Case No. D37/16

Profits tax – determination of profits tax assessment – depreciation – granting of Commercial Building Allowance ('CBA') – surveying fee as deduction – sections 16(1), 17(1), 33A, 60(1), 64(2), 70 of the Inland Revenue Ordinance ('IRO')

Panel: William M F Wong SC (chairman), Chow Lap San Edward and Mun Lee Ming Catherine.

Date of hearing: 4 January 2017.
Date of decision: 28 February 2017.

Company A brought an appeal against the determination of the Deputy Commissioner dated 28th April 2016 (the 'Determination') in respect of the Profits Tax Assessments for the years of assessment 2005/2006 and 2007/2008 to 2010/2011. During the period from its incorporation, in December 2003 to April 2010, Company A purchased 14 properties and sold 13 of them. Mr B, who was a shareholder and director of Company A, gave oral testimony in the appeal. He was also in the business of estate agency during the years of assessment in question. In current appeal, the Board addressed the following issues: (1) whether the profits on disposal of Properties 1, 3, 4, 5, 6, 7, 8, 10, and 11 should be chargeable to Profits Tax; (2) whether CBA in respect of the Properties pursuant to section 33A of the IRO should be granted; and (3) whether the surveying fee should be allowed for deduction under Profits Tax.

Held:

Issue 1

1. The Board agreed that in determining whether a property was a capital asset or trading stock, the intention of taxpayer at the time of acquisition of the property was crucial. The taxpayer's stated intention was not decisive and had to be tested against the objective facts and circumstances (Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioner of Inland Revenue (1980) 53 TC 461, All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750, Brand Dragon Limited (in members' voluntary liquidation) and other v Commissioner of Inland Revenue (2001) 5 HKTC 502, Marson (Inspector of Taxes) v Morton and related appeals (1986) STC 463, Lee Yee Shing v Commissioner of Inland Revenue (2008) 3 HKLRD 51 and Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433 followed).

2. The Board bore in mind that the burden of proof rested with Company A,

the Appellant. From the advertisement put up by Company A, cross-examination of Mr B, etc, Property 1 was clearly in nature of trade and purchased for quick sale and profit. The Board also found that Property 4 was purchased for quick sale for profit as it was sold within two months after assignment and Company A failed to consider the rental prospect of the said property.

3. All the other Properties were let out by Company A for earning rental income during the ownership periods ranging from 23 months to 64 months. The Board agreed that in the context of IRO, properties purchased with a view to reselling them for profits are a person's trading stock rather than capital assets. It did not matter that pending achieving such sale targets, rental incomes were generated in the meantime.

4. The facts that a property was producing rent before disposal and a long holding period shed little, if any, light on whether the property concerned was trading stock or capital asset (Chinachem Investment Co Ltd v Commissioner of Inland Revenue (1987) 2 HKTC 261, and (Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433 considered).

5. In the present case, Company A was engaged in a series of property transactions repeatedly for making profits. The repetition and frequency of property transactions was one of the badges of trade. In the circumstances, the Board found that all these seven properties were acquired as trading stock with target sale prices rather than capital assets (Pickford v Quirke (H M Inspector of Taxes) (1927) 13 TC 251 considered).

Issue 2

6. A loss computation which did not state the amount of tax charged and due date for payment was not an assessment. There was no assessment if the taxpayer suffered a loss and had no assessable income of profits. Finality under section 70 of the IRO was confined to an assessment. The time period set in section 60(1) of the IRO was only applicable to the issue of assessment but not a statement of loss, which was not an assessment but just a measure of administrative convenience (Commissioner of Inland Revenue v Yau Lai Man [2005] 3 HKLRD 737 and Commissioner of Inland Revenue v Common Empire Limited [2007] 1 HKLRD 679 applied).

7. In the present case, the 2004/05 loss computation issued to Company A was not an assessment. The assessor could revise the loss computation after 6 years since expiration of the year of assessment 2004/05. By virtue of section 64(2) of the IRO, the Deputy Commissioner had power to revised the 2005/06 Profits Tax Assessment objected to by Company A in determining the objection. The powers of the Assessor and the Deputy Commissioner to revise the 2004/05 loss computation and the 2005/06

Profits Tax Assessment were not subject to the time limit for making additional assessment under section 60(1). The Deputy Commissioner had not annulled any assessments but acted in accordance with the Laws in disallowing the CBA for years of assessment 2004/05 and 2005/06. Company A's appeal on issue 2 was also dismissed.

Issue 3

8. To be deductible, an expense must have been incurred by the taxpayer, but not every payment made by a taxpayer was deductible. It was not enough that the expense was simply made in the course of, or arise out of, or was connected, with the trade. It must be made for purpose of earning chargeable profits. The Board adopted an objective test to decide whether an expense was incurred by a taxpayer in the production of his taxable profits (Commissioner of Inland Revenue v Chu Fung Chee (2006) 2 HKLRD 718 and Strong & Co of Romsey Limited v Woodifield (Surveyor of Taxes) (1906) AC 448 considered, D94/99, IRBRD, Vol. 14, 603 and So Kai Tong v Commissioner of Inland Revenue (2004) 2 HKLRD 416 followed).

9. To qualify for deduction under sections 16(1) and 17(1) of the IRO, the taxpayer had to prove that (i) the expense was incurred; (ii) it was incurred in the production of its chargeable profits; and (iii) it was not domestic or private in nature (Commissioner of Inland Revenue v Chu Fung Chee (2006) 2 HKLRD 718 and Strong & Co of Romsey Limited v Woodifield (Surveyor of Taxes) (1906) AC 448 applied).

