Case No. D100/03

Profits Tax – sale of a property – whether trading asset or capital asset – trading profit is chargeable to profits tax – ascertain the intention of the appellant at the time of the acquisition – intention to hold property as a capital investment must be definite – stated intention not decisive – actual intention must be determined objectively – onus of proof rests on appellant – analysis on the basis of the 'badges of trade' as described in Marson v Morton – section 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Carlson Tong and Stephen Yam Chi Ming.

Dates of hearing: 1 September and 7 November 2003.
Date of decision: 20 February 2004.

The appellant was a company incorporated in Hong Kong on 11 July 1989. At all material times, its nominal and issued capital was $10,000 divided into 10,000 shares of $1 each. Mr A and his brother Mr B each held 5,000 shares in the appellant. They also made up the board of directors of the appellant whose principal activities consisted of property investment and provision of design and management services.

Mr A and Mr B held interests in other companies.

The appellant had a long history of property dealings involving 10 properties.

Among these 10 properties, Property 7, which was a duplex flat purchased by the appellant for $16,650,000 in June 1993, was the subject matter of the present appeal. By an agreement dated 11 October 1994, the appellant sold Property 7 to Company W for $28,000,000.

The issue on appeal was whether the Commissioner's determination dated 30 May 2003 was correct in rejecting the appellant's objection that the profit derived by the appellant from the sale of Property 7 was a trading profit chargeable to profits tax.

The facts appear sufficiently in the judgment.

Held:

The applicable principles

1. It is trite law to ascertain the intention of the appellant at the time of the acquisition of Property 7 in order to determine whether that flat was purchased as capital asset or trading asset. As stated by Lord Wilberforce in Simmons v IRC (1980) 53 TC 461

   '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?'

2. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer was not decisive. Actual intention can only be determined objectively. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750 Mortimer J gave the following guidance:

   '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 … 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'.

3. Under section 68(4) of the IRO, the onus of proving the assessment appealed against was excessive or incorrect was on the appellant.

Analysis on the basis of the 'badges of trade' as described in Marson v Morton [1986] 1 WLR 1343

4. The sale and purchase of Property 7 was not a one-off transaction. The appellant had dealt with other properties between 1989 and 1996.

5. Property 1, Property 4 and Property 6 were accepted by the Revenue as capital assets.

6. Property 1 was tenanted and was held by the appellant for a period of over six and

a half years. Property 6 was likewise tenanted and held by the appellant for slightly over three years. The appellant held Property 4 for less than five years.

7. During the same period, the appellant had other properties which were its trading assets. These included the two lots in Sai Kung held in joint ventures with Mr N, Property 5 held for about one and a half years and Property 8 held for slightly over five months.

8. The two lots in Sai Kung and Property 8 both involved joint ventures with outside interests. The co-adventurers for Property 8 were Company C and Company E.

9. Prior to the acquisition of Property 7, the appellant had in hands trading as well as capital assets. Very cogent evidence must therefore be adduced to demonstrate that Property 7 fell within the latter as opposed to the former category.

10. The objective features of the subject appeal were however against the appellant.

11. The appellant purchased Property 7 with a sitting tenant and held it for about 16 months between 11 June 1993 and 25 October 1994.

12. The purchase was financed with the assistance of outsiders including Company C, Company D, Company E, Company Q and Mr R.

13. These objective features brought Property 7 more in line with that group of properties found to be trading assets.

14. The appellant placed considerable reliance on its continued retention of Property 9 and Property 10.

15. The Board was of the view that this factor was of limited assistance given the mixed portfolio of the appellant at the material times.

16. Furthermore Property 9 was partially financed out of the substantial profit made from the disposal of Property 7.

17. Given the different financial position of the appellant at the time of the purchase of Property 9, the Board was not prepared to attach any substantial weight on the appellant's holding of Property 9 to support its intention in relation to Property 7.

18. The principal activities of the appellant consisted of property investment and the provision of design and management services. Design and management services were relatively minor parts of its operations. It did engage in the trading of

properties.

19. Property 7 was saddled with a tenant at the date of the appellant's purchase.

20. It was however not the appellant's case that its purchase was motivated by the yields from the then subsisting tenancy. The appellant recognized that the rental was below the market rent and was anticipating an increase for the purpose of covering its mortgage instalments.

