income of Mr A; it was whether or not Mr A had the ability of financing the future cash flow for Property B project, since this points to how feasible the project is on an ongoing basis. In this respect, Mr Leung stressed that it was incumbent on the Taxpayer to

produce documents to show that it or Mr A had the ability to keep the project going on in the short term, the medium term and the long term, and so either the Taxpayer or Mr A should give evidence to show that the shortfall between the rental income and the monthly mortgage instalment amount, about HK\$100,000 per month, could be met. Mr Leung also referred to the clarifications that the Revenue had sought from the Taxpayer and its tax representative time and again and the replies of the tax representative which contained only assertions.

- (i) The existing tenant was an established telecommunications corporation. Mr Cheung submitted that this matter was supported by the reference made in Schedule 9 to the formal agreement for sale and purchase of Property B. Mr Cheung also suggested that a comment of the Revenue's representative during the previous hearing that the tenant was 'a well-known company in Hong Kong' was of assistance to the Taxpayer. Mr Leung acknowledged that while the name of the tenant stated in Schedule did resemble to that of a subsidiary of a publicly listed telecommunications company in Hong Kong, there was nonetheless no evidence to link the tenant with any established telecommunications corporation. The tenancy agreement was not in the evidence before this Board.
- (j) *The Board further found that [the tenant] was likely to afford to pay market rental for the continued or renewed tenancy. The Board also found a good and sufficient evidential basis to sustain the Taxpayer's case that the shortfall between the monthly instalment repayment and the monthly rental income could and would be met by funding from its shareholders and directors.* Mr Cheung submitted that these findings remained open to this Board based on the 'primary facts'. Mr Cheung referred to the relatively long period of completion secured by the Taxpayer when it purchased Property B as indicative of its genuine intention to keep the property for the purpose of investment, given that the property market was rising at the material time, thus presenting opportunities for the Taxpayer to make a quick profit, but that, in fact, the Taxpayer did not sell at all during this period of completion. Instead of securing a quick profit during the completion period, the Taxpayer completed the assignment of the property, drew down the loan and paid stamp duty, and where it sold the property, it had to pay the penalty for early redemption of the mortgage. Mr Cheung submitted that all these were against any claim that the Taxpayer started out to make a quick profit. Mr Leung disagreed and submitted that based on proper evidence, the Taxpayer could not begin to show that the shortfall between the monthly instalment repayment and monthly rental income (which was calculated by Mr Leung to be HK\$102,978.80 per month (excluding rates)) could and would be met by funding

from its shareholders and directors. Mr Leung pointed to the absence of any documentary evidence in support of the claimed 'historical fact' of ability on the part of the Taxpayer, its shareholders or its directors to meet this shortfall. Mr Leung also pointed to the ability on the part of the Taxpayer to repay the mortgage loan being demonstrated, in fact, by its decision and execution of the sale of Property B 11 days after drawing down the mortgage loan. Mr Leung further pointed to the long completion lead-time for the Taxpayer's purchase of Property B, which he suggested to be 'an obvious hallmark of a property speculator or trader hoping to 'flip' a property by selling the property as a confirmor for a quick profit before completion', bearing in mind that a confirmor sale could save on stamp duty and financing costs. Mr Leung also suggested that 'just because a person did not sell a property as a confirmor should not be taken as that person intending to acquire the property as a capital asset. He could well have taken a view that his profits would be even higher if he waited out.' Mr Leung further suggested that the gross yield of the property was 'meagre (3.5% per annum) in comparison with the Taxpayer's cost-of-funds in terms of bank interest alone (9.5% per annum), which financed 60% of the purchase price', and that in respect of the other 40% of financing from the directors, there was no indication in the notes to the accounts that it carried no interest payable by the Taxpayer. Mr Leung finally suggested that Property B with such a gross yield did not appear to be a sound long-term capital investment.

- (k) *The inclusion of the period of time between the signing of the formal agreement of sale and purchase and completion of the sale and purchase, namely the period of about 3 months between February 1997 and May 1997, as part of the relevant time period brings into perspective the inaction on the part of the Taxpayer in disposing of its property during that time and the astonishingly upward buoyant property market circumstances during that time, namely the early to mid parts of 1997. It supports the Taxpayer's case that its intention of acquisition for long term investment for rental purposes was maintained. Mr Cheung submitted that these previous findings by this Board were based on evidence and an inference could be drawn from the undisputed or circumstantial evidence, including the upward trend of the market at the material time. Mr Leung disputed this and submitted that there was no evidence to suggest that the Taxpayer was inactive in disposing of Property B at the material time. This was because Mr A did not give oral evidence.*
- (l) *The unsolicited and very generous offer, which was eventually accepted, was in the amount of HK\$39,500,000. The gain from the sale, after deducting the purchase cost, agency commission on*