10. Company A claimed that the surveying fee was paid to Company N for its service rendered for sale of Property 1. Company A and N were related companies. Even if the surveying fee was incurred, Company A had yet to prove that it was incurred in the production of its chargeable profits. The Board ruled that the surveying fee payable to Company N was not deductible expense incurred in the production of Company A's profits.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioners of Inland Revenue (1980) 53 TC 461

All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750

Brand Dragon Limited (in members' voluntary liquidation) and other v Commissioner of Inland Revenue (2001) 5 HKTC 502

Marson (Inspector of Taxes) v Morton and related appeals (1986) STC 463

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
Chinachem Investment Co Ltd v Commissioner of Inland Revenue (1987) 2 HKTC 261
Pickford v Quirke (H M Inspector of Taxes) (1927) 13 TC 251
Commissioner of Inland Revenue v Yau Lai Man [2005] 3 HKLRD 737
Commissioner of Inland Revenue v Common Empire Limited [2007] 1 HKLRD 679
Commissioner of Inland Revenue v Chu Fung Chee (2006) 2 HKLRD 718
Strong & Co of Romsey Limited v Woodifield (Surveyor of Taxes) (1906) AC 448
D94/99, IRBRD, vol 14, 603
So Kai Tong v Commissioner of Inland Revenue (2004) 2 HKLRD 416

Leung Siu Yin of Messrs SY Leung and Co, for the Appellant.
To Yee Man and Chan Lok Ning Loraine for the Commissioner of Inland Revenue.

Decision:

1. Company A brought an appeal against the determination of the Deputy Commissioner dated 28th April 2016 ('the Determination') in respect of the Profits Tax Assessments for the years of assessment 2005/2006 and 2007/2008 to 2010/2011.

2. This Board has the benefit of the Determination, the Appellant's and the Inland Revenue Department's submissions and the oral testimony of Mr B who is a shareholder and director of the Appellant. Mr B is also in the business of estate agency during the years of assessment in question.

3. In the Determination, the Deputy Commissioner first considered the following properties ('the Properties') to be the Appellant's trading assets and the profits derived by the Appellant from their sale were chargeable to profits tax.

(1) Address C ('Property 1');

(2) Address E ('Property 3');

(3) Address F ('Property 4');

(4) Address G ('Property 5');

(5) Address H ('Property 6');

(6) Address J ('Property 7');

(7) Address K ('Property 8');

(8) Address L ('Property 10'); and

(9) Address M ('Property 11').

4. Secondly, in view of the determination that the Properties were the Appellant's trading assets, the Deputy Commissioner determined that the Appellant did not incur any capital expenditure in respect of the Properties, and, hence, no Commercial Building Allowance ('CBA') as provided in Section 33A of the Inland Revenue Ordinance, Chapter 112 ('the IRO') could be made to the Appellant. Section 33A provides that CBA shall be made to a person who incurred capital expenditure on the construction of a commercial building.

5. Thirdly, in respect of the Appellant's claim for deduction in respect of the surveying fee of $85,000 paid by the Appellant to one Company N, the Deputy Commissioner did not accept the Appellant's claim for the three reasons as set out in paragraph 3(6) of the Determination.

6. The Appellant's ground of appeal in the notice of appeal and supplement by its representative Messrs SY Leung and Co. CPA's oral opening submissions can be summarized as follows:

(1) The profits on the sale of the Properties are capital in nature since they were held for earning rental income and/or capital appreciation within the definition of 'investment property' under HKAS 40 of HKICPA.

(2) Hence, the Appellant should be granted CBA for the years of assessment 2004/2005 and 2005/2006 pursuant to sections 33A and 40 of the IRO. The Appellant also makes the point that there was no basis for the Deputy Commissioner to annul any assessments made 10 years ago in the Determination. CBA should also be granted for the subsequent years of assessment 2006/2007 to 2010/2011. Upon sale of the 'investment properties', CBA granted previously should be clawed back (as balancing charge) under section 35(3)(b) of the IRO.

(3) The surveying fee was paid to Company N for its services provided for the sale of Property 1 and therefore should be allowable for deduction.

7. The Appellant agrees to the three issues as formulated by the Inland Revenue Department and they are:

(1) whether the profits on disposal of the Properties should be chargeable to Profits Tax ('Issue 1');

(2) whether CBA in respect of the Properties should be granted ('Issue 2'); and

(3) whether the surveying fee should be allowed for deduction under Profits Tax ('Issue 3').

Issue 1

8. It is an undisputed fact that since its incorporation, the Appellant had purchased and sold the following properties:

	Property	**Purchase** (a) Date of provisional agreement (b) Date of S&P agreement (c) Date of assignment (d) Purchase cost	**Sale** (a) Date of provisional agreement (b) Date of S&P agreement (c) Date of assignment (d) Sale proceeds
(a)	Address C ('Property 1')	(a) 11-12-2003 (b) 19-12-2003 (c) 10-02-2004 (d) $3,500,000	(a) 29-03-2005 (b) 12-04-2005 (c) 15-06-2005 (d) $8,500,000
(b)	Address P ('Property 2')	(a) Not available (b) 30-07-2004 (c) 24-08-2004 (d) $1,730,000	-
(c)	Address E ('Property 3')	(a) Not available (b) 30-11-2004 (c) 31-12-2004 (d) $790,000	(a) 09-03-2010 (b) 25-03-2010 (c) 26-04-2010 (d) $1,630,000
(d)	Address F ('Property 4')	(a) 15-01-2005 (b) 27-01-2005 (c) 25-04-2005 (d) $2,400,000	(a) 21-06-2005 (b) 08-07-2005 (c) 21-09-2005 (d) $2,680,000
(e)	Address G ('Property 5')	(a) 04-10-2005 (b) 18-10-2005 (c) 22-11-2005 (d) $1,950,000	(a) 03-09-2007 (b) 14-09-2007 (c) 31-10-2007 (d) $2,370,000
(f)	Address H ('Property 6')	(a) 08-10-2005 (b) 21-10-2005 (c) 24-11-2005 (d) $1,920,000	(a) 22-11-2007 (b) 13-12-2007 (c) 11-01-2008 (d) $2,480,000
(g)	Address J ('Property 7')	(a) 21-11-2005 (b) 25-11-2005 (c) 30-12-2005 (d) $442,000	(a) 15-05-2008 (b) 28-05-2008 (c) 27-06-2008 (d) $1,160,000