21. There was no dispute that the appellant did not have sufficient fund to finance the purchase. The bulk of the purchase price came from outside sources. The only realistic source of repayment was from gains arising from disposal of the property.

22. As far as the outside sources were concerned, the Board had no doubt that Mr A controlled Company C, Company D, Company E and Company Q.

23. The Board was not satisfied that he controlled Company H. The Board also had very little information on the financial standing of Mr R and the reasons why he was prepared to advance $2,000,000 on an indefinite basis.

24. The financial strength of the appellant, Company C and Company E was insufficient to enable them to maintain their Property 8 venture.

25. The Board further noted from the audited financial statements of the appellant and its related companies at the material times that they were illiquid and were relying heavily either on bank borrowings and/or borrowings from related companies or directors.

26. The Board was not convinced that the financial strength of these companies was such that would enable the appellant to hold Property 7 on a long term basis.

27. The strength of the appellant's case rested on the following:

    (a) the terms of the minutes of its board dated 11 May 1993 and 10 October 1994;

    (b) the confirmations of Company T and Company V dated 23 June 1997 and 15 July 1997 and;

    (c) the evidence of Mr A and Ms U that the offer for sale was unsolicited.

28. The Board was not prepared to attach much weight to the two minutes given the fact

that these were internal documents of the appellant and the veracity of the latter document had to be viewed in the light of the Board's findings on the basis of the evidence of Mr Y and Mr X.

29. The Board recognized the force of the remaining two heads of evidence. The weight to be attached to them was drastically reduced by its finding that Mr A and Ms U had embellished their evidence and there was no serious water seepage problem that prompted the sale.

30. The Board was of the further view that Mr A was a very shrewd businessman and a very experienced player in the property market.

31. The Board was inclined to the view that he was testing various available options and the offer of Company W was not an unexpected one in the light of the well known market conditions in 1994.

32. Taking an overall view of the factors, the Board was not persuaded that Property 7 was not a trading asset of the appellant.

Appeal dismissed.

Cases referred to:

Simmons v IRC [1980] 53 TC 461
All Best Wishes Ltd v CIR (1992) 3 HKTC 750
Marson v Morton [1986] 1 WLR 1343

Chan Siu Ying for the Commissioner of Inland Revenue.
Cheung Sing Kuen of Messrs Lawrence Cheung CPA Company Limited for the taxpayer.

Decision:

Background facts as found by us

1. The Appellant is a company incorporated in Hong Kong on 11 July 1989. At all material times, its nominal and issued capital was $10,000 divided into 10,000 shares of $1 each. Mr A and his brother Mr B each held 5,000 shares in the Appellant. They also made up the board of directors of that company whose principal activities consisted of property investment and provision of design and management services.

2. Mr A and Mr B held interests in other companies. The following are relevant for the purpose of this appeal:

(a) Company C: At all material times, Mr A and Mr B each held 50% of the issued share capital of Company C and they occupied two out of three seats on the board of directors of that company.

(b) Company D: At all material times, Mr A and Mr B respectively held 182,000 and 77,998 shares in the issued capital of Company D. Their parents each held two shares in the remaining issued share capital. The four of them made up the board of directors of Company D.

(c) Company E: At all material times, Mr A, Mr B and Mr F each held 2,000 shares in the issued capital of Company E. Mr F is the brother-in-law of Mr A. Madam G, wife of Mr B, held the remaining 4,000 shares. All four of them made up the board of directors of Company E.

3. Mr A was also one of four directors that made up the board of Company H for the years ending 31 October 1993 and 31 October 1994. The then issued capital of Company H consisted of 1,000,000 shares of $1 each. It is not clear to what extent Mr A was interested in the issued capital of Company H.

4. The Appellant has a long history of property dealings. It is necessary to examine this history in order to place the subject matter of this appeal in its proper context.

5. Property 1

(a) By an agreement dated 29 September 1989, the Appellant purchased Property 1 for $7,861,990. The purchase was financed initially by a mortgage loan of $5,500,000 extended by Bank J on 10 October 1990 which was subsequently replaced by a mortgage loan of $5,300,000 extended by Bank K in 1992.

(b) By a tenancy agreement dated 28 March 1991, Property 1 was let to a tenant for a term of two years from 22 March 1991 yielding rent at $47,000 per month.

