

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D123/99

Profits Tax – acquisition and sale of property – intention at time of purchase – burden of proof on purchaser to establish that property purchased for long term investment – whether tax chargeable upon revaluation of property – sections 2(1), 14 and 68(4) of the Inland Revenue Ordinance.

Panel: Anna Chow Suk Han (chairman), Vernon F Moore and Mary Teresa Wong Tak Lan.

Date of hearing: 15 July 1999.

Date of decision: 17 February 2000.

The taxpayer was incorporated on 5 May 1992. On 6 August 1992, the taxpayer agreed to purchase a property (the ‘Property’) for \$21,952,100. At the time of acquisition, the Property was subject to a tenancy for a term of three years commencing 1 April 1992 for a monthly rental of \$209,500.

The Property purchase was financed by directors’ advances and a mortgage loan. In the taxpayer’s balance sheets, the repayment of the directors’ advances were classified as ‘current liabilities’. On 17 May 1994, the taxpayer agreed to sell the Property for \$47,415,500.

In the year of assessment 1994/95, the taxpayer did not include as assessable profits the profits of \$24,118,628 (less duties etc.) derived from the sale of the Property.

At the time, the taxpayer’s former representatives submitted that the Property had been sold because the purchaser had offered a good price for it. Further that it was purchased because its return as an investment was attracting. It was purchased and intended as a long term investment. The rental income was good. Further, they had stated that the profits made were a capital gain. The property was acquired for investment purchase in generating steady income.

After further representations by the taxpayer’s new representatives, the Commissioner was unable to accept that the Property had been acquired as a capital asset for its rental income because:

- (1) There had been a short period of ownership which was inconsistent with the firm commitment to hold a property long term;
- (2) The purchase consideration was by directors’ advances that had been classified as ‘current liabilities’;

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- (3) The taxpayer had asked for a price higher than the one which the Property was sold.

In the hearing before the Board, the following legal principles were applied:

- (1) A long-term investment is a capital asset and not a trading asset. Profits arising from the sale of a capital asset is not taxable while profits arising from a sale of a trading asset is taxable. It is not possible for an asset to be both trading stock and a long term investment. Trading requires an intention to trade (Lionel Simmons v CIR, per Lord Wilberforce);
- (2) The stated intention of the taxpayers, although of great weight, is not decisive but must be viewed in the light of the whole of the surrounding circumstances (All Best Wishes Limited v CIR, per Mortimer J, followed);
- (3) The question whether or not there had been a trade or 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 (Marson v Morton, per Sir Nicholas Browne-Wilkinson V-C).

HELD by the Board, applying the legal principles:

- (1) The intention of those behind the taxpayer would be relevant and crucial;
- (2) There was insufficient evidence to establish that the Property was acquired as a long term investment;
- (3) The resale of the Property was not satisfactorily explained. The parties had said that they had a falling out over the intended business which was the reason for the sale of the Property, but the intended sale was actually well planned and was not as hasty as the Board was led to believe;
- (4) The Property was purchased by the taxpayer as a trading stock with the intent to dispose of it as a profit at the appropriate time.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd v CIR [1980] 35 TC 461

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All Best Wishes Ltd v CIR [1992] 3 HKTC 750
Marson v Morton [1986] STC 463

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Julian Lee of Messrs Ernst & Young for the taxpayer.

Decision:

The appeal

1. This is an appeal by the Taxpayer against the determination dated 18 January 1999 by the Commissioner of Inland Revenue, rejecting the objection raised by the Taxpayer against the profits tax assessment for the year of assessment 1994/95 dated 18 September 1996, showing assessable profits of \$24,166,652 with tax payable thereon of \$3,987,497.

2. The gain arose from the sale of the property in Building A at District B ('the Property'). The Taxpayer claimed that the Property was acquired by it as a long term investment and the gain derived from the sale thereof was therefore not chargeable to profits tax under section 14 of the Inland Revenue Ordinance (the IRO).

The background facts

3. The Taxpayer was incorporated as a private company in Hong Kong on 5 May 1992. At all relevant times, the Taxpayer's authorised and issued capital was \$10,000. The shareholders and directors of the Taxpayer are:

Shareholder/Director	Shareholding
Mr C	25%
Ms C	25%
Mr D	25%
Mrs D	<u>25%</u>
	<u>100%</u>

Mr D and Mrs D are husband and wife. Mr C and Ms C are father and daughter.