purchase, legal fee on purchase, stamp duty, finance charge on early loan termination, legal expenses on sale and the agency commission on sale, was HK\$7,100,930. This was equivalent to 6.5 years of the rental income at the level of HK\$90,000, or nearly 5 years of rental income at the level of HK\$120,000, or nearly 4 years of rental income at the level of HK\$150,000. The amount of gain illustrates the generosity of the offer. The early return of such an amount of gain also lends support to the decision to sell. The Taxpayer's case that Property B was acquired as a long term investment for rental purposes has not been undermined by these matters. This Board is of the view that the sale was consistent with the disposal of an investment. Mr Cheung submitted that although there was no evidence to support the finding that the offer was unsolicited from the buyer, this Board could still hold that the offer was very generous, lending support to the decision to sell. Mr Cheung added that this Board should also bear in mind the period of time between January 1997 and June 1997 and the market situation during that time, and give weight to the soaring property market at that time for high end properties. Mr Cheung suggested that these four months would have been a very long time for a person who dealt in property for a quick profit. Mr Cheung further submitted that this Board was entitled to make the calculation on the basis of rental income in consideration of the generosity of the offer, stating that it was natural to consider in the light of the offer whether it would be reasonable or commercially sensible to hold the investment property up to the relevant periods of time before earning the same amount of gain. Mr Leung submitted that firstly, without Mr A's testimony, there was no evidence on how the sale came to be struck; and secondly, on the evidence before this Board, the true and proper conclusion that can reasonably be reached is not that Property B was acquired as a long-term investment for rental purposes. Mr Leung also pointed to the very buoyant property market in the first half of 1997 to draw attention to the possibility then available to people of making quick money in the property market without committing oneself to draw a loan and paying only incidental costs like stamp duty, suggesting that a relatively longer than normal completion period then could be a real possibility that the purchaser would want to see if it could 'flip' the property and make a quick profit by selling it before completion. Mr Leung referred again to the 3 month completion period the Taxpayer had asked for in the present case, which, according to him and in the absence of evidence explaining why the directors of the Taxpayer chose a completion period of such length, was suggestive of a greedy expectation on its part to use that period to sell and make a big profit in short time.

22. Mr Leung for the Revenue submitted that the Taxpayer had not discharged its burden of proof by evidence to establish that the assessment appealed against was excessive or incorrect. Mr Leung stressed that it is incumbent in an appeal before this Board for the Taxpayer to bring out all the evidence to persuade this Board of its case. The evidence before this Board in this connection was the agreed facts and the undisputed documents, such as the various agreements for sale and purchase, the mortgage facility letter from Company F and the Taxpayer's audited financial statements. The tax representative's letters to the Revenue made assertions and those letters were not evidence. Mr A's decision not to testify meant that the Taxpayer had not led important evidence on the intention of the Taxpayer in acquiring Property B.

23. Mr Cheung for the Taxpayer submitted that the declared intention of the Taxpayer of acquiring Property B as long term investment could be supported by the circumstantial evidence, that the financial statement of the Taxpayer supports the proposition that it could very comfortably meet the first month repayment obligation by paying the shortfall between the monthly instalment and the rent, that the approval by the lender of the mortgage financing of the purchase of Property B with Mr A as the guarantor indicates that they were able to satisfy the lender that they could meet the monthly instalments, and this Board should reach the same conclusion as it did originally.

Discussion

24. The case law on the determination of whether an asset is a trading or capital asset 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) 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.
- (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.

25. This Board has taken time to consider the evidence properly before it, and the extensive submissions made in respect of such evidence.

26. The first matter that this Board determines is the weight to be given to the minutes of the board of directors of the Taxpayer dated 25 January 1997, which stated that it was resolved that the Taxpayer 'shall purchase the property ... as an investment property ...'. The Court of First Instance had indicated in paragraph 24 of its Judgment (quoted above) that the Taxpayer could rely on the said minutes as evidence of the intention of the Taxpayer at the time.