	Property	**Purchase** (a) Date of provisional agreement (b) Date of S&P agreement (c) Date of assignment (d) Purchase cost	**Sale** (a) Date of provisional agreement (b) Date of S&P agreement (c) Date of assignment (d) Sale proceeds
(h)	Address K ('Property 8')	(a) Not available (b) Not available (c) 30-12-2005 (d) $350,000	(a) 15-06-2009 (b) Not available (c) 14-08-2009 (d) $730,000
(i)	Address Q ('Property 9')	(a) Not available (b) 16-09-2006 (c) 30-09-2006 (d) $463,000	(a) Not available (b) 12-04-2007 (c) 15-05-2007 (d) $565,000
(j)	Address L ('Property 10')	(a) Undated (b) 13-09-2006 (c) 18-10-2006 (d) $2,180,000	(a) 10-04-2010 (b) 18-06-2010 (c) 18-06-2010 (d) $4,080,000
(k)	Address M ('Property 11')	(a) 19-01-2007 (b) 30-03-2007 (c) 30-03-2007 (d) $1,380,000	(a) 16-06-2009 (b) 29-06-2009 (c) 27-08-2009 (d) $3,068,000
(l)	Address R ('Property 12')	(a) Not available (b) 27-11-2007 (c) -* (d) $800,000	(a) Not available (b) 13-12-2007 (c) 21-12-2007 (d) $950,000
(m)	Address S ('Property 13')	(a) Not available (b) 05-11-2007 (c) 10-12-2007 (d) $940,000	(a) Not available (b) 10-03-2008 (c) 16-04-2008 (d) $1,295,000
(n)	Address T ('Property 14')	(a) Not available (b) 26-06-2008 (c) 20-08-2008 (d) $1,130,000	(a) Not available (b) 11-03-2009 (c) 15-04-2009 (d) $1,200,000

* The Company acted as a confirmor.

9. As the Inland Revenue Department rightly submitted, during the period from its incorporation in December 2003 to April 2010, the Appellant purchased 14 properties and sold 13 of them (apart from Property 2 which is still held by the Appellant up to present). The profits and loss derived from the sale of 4 trading properties, namely Property 9, Property 12, Property 13 and Property 14 were offered for assessment or claimed for set-off. However, the Appellant claimed that the profits on disposal of the other properties, namely the Properties should not be chargeable to profits tax.

The Applicable Legal Principles

10. The statutory basis is that of Section 14(1) of the IRO which provides that:

> '*Subject to the provisions of [the IRO], 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.*'

11. Section 2(1) of the IRO defines 'trade' as:

> '*trade (行業、生意) includes every trade and manufacture, and every adventure and concern in the nature of trade*'

12. This Board agrees with the legal submissions of the Inland Revenue Department that in determining whether a property is a capital asset or trading stock, the intention of the taxpayer at the time of acquisition of the property is crucial. In Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioners of Inland Revenue (1980) 53 TC 461, Lord Wilberforce said at page 491G-H:

> '*One must ask, first, what the Commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss.*'

13. The taxpayer's stated intention is not decisive and has to be tested against the objective facts and circumstances. In All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750, Mortimer J (as he then was) said at page 771:

> '*The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realizable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things*

said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words.'

14. In Brand Dragon Limited (in members' voluntary liquidation) and other v Commissioner of Inland Revenue (2001) 5 HKTC 502, Chu J said at pages 528 and 529:

'*18. It is common ground that the relevant intention is that of the appellants. But given that the appellants are not natural persons, their intention can only be inferred and defined from the acts and intentions of their controlling minds …*

19. In my view, it must be permissible for the Board to look at the intentions and acts of its controlling minds in ascertaining the purpose and intention of a corporation …'

15. In Marson (Inspector of Taxes) v Morton and related appeals (1986) STC 463, Sir Nicolas Browne-Wilkinson VC said at page 470e to 471f:

(a) Only one point is as a matter of law clear, namely that a single, one-off transaction can be an adventure in the nature of trade.

(b) The question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case.

(c) There are certain features or badges which may point to one conclusion rather than another and the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate. The matters which are apparently treated as a badge of trading are as follows:

(i) That the transaction was a one-off transaction.

(ii) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on?

(iii) Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realization?

(iv) Was the transaction carried through in a way typical of the trade in a commodity of that nature?

(v) What was the source of finance of the transaction?

(vi) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale?

(vii) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots?

(viii) What were the purchasers' intentions as to resale at the time of purchase?

(ix) Did the item purchased either provide enjoyment for the purchaser or pride of possession or produce income pending resale?

16. In Lee Yee Shing v Commissioner of Inland Revenue (2008) 3 HKLRD 51, Bokhary PJ and Chan PJ emphasized at paragraph 38, page 66 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances.

(a) On the question of 'trade', McHugh NPJ stated at paragraph 60, page 73 that for most cases, the 'badges of trade' that indicate the carrying on of a trade are whether the taxpayer:

(i) has frequently engaged in similar transactions?

(ii) has held the asset or commodity for a lengthy period?

(iii) has acquired an asset or commodity that is normally the subject of trading rather than investment?

(iv) has bought large quantities or numbers of the commodity or asset?

(v) has sold the commodity or asset for reasons that would not exist if the taxpayer had an intention to resell at the time of acquisition?

(vi) has sought to add re-sale value to the asset by additions or repair?

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

(viii) has conceded an actual intention to resell at a profit when the asset or commodity was acquired?

(ix) has purchased the asset or commodity for personal use or

pleasure or for income?

(b) On the question of business, Bokhary PJ and Chan PJ stated at paragraph 17, page 60 that it has long been recognised that business is a wider concept than trade. Mchugh NPJ said at page 76:

(i) There is no definition or ordinary meaning of 'business' that can be universally applied. Nevertheless, common law courts have never doubted that the expression 'carrying on' implies repetition of acts and that, in the expression 'carrying on a business', the series of acts must be such that they constitute a business. The term 'business' itself when used in the context of a taxation statue is the fundamental notion of the exercise of an activity in an organized and coherent way and one which is directed to an end result. (at paragraph 69)

(ii) Ordinarily, a series of acts will not constitute a business unless they are continuous and repetitive and done for the purpose of making a gain or profit. Depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between. (at paragraph 70)

17. In Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (2008) 11 HKCFAR 433, Bokhary PJ and Chan PJ said at pages 448 and 452:

'*40. It is clear that question (ii)(b) uses the expression 'badges of trade' to mean the circumstances that shed light on the issue of intention. Those circumstances simply do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention.*'

'*55. The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case.*'