(c) By a tenancy agreement dated 19 May 1993, Property 1 was let to Company L for two years commencing on 19 May 1993 at $68,000 per month.

(d) By a third tenancy agreement dated 26 May 1995, Property 1 was let to Company M for two years commencing on 19 May 1995 at $145,000 per month.

(e) By an agreement dated 21 May 1996, the Appellant sold Property 1 for $27,500,000. The Revenue accepted that the gains of the Appellant was capital in nature and not assessable to profits tax.

6. Joint ventures between the Appellant and Mr N in the years 1991/92 and 1992/93

(a) The joint venture for the year 1991/92 was in respect of Property 2 (a lot in Sai Kung) which was purchased at $1,050,000 and sold at $1,230,000. The Appellant and Mr N shared the profit on a 50%:50% basis. The Appellant's share of the profit was set off against its loss under section 19C(4) of the Inland Revenue Ordinance ['IRO'].

(b) The joint venture for the year 1992/93 was in respect of Property 3 (another lot in Sai Kung) which was purchased at $980,000 and sold at $1,350,000. The Appellant's 50% share of the profits was again set off against its loss under section 19C(4).

7. Two flats in the Housing Estate

(a) By two agreements both dated 9 May 1992, the Appellant purchased Property 4 for $2,123,000 and Property 5 for $2,116,000.

(b) The purchase of Property 4 was financed by a loan of $1,486,100 extended by Credit Company P which loan was repayable by fortnightly instalment of $6,332 each. Property 4 was sold by an agreement dated 16 April 1997 for $3,420,000. The Revenue accepted that the gains of the Appellant arising from its disposal of Property 4 was capital in nature and not assessable to profits tax.

(c) The purchase of Property 5 was financed by loan of $1,479,576.08 extended by the Credit Company which loan was repayable by 335 fortnightly instalments of $7,177 each. Property 5 was sold by an agreement dated 28 January 1994 for $2,685,000. The Revenue rejected the Appellant's claim that the profits arising from the disposal of Property 5 was capital in nature. The Appellant says that it did not pursue any objection in view of the time and expenses involved.

8. Property 6

(a) By an agreement dated 11 March 1993, the Appellant purchased Property 6 for $7,880,000. The purchase was financed by a $5,500,000 loan from Bank K which loan was repayable by 120 monthly instalments of $67,459.15 each.

(b) The Appellant's purchase of Property 6 was subject to a subsisting tenancy in favour of Company P. By a tenancy agreement dated 1 April 1994, the Appellant renewed the tenancy in favour of Company P for two years from 1 April 1994 yielding rent at $52,360 per month.

(c) The Appellant sold Property 6 for $12,880,000 by an agreement dated 13 April 1996. The Revenue accepted that the gains of the Appellant arising from this disposal was not subject to profits tax.

9. Property 7

(a) Property 7 is the subject matter of the present appeal. The Appellant purchased this duplex flat for $16,650,000 pursuant to a preliminary agreement for sale and purchase dated 4 June 1993. Under this preliminary agreement, the Appellant had to pay deposits as follows:

Date	**Amount**
Upon signing of the preliminary agreement	$700,000
On or before 11-6-1993	$1,830,000
On or before 28-6-1993	$1,880,000
On or before 28-7-1993	$1,530,000
	$5,940,000

The balance of the purchase price amounting to $10,710,000 had to be paid at completion on 23 September 1993.

(b) Between 10 June 1993 and 27 July 1993, the Appellant received a total of $5,200,000 from various entities as follows:

Date	**Company C**	**Company E**	**Company D**	**Company Q**	**Mr R**
10-6-1993					$1,300,000
25-6-1993			$300,000		
25-6-1993		$300,000			
28-6-1993	$100,000				
29-6-1993				$1,300,000	
29-6-1993				$200,000	
5-7-1993		$300,000			
26-7-1993		$20,000			
26-7-1993		$480,000			
27-7-1993	$200,000				

27-7-1993					$700,000
	$300,000	$1,100,000	$300,000	$1,500,000	$2,000,000

Mr R is a brother-in-law of Mr A.

(c) The payments outlined in sub-paragraph (b) above totalling $5,200,000 were used by the Appellant to pay part of the deposits totalling $5,940,000. The Appellant financed the balance of the purchase price of $10,710,000 by a mortgage loan of $11,650,000 extended by Bank K on 14 September 1993 which loan was repayable by 180 monthly instalments of $113,021.31 each.