27. This Board has considered the objections that Mr Leung has raised on behalf of the Revenue against relying on the minutes of the board of directors of the Taxpayer dated 25 January 1997. This Board decides that full weight is to be given to the contents of the minutes of the board of directors of the Taxpayer, notwithstanding the objections raised by Mr Leung in respect of the provenance of this document. This Board considers this document records the authorization of Mr A to sign the formal sale and purchase agreement and to execute the assignment. This Board, which consists of three legal practitioners, also takes notice and account of the property conveyance practice of

including in the bundle of ‘title deeds’ the company vendor/purchaser’s authorization of a signatory to sign the sale and purchase agreement and to execute the assignment. With these matters in mind, this Board does not share Mr Leung’s suggestion that this document is an ‘after the event’ document. This Board has also considered this document in the light of the other three minutes of the Taxpayer that were produced to the Revenue on its request and notes that these 4 documents do not resemble each other in font, line spacing and other formatting elements significantly. Although the minutes of the board of directors of the Taxpayer dated 25 January 1997 in respect of the purchase of Property B and the minutes of the board of directors of the Taxpayer dated 25 June 1997 in respect of the sale of Property B may share similarities in content, this is understandable since both are concerned with the purchase and sale of the same property. This Board agrees with Mr Leung that the Revenue had asked the Taxpayer’s then tax representative for documentary evidence of the Taxpayer’s intention in purchasing Property B like director’s resolution in 1998; that this document was only produced by the tax representative in 2002; and that there was no explanation for the duration of time that was taken. On the other hand, this Board is of the view that while it is for the Taxpayer to provide an explanation for the belated availability of this document to the Revenue after repeated requests, the absence of such an explanation does not, by itself, undermine and destroy the prima facie genuineness and contemporaneous nature of this document.

28. This Board has also considered Mr Leung’s submission for the Revenue on the meaning or interpretation of the resolution in the minutes of the board of directors of the Taxpayer dated 25 June 1997. This Board understands that Mr Leung contends that since investment could be for the short term or the long term for a business, a resolution to purchase Property B as ‘an investment property’ throws no light on the question of the Taxpayer’s intention at the time of the resolution. This Board refers to the Court of First Instance’s observation that ‘it is arguable – and I need put it no higher than that – that the phrase ‘investment property’ would suggest that the property was purchased as capital asset rather than trading stock’. With respect, and in the clear understanding that an expressed view of intention at the time of purchase is not decisive, this Board proposes to follow the learned judge’s view.

29. This Board’s finding of the intention of the Taxpayer at the time of the acquisition of Property B 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.

30. This Board now turns to consider the ‘whole picture’ of evidence that is validly before this Board. In respect of each of the matters that follow, this Board has considered and debated upon the merits of the submissions of the parties in respect of each of them, which have been set out above. This Board does not wish to prolong this already long and long awaited Decision with over extensive reproduction and discussion of the submissions.

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

31. Firstly, this Board considers that the agreed fact that the Taxpayer purchased Property B with a sitting tenant at a time when there was tenure protection of the tenancy subject to payment of the market rent to be a factor that should be taken into account, but not as a factor to which much weight can be placed in support of the Taxpayer's contention that Property B was acquired as a capital asset.

32. Secondly, and more importantly, this Board considers the financing of the purchase of Property B by the Taxpayer. This Board recognizes that the purchase price for Property B came partly from Company C (which in turn borrowed from its directors), partly from the personal funds of Mr A, and partly by a 15 year mortgage loan from Company F. The 15 year mortgage loan was of 60% of the purchase price of HK\$30,800,000. This Board also recognizes that there has not been much evidence to demonstrate the sustainability of the financing of the Taxpayer's purchase in the medium to long term, since Property B was sold before the first loan instalment was due and payable, the Taxpayer had been operating at a net loss in 1997 in the order of about HK\$1 million, there would have been a significant shortfall between the monthly instalment payment of HK\$192,972.80 and the HK\$90,000 monthly rental income, and there was very little in evidence of the financial capability of the shareholders and directors of the Taxpayer to fund that shortfall. Although Mr Cheung for the Taxpayer had turned to the fact that the Mr A signed a personal guarantee of the mortgage loan and the assertion that Mr A had substantial annual income from his investments, the first is only as good as the second goes, but there is admittedly nothing further than an assertion that Mr A had substantial annual income (which was sought to be substantiated by another assertion that he received dividends of HK\$8 million odd from one company in 1996/97). Although Mr Cheung for the Taxpayer has also sought to illustrate from the financial statements of the Taxpayer that the advances to the Taxpayer from its shareholder and director had no fixed terms of repayment, that at most only covered 40% of the purchase price of Property B. This Board has to agree with the submission of Mr Leung for the Revenue that the feasibility and realizability of the project of purchasing Property B as a capital asset had to be shown by the production of evidence, oral and documentary, to show that the Taxpayer and/or its shareholders and directors had the ability to keep the project going on in the short, medium and long term, at least with reference to the 15 year time frame of the mortgage loan of 180 monthly instalments and the real need to finance the shortfall every month between the monthly instalment and the rental income.