18. Bearing the above legal principles in mind, this Board examines in detail whether the sale and purchase of each of the Properties amounts to the carrying on of a trade with the Properties being trading stock or they were for permanent investment with the Properties being capital assets. This Board also bears in mind that the burden of proof rests with the Appellant. As Bokhary PJ and Chan PJ said in Real Estate Investments (NT) Ltd (supra) at pages 445 and 450:

'*32. It is natural and appropriate to strive to decide on something more satisfying than the onus of proof. And it should generally be possible to do so. But tax appeals do begin on the basis that, as s.68(4) of the Inland Revenue Ordinance provides, "(t)he onus of proving that the assessment appealed against is excessive or incorrect shall be on the*

> *appellant". And it is possible although rare for such an appeal to end – and be disposed of – on that basis.*'
>
> '*47. … The taxpayer will have to prove his contention. So his appeal to the Board of Review would fail if the Board positively determines that, contrary to his contention, the position is X. And it would likewise fail if the Board merely determines that he has not proved his contention that the position is Y.*'

Property 1

19. In December 2003, the Appellant and Ms U signed the provisional agreements to purchase Property 1 and its adjacent shop, i.e. Shop 6 ('the Adjacent Shop') respectively. Ms U is Mr B's mother and is also the only other director and shareholder of the Appellant. Both purchase transactions were completed on 10 February 2004.

20. This Board has no hesitation in coming to the view and finds that the sale of Property 1 is clearly in the nature of trade. As soon as the agreement for the purchase of the Property 1 was signed, the Appellant put up an advertisement in the 30 January 2004 issue of Newspaper V Property Classified for the sale of Property 1 and the Adjacent Shop. Further, according to the documentary evidence, Company W itself, or on behalf of Company X (the agent acting for the Appellant in the sale of Property 1), confirmed that the Appellant had indicated on 30 August 2004 (i.e. 6 months after Property 1 was assigned to the Appellant) that Property 1 could be sold at $5,000,000. The asking prices were subsequently increased to $7,000,000 and $7,800,000 in November 2004 and March 2005 respectively. This Board accepts the Inland Revenue Department's submission that the quick offer for sale and active pursuit of higher asking prices contradict the Appellant's claim of acquiring Property 1 for long-term investment but point strongly to its intention to trade. This Board finds that to put up Property 1 for such a quick sale is inconsistent with holding it for the long term. The Board also agrees that even if the Appellant had offered Property 1 both for sale and for lease, an attempt to solicit tenant pending an opportune time to sell Property 1 for a profit is not inconsistent with the Company's trading intention.

21. During cross-examination of Mr B and indeed during the Appellant's opening submissions, it was asserted that the putting up of Property 1 for sale was only for testing its market value in order to ascertain the amount of capital appreciation for the property. This Board has no difficulty in rejecting such excuse and submission. Mr B and the Appellant were experienced in the property market, it is inconceivable that the only way to get to know the market price of Property 1 was to actually put it up for sale. As the evidence shows, the testing of the market was carried out quite frequently at short intervals of three to four months, which pointed to an intention to sell off Property 1 at certain target price more than a mere gathering of information on the amount of capital appreciated as asserted. One can also legitimately query what purpose the frequent testing of the market would serve if the real intention of acquiring Property 1 was for long term rental purpose as alleged.

22. Mr B under cross-examination denied that the asking prices were information provided by him to Company W. His initial evidence was that the asking prices were recommended by Company W to which he never agreed. This Board does not find Mr B's evidence believable because he would have agreed to some asking prices if his stated intention was to test the market. Secondly, he was fully aware of the asking prices put forward by Company W. Had Company W put forward such asking prices without his consent, he could have taken steps to stop them doing so but he took no steps. In any case, in his later evidence given under cross-examination, he admitted that in relation to his conversation with Company W on 29 March 2005, he did advise Company W of the sale price. Thirdly, the Appellant was fully aware that the Inland Revenue Department relied on the Company W's asking prices as evidence pointing to a quick sale for profit, it is up to the Appellant to adduce evidence that Company W or Company X had gone ahead to put forward the asking prices without his consent. The Appellant has not adduced any evidence of such nature. In the circumstances, this Board rejects Mr B's evidence on this aspect and it affects this Board's assessment of Mr B's credibility as a witness.

23. The undisputed facts are that the Adjacent Shop and Property 1 were sold on 11 January 2005 and 29 March 2005 respectively, some 11 months and 13 months after the said properties were assigned to them, at gross profits of about HK$2,000,000 and HK$5,000,000 respectively. This Board finds that such quick sale for profits does not sit well with the Appellant's ground of appeal that Property 1 was purchased for long term rental purpose. This Board finds these facts alone to be persuasive to dismiss the Appellant's appeal in relation to Property 1.

24. Further, this Board is also troubled by Mr B's evidence that one of the main reasons for selling Property 1 was that it did not have a good entrance in that the main door of Property 1 faced the back of a temporary market and so pedestrians could hardly notice Property 1 unless they passed through the temporary market. In his oral evidence, Mr B gave evidence that at the time of purchase of Property 1 he was aware of the temporary market, but he was unable to identify the exact location of the main door of Property 1 because the building of which Property 1 formed part was under construction and shop nos. 1 to 6 on the ground floor were blocked up by hoarding boards. When he was confronted with the floor plan of Property 1 as attached to the assignment which clearly showed that the main door of Property 1 faced the pavement of Market Y, Mr B's answer was that he did not read the floor plan attached to the assignment of Property 1 at the time of purchase. This Board finds it surprising that for a seasoned businessman in the property market, Mr B for the Appellant would have purchased Property 1 for long term purpose without making an effort to understand where its main door was. The Board accepts the Inland Revenue Department's submission that the rental value of commercial shop depends greatly on its location and streams of people. Had the Appellant really intended to acquire Property 1 for earning rental income in the long run, it would have taken all possible steps to find out the precise location of its main door before committed to the purchase. It is inconceivable that the Appellant would have purchased Property 1 for long-term investment in such a causal manner. This Board does not believe Mr B's evidence on this aspect as well.