(d) According to the audited accounts of the Appellant, the following amounts were due from/(to) various related companies as at 31 March 1995 and 31 March 2002:

Amounts due from related companies

Related companies	31-3-1995	31-3-2002
Company C	$2,772,400	
Company E	$1,656,400	$1,531,400
Company D		$168,642
Others	$10,000	$59,140,488
	$4,438,800	$60,840,530

Amount due to related companies

Related companies	31-3-1995	31-3-2002
Company C		($1,292,733)
Company Q	($2,310,000)	($15,919,109)
	($2,310,000)	($17,211,842)

(e) The Appellant's purchase of Property 7 was subject to a tenancy dated 23 December 1992 in favour of Company S. That tenancy was for a term of two years commencing from 4 January 1993 at a rental of $69,000 per month. Company S was entitled to terminate this tenancy by three months' written notice although such notice could not be given before 4 January 1994.

(f) The acquisition of Property 7 was considered by the board of the Appellant at a meeting held on 11 May 1993. According to the minutes of that meeting, the board comprising of Mr A and Mr B resolved to purchase Property 8 'for long-term investments'.

(g) By written notice dated 17 May 1994, Company S terminated its tenancy in Property 8 with effect as from 16 August 1994.

(h) According to a letter of confirmation issued by Company T dated 23 June 1997, Company T was appointed by the Appellant as its leasing agent in respect of Property 7 between June and September 1994. Company T further asserted that 'Since the properties leasing market is very quiet and the said premises has a serious water leakage problem, the owner change to sell on October 1994'. The letter was signed by Ms U, Assistant Manager of Company T.

(i) According to a further letter of confirmation issued by Company V dated 15 July 1997, Company V was appointed by the Appellant to market Property 7 'for lease between May and September 1994' with rent at an asking rate of $140,000 per month. Company V indicated that they were unsuccessful in locating an appropriate tenant.

(j) By an agreement dated 11 October 1994, the Appellant sold Property 7 to Company W for $28,000,000. Company W was granted a gratuitous licence to occupy Property 7 for the period between 25 October 1994 and 20 January 1995. In the absence of any advance completion on 20 January 1995, Company X was to pay the Appellant a licence fee of $125,000 per month in respect of its continued occupation for the period between 20 January 1995 and 31 May 1995 when the sale was scheduled to be completed. Completion by assignment did take place on 20 January 1995. It follows that Company W did not have to pay any licence fee to the Appellant.

(k) The sale of Property 7 was considered by the board of the Appellant at a meeting held on 10 October 1994. Mr A and Mr B were allegedly present at this meeting. According to the minutes of that meeting:

> ' The property was acquired in May 1992 with an intention for long-term rental purposes. However, the tenant terminated the Tenancy Agreement as the property had serious rain leak-in problem during the rain season and the Company was unable to solicit another tenant for the property. In this circumstance, in order to protect the long-term interests of the Company, it was unanimously resolved to sell the aforesaid property to realise fund for other long-term investment opportunities'.

(l) According to the profits tax computation annexed to the Revenue's notice of assessment for the year 1994/95 dated 24 March 1998, the assessor took the view that:

‘ Gain on disposal of [Property 5] and [Property 7] are assessable to tax since the company was not financially viable to hold the property for long term investment’.

10. Property 8

(a) By a joint venture agreement dated 1 September 1993, the Appellant, Company C and Company E agreed to invest equally in the purchase of Property 8. They further agreed to rent out that flat ‘as long term investment’.

(b) By a preliminary agreement dated 2 October 1993, the Appellant agreed to purchase Property 8 for $14,980,000.

(c) By letter dated 15 January 1994, Bank K informed the Appellant that Bank K was not prepared to extend a mortgage loan for Property 8.

(d) By an agreement dated 3 February 1994, the Appellant sold Property 8 for $23,300,000. The Revenue assessed the Appellant on the gains made in this purchase. The Appellant was unsuccessful in its challenge of that assessment before a differently constituted Board of Review.

11. Property 9

(a) The Appellant purchased Property 9 for $16,500,000 by an agreement dated 31 October 1994. The purchase was financed by a mortgage loan of $10,000,000 extended by Bank K on 2 December 1994 which loan is repayable by 144 monthly instalments of $120,957 each.