4. In its profits tax returns, the Taxpayer described the nature of its business as 'property investment'.

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5. On 6 August 1992, the Taxpayer entered into an agreement to purchase the Property for a consideration of \$21,952,100. The purchase of the Property was completed on 30 September 1992 when the Property was assigned to the Taxpayer.

6. At the time of acquisition, the Property was subject to a tenancy for a term of three years commencing 1 April 1992. The monthly rental was \$209,500.

7. The purchase consideration of the Property was financed by advance of \$6,652,100 from the directors and a mortgage loan of \$15,300,000 from a bank. The directors' advance was interest-free without specific repayment terms and classified as 'current liabilities' in the Taxpayer's balance sheets. The mortgage loan was repayable by 84 equal monthly instalments of \$240,379.

8. By an agreement for sale and purchase dated 17 May 1994, the Taxpayer agreed to sell the Property, with existing tenancy, to a bank for a consideration of \$47,415,500. The sale was completed by way of an assignment dated 17 June 1994.

9. After the sale of the Property, the Taxpayer became dormant. Other than the Property, the Taxpayer has not acquired any property nor has the Taxpayer been involved in the letting of any other property.

10. The Taxpayer's accounts for the period ended 31 March 1993 and for the year ended 31 March 1994, both approved by the Taxpayer on 24 October 1994, showed net profits before taxation of \$574,463 and \$1,396,321 respectively.

11. The Taxpayer declared in its profits tax return for the year of assessment 1994/95 an assessable profit of \$48,024. In arriving at this amount, the Taxpayer did not include as assessable profits the profit of \$24,118,628 it derived from the sale of the Property.

12. The profit from the sale of the Property was computed as follows:

	\$	\$
Sale proceeds		47,415,500
<u>Less:</u> Legal fee	75,302	
Valuation fee	8,000	
Commission	<u>474,155</u>	<u>557,457</u>
		46,858,043
 <u>Less:</u> Purchase cost	 21,952,100	
Stamp duty	603,683	
Legal fee	134,140	
Valuation fee	<u>49,492</u>	<u>22,739,415</u>
		<u><u>24,118,628</u></u>

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13. In reply to enquiries raised by the assessor, Messrs Eric M C Li & Co. (‘ the Former Representatives’) provided the following information in connection with the profit from the sale of the Property:

- (a) ‘ The monthly instalment was \$240,379.2. The directors only need to advance around \$30,000 monthly in total to finance the property. As there were four directors, each only need to advance HK\$7,500 monthly. The property had a return around 12% per annum. It was quite a good return as an investment.’
- (b) ‘ The property was sold as the purchaser offer a good price.’
- (c) ‘ The property was purchased as its return as an investment was quite attracting. It was purchased and intended as a long term investment as it had a quite long rental contract guaranteeing a good return in immediate four years. Further future benefits should not be less than this in view of the coming economic trend.’
- (d) ‘ The purchaser was found through two estate agency.’
- (e) ‘ The shareholders did not have any good investment plan for the company yet, so they distributed the money first for their own use until further good investment opportunities arise.’

14. The assessor was of the view that the profit from the sale of the Property was a revenue profit and raised on the Taxpayer the following profits tax assessment for the year of assessment 1994/95:

	\$
Profit per return	48,024
<u>Add: Profit on sale of the Property</u>	<u>24,118,628</u>
Assessable profits	<u>24,166,652</u>
Tax payable thereon	<u>3,987,497</u>

15. By a letter dated 23 September 1996, the Former Representatives, on behalf of the Taxpayer, objected to the profits tax assessment for the year of assessment 1994/95 in the following terms:

‘ the gain from disposal of investment property should not be assessable since it is a capital gain. The property was acquired for investment purchase in generating steady rental income.’