25. The Appellant submits that the reason why it had to sell Property 1 was that in the aftermath of SARS, it could not procure a tenant for one year after the purchase. The Appellant provided 5 advertisements placed quarterly on 30 January 2004, 30 April 2004, 24 July 2004, 19 November 2004 and one undated to support its claim. Under cross-examination, Mr B confirmed that the shop in Location Z referred to in the advertisements was Property 1 or together with the Adjacent Shop. The asking monthly rents of Property 1 were $38,000 to $40,000 before 19 November 2004 and then reduced to $28,000 upwards on 19 November 2004. The Appellant did not place any further advertisement to let out Property 1 after 19 November 2004. Mr B also provided two undated advertisements issued by property agents which showed that Property 1 was offered for lease at monthly rents of $38,000 and $40,000.

26. According to the information provided by Company W, the asking rents of Property 1 remained at $38,000 to $40,000 throughout the period from 30 August 2004 to 29 March 2005 (the date on which the Appellant signed the provisional agreement to sell Property 1). Such information was also confirmed by the Appellant in its opening submission. This Board accepts the Inland Revenue Department's submission that had the Appellant really intended to let out Property 1, it is doubtful why it did not reduce the asking rent at material times when no tenant could be procured for quite some time.

27. Finally, the Appellant asserts that it expected that Property 1 would produce a rental yield of 13.7% at a monthly rent of $40,000. Such rental yield would be highly attractive and support the Appellant's case that it purchased Property 1 for long term rental purpose. However, the Inland Revenue Department is correct in making the submissions that there is no evidence to support that the estimated monthly rent as being reasonable. The Appellant provided the Land Registry reports of Location AA showing that their monthly rents were in the respective amounts of $33,000 and $61,000 at the relevant times. However, despite the Assessor's request, the Appellant did not provide the floor areas of two properties or other information to substantiate that their monthly rents were suitable comparisons. Bearing in mind that the burden of proof rests with the Appellant, this Board finds that the Appellant fails to make good its assertion that the expected rental return was as good as it claims.

28. For all the above reasons, this Board finds that Property 1 was purchased for quick sale and profit.

Property 4

29. On 15 January 2005, the Appellant signed the provisional agreement to purchase Property 4 subject to an existing tenancy that expired on 24 May 2006. The Appellant asserts that it projected that the rental yield of 3.5% based on a monthly rent of $7,000 at the time of purchase would increase to 8% based on a monthly rent of $16,000 upon expiry of the existing tenancy. The purchase of Property 4 was financed by a bank loan of $1,540,000 repayable at monthly instalments of about $9,500. The monthly rents of $7,000 were insufficient to cover the monthly mortgage instalments of $9,500. If the monthly mortgage interests of about $5,400 were taken into account, the net rental yield would reduce substantially to 0.8% [($7,000 – $5,400) x 12 ÷ $2,400,000 x 100%].

30. When being asked as to the basis of his expectation that the rental would be as high as 8% after May 2006, Mr B could offer no credible explanation other than that he was in the property market and that was his personal assessment. This Board does not believe Mr B's evidence because such expectation fell short of what the actual market could achieve. This Board accepts the Inland Revenue Department's submission that the projected increase in rental yield is doubtful where there is no evidence of any research made to support the more than double upward adjustment of market rent in the area after 16 months.

31. However, what is significant is that, like Property 1, Property 4 was offered for sale and for lease in the undated advertisement issued by Company AB, an estate agency. Subsequently, the Appellant entered into a provisional agreement to sell Property 4 on 21 June 2005, only 2 months after it took up the assignment on 25 April 2005. Mr B admitted that the Appellant appointed Company AB to sell Property 4 less than 2 months after assignment. The quick offer for sale is a strong indicator of the Appellant's trading intention. The objective facts show the Appellant's readiness to sell Property 4 for quick profit at an opportune time while soliciting tenant or letting it out.

32. Inland Revenue Department also relies on the fact that under cross-examination, Mr B confirmed that he took possession of Property 4 on 20 April 2005 (i.e. 5 days before assignment took place on 25 April 2005) and found that the existing tenant had disappeared. He was notified of the disappearance of the tenant by a property agent of Company AC which acted for the Appellant in the purchase of Property 4. The Appellant did not take any steps to recover the rents from the tenant for the remaining term of 12 months up to 24 May 2006. Nor did the Appellant place any advertisement to offer Property 4 for lease. The Appellant only instructed Company AB to let out Property 4 but was unable to procure a new tenancy owing to its small size.

33. Inland Revenue Department submits that if Property 4 had really been acquired as investment property for earning rental income, the Appellant would have tried to recover the rents in arrears, used all possible means to find a tenant and made allowance for vacant periods in between two tenancies. The Appellant also complained that the size of Property 4 was too small and hence difficult to find suitable tenants. This Board finds that if the Appellant had indeed intended to purchase Property 4 for long time rental purpose, it would have taken the small size of Property 4 into account before committed to the purchase. The fact that no such account was taken in assessing the prospects of securing suitable tenants and that the said property was sold within two months after assignment shows that Property 4 was purchased for a quick profit.

34. For all the above reasons, this Board finds that Property 4 was also purchased for a quick sale for profit.

Other Properties

35. The Appellant acquired Property 3, Property 5, Property 6, Property 7, Property 8, Property 10 and Property 11 from November 2004 to January 2007 and sold

them successively from September 2007 to April 2010. All of them were let out by the Appellant for earning rental income during the ownership periods ranging from 23 months to 64 months.

36. It is significant that during cross-examination, Mr B gave evidence that the Appellant acquired these properties both for long term rental purpose and capital appreciation purpose. When asked by this Board as to what the Appellant would do if there was a capital appreciation within a short period of time, Mr B's evidence was that if the goal of capital appreciation was achieved then the properties would be sold.

37. All these properties were sold with sitting tenants generating rental yields ranging from 5.3% to 13.5%. Such returns would have suited a long term property investor. However, once capital appreciation target was achieved, the Appellant had no hesitation to sell the properties. Mr B admitted that these properties were sold because the goals of capital appreciation/profit margin were achieved. The goals of capital appreciation/profit margin show that the Appellant had set target sale prices when purchasing the said properties and it was ready to resell the same for profits whenever the target sale prices were achieved. In fact, during the Appellant's oral opening submission, the Appellant's representative submitted that the goal of 'capital appreciation' would be achieved if there was a 'capital gain' of over 100%.