(b) By a tenancy agreement dated 10 November 1995, the Appellant let Property 9 out for one year with rental at $75,000 per month. In May 1996, the tenant moved out of Property 9 and that flat has since been used as a quarter for one of the Appellant’s directors.

12. Property 10

(a) By an agreement dated 10 October 1996, the Appellant purchased Property 10 for $19,600,000.

(b) The Appellant let Property 10 out to successive tenants and is still holding this flat at the hearing of this appeal.

13. The issue before us is whether the Commissioner's determination dated 30 May 2003 is correct in rejecting the Appellant's objection that the profit derived by the Appellant from the sale of Property 7 is a trading profit chargeable to profits tax.

The oral testimony before us

14. The Appellant called Mr A and Ms U as its witnesses. The Appellant further invited this Board to exercise its powers under section 68(10) of the IRO to summon Mr X of Company W (purchaser of Property 7 from the Appellant) to give evidence at the adjourned hearing on 7 November 2003. Mr X duly attended in response to the Board's summons. He was accompanied by Mr Y, a shareholder and director of Company W. Both Mr X and Mr Y were interposed and they gave evidence prior to the conclusion of Mr A's testimony. The sworn testimony of the four witnesses is summarised hereinbelow.

15. The testimony of Ms U

(a) She started working with Company T in 1989 as a senior real estate consultant. She left that company in 2001. She knew Mr A prior to joining Company T.

(b) She confirmed the Appellant's instructions to let Property 7 prior to expiration of the then subsisting tenancy. The instructions were given over the phone some time before June 1994.

(c) She proposed that the asking rent for the new tenancy should be $140,000 and the Appellant should not take less than $120,000. She made this proposal before inspecting Property 7.

(d) She inspected Property 7 prior to the departure of the sitting tenant. She found watermarks spanning from the upper level down to the lower level. The problem was serious. It affected a wall in the living room. Water could also be found seeping out of the floor tiles. The tiles turned black as a result of the watermarks. She did not notice problem anywhere else.

(e) She told Mr A that the problem had to be sorted out before letting Property 7 out to tenant.

(f) She showed Property 7 to various potential tenants but the watermarks remained problematical. The watermarks had turned dark brown.

(g) She spent three months trying to let Property 7 out but without success. Less than five potential tenants inspected the premises.

(h) She suggested to Mr A to consider selling Property 7. Mr A told her that he would consider as the quotation he received for sorting out the water seepage problem was high. The anticipated costs was in the range of $1,000,000. The tiles of both levels had to be replaced and the wall had to be restored.

(i) The purchaser was also aware of the problem. As agent in the sale, she had to tell the purchaser of the problem. Mr A had no contact with the purchaser. The purchaser simply took her word for it and offered to purchase the flat at the eventual offer price. The purchaser was very familiar with the conditions in Property 7's complex and had to spend $5,000,000 renovating the flat before occupation.

16. The testimony of Mr A

(a) Apart from Property 7, there were other units in the complex that were being offered in the market. He is not sure that he viewed Property 7 prior to its purchase. He was not aware of any serious water seepage problem when he purchased that flat.

(b) At all material times, the Appellant did not have much fund. It was merely a vehicle for holding various premises. Money was injected into the Appellant from other companies.

(c) He selected Property 7 for investment because of its good layout and good location. The tenant was Company S, a highly respectable company. Although the rental under the then subsisting lease was below market rent, the same can be adjusted upwards on renewal.

(d) The down payment was made by transfers from other companies under his control and from Mr R to the Appellant. When they made the advances in favour of the Appellant, there was no agreement as to the time of repayment. There was no written agreement in relation to these loans. The loans were all recorded in current accounts of the Appellant.

(e) The rents from the subsisting tenancy would not be sufficient to cover the mortgage repayments but he had sufficient fund to cover the shortfall estimated at about $300,000 per year. Reliance is placed in particular on his interests in Company H. He pointed out that dividends from Company H were substantial.

(f) When Company S indicated their wish to terminate the tenancy, he was told by Company S that there was water seepage in the flat. He appointed two to three

agents to let the flat out but was told that it would be difficult to let the flat out due to the water seepage problem.