33. Thirdly, although it is an agreed or undisputed fact that after the signing of the formal agreement for sale and purchase on 5 February 1997, the Taxpayer had not put Property B in the market by appointing estate agents, publishing advertisements or using other means to make it known that it was on sale, this Board can take this matter into account attaching only limited weight to it, since the relative period was a short one of just over 3 months.

34. Fourthly, the Taxpayer's claim that its directors and management were experienced in the buying and selling of properties in Hong Kong both as long term investment and as trading stock has not been adequately made out with evidence. Although Mr A did draw to this Board back on 17 February 2014 in his submissions to

(2019-20) VOLUME 34 INLAND REVENUE BOARD OF REVIEW DECISIONS

Company K's purchase of property, his words in this respect were not evidence and in any measure untested by cross-examination. This Board is unable to give much weight to what had been referred to about Company K and to act on such matters to draw any observations or inference from them to be of assistance to the Taxpayer.

35. Fifthly, while this Board is inclined to assume that the existing tenant to be 'an established telecommunications corporation', that only goes as far as confirming the potential reliability or stability of rental income. That would have been only small comfort to the Taxpayer in the light of the shortfall between the monthly mortgage instalment and the monthly rental income that needs to be financed.

36. Sixthly, Mr Leung has made extensive submissions to suggest that the long completion lead-time for the Taxpayer's purchase of Property B belies the 'obvious hallmark of a property speculator or trader hoping to "flip" a property by selling the property as a confirmor or a quick profit before completion' and that the gross yield of Property B of 3.5% per annum when compared with the Taxpayer's cost-of-funds in terms of bank interest of 9.5% alone does not appear to be a sound long-term capital investment. This Board observed back in 2014 that the chronology of events should not be read in terms of disposing of Property B 11 days after completion of the sale and purchase, and the the proper perspective should include this three month period of completion between the formal sale and purchase agreement and the assignment, read together with the data submitted by the Revenue of an upwardly buoyant property market in the early to mid parts of 1997. Having reconsidered all these points, this Board finds Mr Leung's points to be matters that the Taxpayer should address, preferably with explanation and evidence, and in the state of the evidence before it, they have remained not addressed. The Taxpayer's case could have been reinforced if there was oral evidence, tested by cross-examination, as to why the 3 month completion period was chosen or agreed upon, whether there had been approaches by estate agents during the 3 month completion period for a confirmor sale, whether the potential option or offer of a confirmor sale without the need to drawdown the mortgage loan was considered and if so, why it was not proceeded upon.

37. Seventhly, this Board considers that it was entitled to maintain its observation back in 2014 on the basis of calculations from the rental income Property B was generating in mid-1997 that the offer was a generous one, and the Taxpayer's disposal of Property B by accepting that offer could be consistent with the disposal of an investment. Yet, in the light of the matters discussed above, this observation alone does not, in the opinion of this Board, overcome or pave over the matters that the Taxpayer needs to address and/or adduce evidence in order to establish its case.

38. Having considered the evidence validly before it, this Board has to conclude that, in the round, the evidence validly before it has not established that the Taxpayer's stated intention of acquisition of Property B as an 'investment property' (qua capital asset) was one that was genuinely held, realistic and realizable; and that at the time of acquisition, all the circumstances showed that the Taxpayer was investing in it.

Decision

39. This Board has respectfully followed the opinion and observations of the Court of First Instance. In the event, due to the insufficiency of the evidence before this Board in presenting the ‘whole picture’, the Taxpayer has failed to discharge the burden of proof he has under section 68(4) of the Inland Revenue Ordinance to show that the Profits Tax Assessment for the year of assessment 1998/99 imposed on it was excessive or incorrect. The Taxpayer’s appeal has to be dismissed. The Profits Tax Assessment for the year of assessment 1998/99 that the Deputy Commissioner of Inland Revenue, by his Determination dated 27 September 2013, had increased the net assessable profits to HK\$6,334,972 with Tax Payable thereon of HK\$1,013,595, is affirmed.

40. Lastly, this Board expresses its appreciation to the assistance provided by counsel for both the Taxpayer and the Revenue and its apology for the time taken to prepare this Decision. In the light of the limited evidence before this Board, it has been necessary not only to conduct a thorough discussion of the extensive submissions of the parties but also to express our considerations thoughtfully and with care.