38. This Board agrees that in the context of the IRO, properties purchased with a view to reselling them for profits are a person's trading stock rather than capital assets. It really does not matter that pending achieving such sales targets, rental incomes were generated in the meantime.

39. Further, according to the information provided by Company W, the Appellant first indicated on 3 December 2005 that Property 5 could be sold at $2,300,000, which was only 2 weeks after the Appellant took up the assignment on 22 November 2005. The quick offer of Property 5 for sale reflects the Appellant's trading intention. Property 3, Property 5, Property 6, Property 7 and Property 8 were all subsequently sold through Company N of which Mr B was a director.

40. Mr B gave evidence that the Appellant decided to sell Property 5 and Property 6 for shifting to Property 11 (a commercial shop) with higher rental yield. But the fact remains that Property 5 and Property 6 were sold about 7.5 months and 10 months after Property 11 was purchased. Property 11 was not a substitute of Property 5 and Property 6. Mr B admitted that the Appellant did not acquire any commercial shop or other replacement properties for letting with higher rental yields after selling Property 5 and Property 6.

41. Inland Revenue Department also draws attention to the Board that the Appellant's audited accounts showed the following:

(1) Total dividend of $9,000,000 was distributed for the year ended 31 March 2012.

(2) No new properties were acquired during the years ended 31 March 2012 to 2016.

42. It is submitted that the above information shows that after disposal of all Properties on or before April 2010, the sale proceeds were subsequently distributed to the shareholders as dividends. The Appellant has not acquired any replacement properties up until present. These cast serious doubt on its alleged intention of acquiring investment properties for earning rental income. It tends to show that the Appellant's sole and only purpose of acquiring the Properties was to resell them whenever the target sale prices were achieved.

43. On this, Mr B's evidence was that because at the material time the Appellant had another tax case, so it was not considered appropriate for the Appellant to purchase more properties. Be that as it may, the undisputed fact is that whenever the target sale prices were achieved, irrespective of the then rental returns, properties would be sold to lock in the capital appreciation. That was the admitted intention at the time of acquisition. That being the case, this Board has no difficulty in also finding that these properties, namely, Property 3, Property 5, Property 6, Property 7, Property 8, Property 10 and Property 11 were all acquired as trading stock rather than capital assets.

44. The Appellant in the course of its oral submission strongly submitted that the all these properties were purchased as capital assets as evidenced by the fact that they all generated rental income and were held for long periods ranging from 23 months to 64 months. On this specific point, this Board fully agrees with the Inland Revenue Department's submission that the acquisition of a property with a good rental yield could also sit well with acquiring the said property as trading stock. Commercial properties (like Property 10) are commonly traded with sitting tenants. A long holding period may not preclude a property transaction from being trading in nature. If a property was acquired for trading purpose with target sale price, the effluxion of time cannot turn it into a capital asset.

45. In Chinachem Investment Co Ltd v CIR (1987) 2 HKTC 261, the properties there in question had been held for substantial periods, in some instances for as long as 15 years, and they had generally been let throughout. On the question whether the above facts were inconsistent with the Revenue's case, Sir Alan Huggins VP, gave the following answer at page 311:

> '*They are not – particularly having regard to the economic climate of Hong Kong during the relevant periods: (the taxpayer) may have been waiting for a favourable opportunity to sell and merely have been turning the properties to good account in the mean time. Equally, the fact that the properties were let at full economic rents is consistent with the case of both sides, although if the lettings had been at rents below the economic rents that would clearly have supported (the Revenue's) contention. Again, the renewal of the leases was equivocal and it is immaterial that the initiative was taken by (the taxpayer): these facts may indicate nothing more than that the "favourable opportunity to sell" had not arrived and that it was*

> *expected that lettings would be more beneficial than sales within the period of the new leases.'*

46. In Real Estate Investments (NT) Ltd, the taxpayer's profits from redevelopment of a property were held to be assessable even though the property was held for more than 17 years from 1979 (the year of purchase) to 1996 (the year when the redevelopment was completed). The property was acquired subject to certain tenancies and continued to produce rent. Bokhary PJ and Chan PJ held at paragraphs 50 to 52 that the facts that the property was producing rent before disposal and a long holding period shed little, if any, light on whether the property concerned was trading stock or a capital asset, citing the answer of Sir Alan Huggins VP in Chinachem Investment Co Ltd.

47. In the present case, the Appellant admitted that Property 3 was purchased and sold under similar circumstances to Property 5, Property 6, Property 7, Property 8, Property 10 and Property 11. There is a high degree of similarities among the 7 property transactions. The Appellant was engaged in a series of property transactions repeatedly for making profits. The repetition and frequency of property transactions was one of the badges of trade.

48. In Pickford v Quirke (H M Inspector of Taxes) (1927) 13 TC 251. In Pickford, a syndicate was formed to buy and sell cotton mills. After making a profit in the first transaction, it repeated the transaction three times. The Court of Appeal pointed out that an isolated transaction would have given rise to a capital gain but drew a completely different inference from the four incidents taken together. Accordingly, the Court of Appeal held that the taxpayer's participation in the four transactions constituted a trade. Lord Hanworth, M R said at page 269:

> *' "In [the Commissioners'] view, [these four transactions] considered separately are capital transactions, and the first transaction considered by itself would not have constituted a trade … when all the four transactions are regarded together, [the taxpayer] can be said to have entered 'habitually' into profitable contracts in such a sense as to constitute the four transactions into which he did enter, a trade …" … it appears to me that the Commissioners … have correctly appreciated the problem which they were called upon to solve. Now you may have an isolated transaction so independent and separate that it does not give you any indication of carrying on a trade … When, however, you come to look at four successive transactions you may hold that what was, considered separately and part, a transaction to which the words "trade or concern in the nature of trade" could not be applied, yet when you have that transaction repeated, not once nor twice but three times, at least, you may draw a completely different inference from those incidents taken together …'*

49. In the circumstances, this Board finds that all these seven properties (including Property 3 which had a longer holding period of 64 months) were acquired as trading stock with target sales prices.