(g) He himself inspected Property 7 and he also brought along a decorator from Company Z to view the watermarks. He disagreed with the evidence of Ms U. He said the problem was not confined to one wall. The decorator told him that extensive works had to be done with no guarantee of results. The decorator further indicated that the costs involved could run up to several millions. Company Z merely gave an oral quotation. Company Z had since closed down. After hearing evidence of Mr Y, he agreed that the quotation was an over-estimate.

(h) The potential purchaser was aware of the water seepage problem and had therefore asked for a longer period of renovation which resulted in the grant of the licence under the sale agreement.

(i) He sought confirmation from Company W and who indicated that they spent $5,000,000 in redecorating the premises.

(j) He used the proceeds obtained from sale of Property 7 for the purchase of Property 9. Property 9 was first rented out. It is now being used by him as his own quarter.

17. The sworn testimony of Mr X

(a) He is the manager of Company W. He started collecting rent for Company W in 1994.

(b) He did not inspect Property 7 prior to Company W's purchase. Only Mr Y went and Mr Y did not notice any water seepage problem.

(c) When he first inspected the flat, he did not notice any water seepage problem. He only became aware of such problem after the purchase.

(d) Prior to occupation, Company W spent about a million dollars in renovating the flat. He was not aware of any water seepage problem during such renovation.

(e) After completion of renovation there was water seepage during the rainy season. As a result of the water seepage, the staircase in the flat was bulging like a ball.

(f) The tenant of Company W made its first complaint at the end of 1996. The problems were twofolds:

(i) There was seepage from the external walls.

(ii) There was internal seepage. The seepage extended to the kitchen and the servant's quarter. The tenant was complaining and they had to spend a million or so to sort out the problem.

18. The sworn testimony of Mr Y

(a) He participated in the initial decision of Company W to purchase Property 7. He then left the details for Mr X to follow up.

(b) He inspected Property 7 twice prior to the purchase by Company W. He did not notice any problem when inspecting the flat. There was no water mark when he purchased the same. He was not aware of any problem when the flat was being renovated for occupation.

(c) After letting it out, the tenant was complaining about water seepage problem. He inspected the flat upon receipt of the complaint. Remedial works did not yield satisfactory results. About two years later, he sought help from more experienced contractors. The problems relating to the bathroom still subsist. Between 1995 and 2000, he did not spend more than $1,000,000 dealing with this problem. On the most serious occasion the amount that he spent was about $300,000.

19. Our assessment of the testimony

(a) Ms U and Mr A differ on the extent of the water seepage.

(b) The testimony of Ms U and Mr A conflicts with the testimony of Mr X and Mr Y in the following respects:

(i) In relation to Company W's awareness of the water seepage problems prior to its purchase of Property 7: Ms U said she conveyed the problem to the purchaser but Mr Y and Mr X were emphatic on their lack of knowledge.

(ii) Mr A explained that the grant of the gratuitous licence in the provisional agreement for sale was attributable to Company W's desire to have a substantially longer period to tackle the water seepage problem. This

piece of evidence sits ill with the denial of knowledge on the part of Mr Y and Mr X.

(iii) The alleged estimate given by Company Z to Mr A to tackle the problem. After hearing the testimony of Mr Y. Mr A himself conceded that Company Z over estimated what was required.

(c) We are particularly impressed by the evidence of Mr Y. He has no personal interests in this appeal. The summons issued by this Board was not addressed to him but he attended in order to give us assistance. He gave his evidence with care. We prefer his evidence and the evidence of Mr X to the evidence of Ms U and Mr A. We therefore

(i) reject the evidence of Ms U and find that there was no express intimation given to Company W as to the existence of water seepage.

(ii) reject the evidence of Mr A that there was serious water seepage problem when Property 7 was offered to Company W and that the provisions in the provisional sale agreement for the grant of a gratuitous licence was designed to cater for such problem.

(iii) reject the evidence of Mr A that when Property 7 was offered to Company W there was water seepage to the extent that warranted the incurrence of renovation costs in terms of millions of dollars.

(iv) find that there was water seepage in Property 7 but the extent was over-exaggerated by Mr A.

The applicable principles

20. It is trite law that our task is to ascertain the intention of the Appellant at the time of the acquisition of Property 7 in order to determine whether that flat was purchased as capital asset or trading asset. As stated by Lord Wilberforce in Simmons v IRC (1980) 53 TC 461

> *'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?'.*

21. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750 Mortimer J gave the following guidance:

> *'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 realisable, 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 ... 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'.*

22. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the Appellant.