50. Insofar as the Appellant seeks to rely on its classification of the Properties in its audited accounts as non-current assets is concerned, the Board rules that such accounting treatment on its own does not constitute sufficient proof as to the Appellant's intention. Had it been otherwise, it would have been very easy for taxpayers to make such classification in their audited accounts for the purpose of avoiding profits tax. All the objective facts have to be taken into account in assessing whether the subject property was acquired as trading stock or a capital asset. In Real Estate Investments (NT) Ltd, Bokhary PJ and Chan PJ commented on the significance of accounting treatment at page 446:

> '*33. … the Property had been described in the Taxpayer's accounts from 1980 to 1995 as a fixed asset. It is argued on the Taxpayer's behalf as follows. Such accounting treatment gave rise to a prima facie case that the profits in question arose from the sale of a capital asset. Consequently, the onus of proof shifted so that the Revenue had to show by evidence that the assessments were correct.*
>
> *34. That argument is misconceived. Consistency between a taxpayer's audited accounts and its stance does not go so far as to set up a prima facie case of that stance's correctness in law. Where a taxpayer's audited accounts are consistent with its stance, such consistency is some evidence in support of that stance. Even where accounting treatment amounts to strong evidence, it still falls to be considered together with the rest of the evidence adduced in the case.*'

51. As to the Inland Revenue Department's reliance on the fact that the Appellant's paid up capital was only HK$2, the Board does not consider that the mere fact that a company's paid up capital is HK$2 necessarily means that the properties that it acquired were for trading purpose. The non-capitalization of shareholders' loan does not necessarily mean that the properties were not acquired as capital stock. The key consideration, to this Board, is whether the Appellant has adduced sufficient evidence to demonstrate that it had the financial ability to hold the Properties on a long term basis. In view of the fact that the Appellant is yet to substantiate the sources of funds from Ms U for financing the purchase of the Properties, this Board agrees with the Inland Revenue Department's concern about the Appellant's financial ability to hold the Properties on a long term basis.

52. For all the above reasons, this Board also finds that Property 3, Property 5, Property 6, Property 7, Property 8, Property 10 and Property 11 were acquired as trading stock rather than capital assets.

53. The Inland Revenue Department also made comprehensive submissions on the badges of trade. As a matter of principle, the badges of trade approach is a useful guidance but it is not a matter of ticking boxes. The proper approach is to examine all the relevant facts in order to decide on the key issue, namely, the taxpayer's intention at the relevant time. For the reasons above, this Board rules that the Properties were purchased as trading stock rather than capital assets. Insofar as necessary, this Board also agrees with

the analysis of the badges of trade as set out in paragraph 55 of the Inland Revenue Department's helpful closing submission.

Issue 2

54. The issue is whether CBA should be granted in respect of the Properties.

Applicable Legal Principles

55. Section 33A(1) of the IRO provides that:

> '*Where any person is, at the end of the basis period for any year of assessment, entitled to an interest in a building ... which is a commercial building … and where that interest is the relevant interest in relation to the capital expenditure incurred on the construction of that building …, an allowance for depreciation by wear and tear of that building …, to be known as an "annual allowance" of an amount equal to … one-twenty-fifth of the expenditure, shall be made to the person for that year of assessment.*'

56. Section 40 of the IRO further defines commercial building as follow:

> '***commercial building*** *… (商業建築物…) means any building … or part of any building … used by the person entitled to the relevant interest for the purposes of his trade, profession or business other than an industrial building or structure.*'

57. Section 35(1) of the IRO provides for a balancing allowance or balancing charge to be made to a person for the year of assessment where, among others, the relevant interest in the building is sold and the building has been a commercial building at any time before sale.

58. Section 35(3)(a) provides that where the sale moneys arising from the sale of the relevant interest in the commercial building exceed the residue of expenditure immediately before the sale, a balancing charge shall be made in respect of the excess. Section 35(3)(b) provides that the amount of a balancing charge is limited to the amount of the annual allowances, if any, made to the person under section 33A.

Analysis

59. In view of this Board's decision on Issue 1, it follows that the Appellant did not incur any *capital expenditure* on the Properties and is not entitled to CBA in respect of the Properties, including Property 3, Property 5, Property 6, Property 7, Property 8, Property 10 and Property 11 claimed by it for the years of assessment 2004/05 to 2009/10. Similarly, no balancing charge should be assessed for the years of assessment 2007/08 to 2010/11 when the above properties were sold. Adjustments on CBA and balancing charges were made when the loss computation for the year of assessment 2006/07 and

Profits Tax assessments for the years of assessment 2007/08 to 2010/11 were issued to the Appellant.

60. The Appellant argues that there was no basis for the Deputy Commissioner to annul the assessment made 10 years ago. The Inland Revenue Department submits that it is established law that a loss computation which does not state the amount of tax charged and due date for payment is not an assessment: Commissioner of Inland Revenue v Yau Lai Man [2005] 3 HKLRD 737 and Commissioner of Inland Revenue v Common Empire Limited [2007] 1 HKLRD 679. Hence, there is no 'assessment' if the taxpayer suffers a loss and has no assessable income or profits. Further, finality under section 70 of the IRO is confined to an assessment: Yau Lai Man (Supra). The time limit sets in section 60(1) of the IRO is only applicable to the issue of assessment but not a statement of loss, which is not an assessment but just a measure of administrative convenience: Common Empire Limited (Supra). The Appellant does not dispute the above propositions of law.

61. As a matter of fact, for the years of assessment 2004/05 and 2005/06, the Assessor issued loss computations to the Appellant showing the adjusted losses of $450,266 and $730,522 (after excluding the CBA claimed) in accordance with its Profits Tax returns. Subsequently, Profits Tax assessment for the year of assessment 2005/06 (incorporating the loss of $450,266 brought forward from the year of assessment 2004/05) was raised on the Appellant to assess the gain on disposal of Property 1 and Property 4. The Appellant lodged a valid objection against the assessment. The Assessor considers that the 2004/05 loss computation and the 2005/06 Profits Tax Assessment should be revised to, among others, disallow the CBA previously granted. The revised 2005/06 Profits Tax Assessment was determined by the Deputy Commissioner in the Determination.