Our analysis on the basis of the 'badges of trade' as described in Marson v Morton [1986] 1 WLR 1343

23. The sale and purchase of Property 7 was not a one-off transaction. The Appellant had dealt with other properties between 1989 and 1996. Property 1, Property 4 and Property 6 were accepted by the Revenue as capital assets. Property 1 was tenanted and was held by the Appellant for a period of over six and a half years. Property 6 was likewise tenanted and held by the Appellant for slightly over three years. The Appellant held Property 4 for less than five years. During the same period, the Appellant had other properties which were its trading assets. These include the two lots in Sai Kung held in joint ventures with Mr N, Property 5 held for about one and a half years and Property 8 held for slightly over five months. The two lots in Sai Kung and Property 8 both involved joint ventures with outside interests. The co-adventurers for Property 8 were Company C and Company E. Prior to the acquisition of Property 7, the Appellant had in hands trading as well as capital assets. Very cogent evidence must therefore be adduced to demonstrate that Property 7 falls within the latter as opposed to the former category. The objective features of the subject appeal are however against the Appellant. The Appellant purchased Property 7 with a sitting tenant and held it for about 16 months between 11 June 1993 and 25 October 1994. The purchase was financed with the assistance of outsiders including Company C, Company D, Company E, Company Q and Mr R. These objective features bring Property 7 more in line with that group of properties found to be trading assets. The Appellant places considerable reliance on its continued retention of Property 9 and Property 10. We are of the view that this factor is of limited assistance given the mixed portfolio of the Appellant at the material times. Furthermore Property 9 was partially financed out of the substantial profit made from the disposal of Property 7. Given the different financial position of the Appellant at the time of the purchase of

Property 9, we are not prepared to attach any substantial weight on the Appellant's holding of Property 9 to support its intention in relation to Property 7.

24. The principal activities of the Appellant consisted of property investment and the provision of design and management service. Design and management services were relatively minor parts of its operations. As indicated in the preceding paragraph, it did engage in the trading of properties.

25. Property 7 was saddled with a tenant at the date of the Appellant's purchase. It is however not the Appellant's case that its purchase was motivated by the yields from the then subsisting tenancy. The Appellant recognised that the rental was below the market rent and was anticipating an increase for the purpose of covering its mortgage instalments. There is no dispute that the Appellant did not have sufficient fund to finance the purchase. The bulk of the purchase price came from outside sources. The only realistic source of repayment was from gains arising from disposal of the property.

26. As far as the outside sources are concerned, we have no doubt that Mr A controlled Company C, Company D, Company E and Company Q. We are not satisfied that he controlled Company H. We also have very little information on the financial standing of Mr R and the reasons why he was prepared to advance $2,000,000 on an indefinite basis. The financial strength of the Appellant, Company C and Company E was insufficient to enable them to maintain their Property 8 venture. We further note from the audited financial statements of the Appellant and its related companies at the material times that they were illiquid and were relying heavily either on bank borrowings and/or borrowings from related companies or directors. We are not convinced that the financial strengths of these companies were such that would enable the Appellant to hold Property 7 on a long term basis.

27. The strength of the Appellant's case rests on the following:

(a) the terms of the minutes of its board dated 11 May 1993 and 10 October 1994;

(b) the confirmations of Company T and Company V dated 23 June 1997 and 15 July 1997 and

(c) the evidence of Mr A and Ms U that the offer for sale was unsolicited.

We are not prepared to attach much weight to the two minutes given the fact that these are internal documents of the Appellant and the veracity of the latter document has to be viewed in the light of our findings on the basis of the evidence of Mr Y and Mr X.

We recognise the force of the remaining two heads of evidence. The weight to be attached to them is drastically reduced by our finding that Mr A and Ms U had embellished their evidence and there

was no serous water seepage problem that prompted the sale. We are of the further view that Mr A is a very shrewd businessman and a very experienced player in the property market. We are inclined to the view that he was testing various available options and the offer of Company W was not an unexpected one in the light of the well known market conditions in 1994.

28. Taking an overall view of the factors which we outlined above, we are not persuaded that Property 7 was not a trading asset of the Appellant. For these reasons, we dismiss the Appellant's appeal.

29. We would like to express our appreciation for the assistance given by Mr Cheung Sing Kuen throughout the course of this appeal.