62. Applying the above legal propositions to the facts of the present case, the 2004/05 loss computation issued to the Appellant is not an assessment. Hence, the Assessor can revise the loss computation after 6 years since expiration of the year of assessment 2004/05. By virtue of section 64(2) of the IRO, the Deputy Commissioner has power to revise the 2005/06 Profits Tax Assessment objected to by the Appellant in determining the objection. The powers of the Assessor and the Deputy Commissioner to revise the 2004/05 loss computation and the 2005/06 Profits Tax Assessment are not subject to the time limit for making additional assessment under section 60(1). The Deputy Commissioner has not annulled any assessments but acted in accordance with the laws in disallowing the CBA for the years of assessment 2004/05 and 2005/06.

63. The Appellant further argued that disallowance of CBA in respect of the properties in question was inconsistent with the granting of depreciation allowances in respect of the furniture and fixtures acquired for the same properties. This Board agrees that the Assessor might have made no adjustment on depreciation allowances owing to insufficient information about the furniture and fixtures provided in the Appellant's supporting tax schedules. However, the non-adjustment on depreciation allowances due to insufficient information does not mean the disallowance of CBA is incorrect.

64. Finally, the Appellant has been holding Property 2 for over 12 years up to present which has been generating rental income for over 10 years. CBA in respect of Property 2 was therefore granted. The Appellant asks: whether an investment property must be held eternally or will automatically turn into trading stock once it is sold. With respect, that is a wrong question to ask. Of course, the duration of holding a property is one of the indicia that this Board should take into consideration, but this Board applies the legal principles above to ascertain the intention of the taxpayers at the relevant time. Property 2 is treated as an investment property by the Inland Revenue Department and the Appellant has no disagreement with that classification. The Inland Revenue Department submits that if subsequent events transpire that the basis of treating Property 2 as investment property is wrong and the CBA should not be granted, the Inland Revenue Department is free to revise the position: *Rellim, Ltd*. This Board agrees.

65. For all the above reasons, the Appellant's appeal on Issue 2 is also dismissed.

Issue 3

Legal Principles

66. As a matter of legal principle, to be deductible, an expense must have been incurred by the taxpayer; but not every payment made by a taxpayer is deductible. It is not enough that the expense is simply made in the course of, or arises out of, or is connected with, the trade. It must be made for the purpose of earning chargeable profits. In Commissioner of Inland Revenue v Chu Fung Chee (2006) 2 HKLRD 718, A Chung J cited with approval the following extracts from Strong & Co of Romsey Limited v Woodifield (Surveyor of Taxes) (1906) AC 448 at paragraph 19, pages 724 and 725:

> '*In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade, … I think only such losses can be deducted as are connected with in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation or fall on the trader in some character other than that of trader. The nature of the trade is to be considered.*' (per Lord Loreburn L C at page 452)
>
> '*I think that the payment of these damages was not money expended 'for the purpose of the trade'. These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits.*' (per Lord Davey at page 453)

67. The Board is to adopt an objective test to decide whether an expense is incurred by a taxpayer in the production of his taxable profits. (See: D94/99, IRBRD, vol 14, 603 and So Kai Tong v Commissioner of Inland Revenue (2004) 2 HKLRD 416) The Board in D94/99 said at pages 611 and 612:

> '*24. … The Taxpayer is free to give away part of its income as it so wishes to a related company or to a relative or indeed to any third party. The question here is whether that payment is a deductible expense in law when computing the chargeable profits. This question must be answered objectively. The agreement between the Taxpayer and Company D does not preclude us from examining whether the payment is or is not a deductible expense incurred in the production of profits.*
>
> *25. Such expense must have been bona fide incurred in the production of profits. We must look at all surrounding circumstances. For example, the relation between the payer and the payee is a relevant circumstance. So is the purpose or the reason of the payment. The basis and the breakdown of the amount are also important. The lack of a rational basis may lead us to the conclusion that the amount is wholly arbitrary, lacking in commercial reality, and thus not bona fide incurred.*'

68. Chu J (as she then was) in So Kai Tong approved the approach adopted by the Board in D94/99 and said at paragraph 26, page 427:

> '*… The objective test simply requires all circumstances to be looked at in deciding whether an item is a deductible expense. The Board may conclude that the item is or is not a deductible expense, and if it is, the extent to which it is deductible in accordance with the plain words of s.16(1).*'

69. To qualify for deduction under sections 16(1) and 17(1) of the IRO, the taxpayer has to prove that (i) the expense was incurred; (ii) it was incurred in the production of its chargeable profits; and (iii) it was not domestic or private in nature. It is not enough that the expense is simply made in the course of, or arises out of, or is connected with, the trade. It must be made for the purpose of earning chargeable profits: Fung Chee and Strong & Co of Romsey Limited (Supra). In determining whether an expense is incurred by the taxpayer in the production of its chargeable profits, an objective test should be adopted which requires all circumstances to be looked at: D94/99 and So Kai Tong (Supra).

Analysis

70. The Appellant claimed that the surveying fee was paid to Company N for its services rendered for the sale of Property 1 which included making internet search, sticking posters and placing advertisements, and extracting relevant market information from the computer and database of Company N. To support its claim, the Appellant only

provided a receipt issued by Company AD (of which Mr B was one of the partners) to it for payment of the surveying fee. The Inland Revenue Department is right that there is nothing to show the details of the alleged services rendered and market information provided by Company N. Even if the surveying fee was incurred, the Appellant has yet to prove that it was incurred in the production of its chargeable profits.

71. The Appellant and Company N were related companies. There is no written agreement signed between them in respect of the surveying fee. There is no reasonable basis upon which the surveying fee was arrived at. In accordance with clause 10 of the provisional agreement, the Appellant had already paid commission of $85,000 to Company X in consideration of its services for the sale of Property 1. At the bottom of it, there is no evidence that Company N did anything related to the Appellant's production of its chargeable profit other than that Company N issued a receipt.

72. Applying the objective test as set out in D94/99 and So Kai Tong by looking at all the circumstances objectively, this Board rules that the surveying fee payable to Company N is not deductible expense incurred in the production of the Appellant's profits.

Conclusion

73. For all the reasons above, this appeal is dismissed. This Board will like to thank Ms To Yee-Man of the Inland Revenue Department for her very helpful assistance and comprehensive submissions.