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16. In response to the assessor's draft statement of facts, Messrs Ernst & Young ('the New Representatives') made the following representations and arguments in their letter of 27 February 1997:

- (a) 'Before the establishment of (the Company), these shareholders were trading with each other on electrical appliances through private companies controlled by them. Mr C and Ms C represented Company E, an electrical appliances company and Mr D and Mrs D represented Company F ... To further build up a long term business relationship, they joined together and set up (the Company) to hold long term investment in property.'
- (b) 'While (the Company) purchased the Property, the shareholders were attracted by its location and investment return, that is, the rental income generated by the Property ... This fixed tenancy agreement therefore guaranteed stable income of not less than 12% of the investment. In view of the location and the investment return of the Property, the shareholders found that the Property was good for long term investment.'
- (c) 'Unexpectedly, the relationship between the shareholders, with each representing different companies, went sour. Soon after the purchase of the Property, trading transactions between Company E and Company F dropped significantly and then stopped. Some cheques paid by Company F to Company E were bounced. Goods around \$8,000,000 were subsequently returned from Company F to Company E in June 1993 ... In view of the numerous disputes and arguments which worsened the business relationship among the shareholders, they found that the Property could not serve the original purpose of enhancing their relationship and they lost interest to hold the Property together.'
- (d) 'A selling price of around \$3,700 per square feet was offered by the purchaser which was solicited through property agents. The price offered was very attractive to the Taxpayer ...'
- (e) The Property was classified as fixed assets in the audited accounts for all relevant time and such classification was consistent with the Taxpayer's intention of holding it for long term investment purpose.
- (f) Apart from the Property, the Taxpayer had no other property transaction. The Taxpayer did not have any history in property dealing.

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- (g) The Taxpayer did not put any efforts, such as undertaking repairs and improvements, to enhance the value of the Property for re-sale upon the purchase of the Property.
- (h) The Property had been held by the Taxpayer for more than two years.

17. The trading transactions between Company E and Company F in terms of numbers of orders and amounts for the years 1990 to 1994 are as follows:

Year	Month	Purchase orders placed with Company F by Company E		Sale invoices issued to Company F by Company E	
		Number	Amount(\$)	Number	Amount(\$)
1991	January	0	0	0	0
	February	0	0	0	0
	March	0	0	0	0
	April	0	0	0	0
	May	0	0	0	0
	June	0	0	2	462,080
	July	0	0	13	7,697,140
	August	0	0	18	10,977,945
	September	0	0	25	10,044,410
	October	4	1,163,440	31	22,352,170
	November	2	1,642,355	15	8,820,695
	December	<u>3</u>	<u>504,000</u>	<u>11</u>	<u>8,505,750</u>
	<u>9</u>	<u>3,309,795</u>	<u>115</u>	<u>68,860,190</u>	
1992	January	3	647,640	24	14,888,700
	February	5	1,956,330	15	15,979,370
	March	3	1,913,950	21	13,730,220
	April	4	4,980,370	22	20,832,560
	May	6	575,910	36	23,867,040
	June	1	1,388,750	19	23,190,870
	July	1	704,000	18	12,403,390
	August	3	4,333,500	15	14,173,680
	September	5	2,848,850	9	10,437,780
	October	1	1,275,000	6	2,966,895
	November	0	0	0	0
	December	<u>1</u>	<u>217,500</u>	<u>2</u>	<u>674,650</u>
	<u>33</u>	<u>20,841,800</u>	<u>187</u>	<u>153,145,155</u>	
1993	January	0	0	0	0

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	February	0	0	0	0
	March	0	0	0	0
	April	0	0	0	0
	May	0	0	0	0
	June	7	5,807,715	0	0
	July	3	2,389,755	0	0
	August	1	346,500	0	0
	September	3	3,296,880	1	821,030
	October	0	0	0	0
	November	0	0	0	0
	December	<u>0</u>	<u>0</u>	<u>1</u>	<u>35,040</u>
		<u>14</u>	<u>11,840,850</u>	<u>2</u>	<u>856,070</u>
1994	January	0	0	0	0
	February	1	414,720	0	0
	March	0	0	0	0
	April	0	0	0	0
	May	0	0	0	0
	June	0	0	0	0
	July	2	516,000	0	0
	August	0	0	0	0
	September	0	0	0	0
	October	0	0	0	0
	November	0	0	0	0
	December	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
		<u>3</u>	<u>930,720</u>	<u>0</u>	<u>0</u>

18. The New Representatives provided the assessor with the following:

- (a) Copies of cheques issued by Company F to Company E which were bounced by the bank:
 - (i) Cheque dated 15 August 1992 in the sum of \$1,030,000 which was bounced on 14 September 1992.
 - (ii) Cheque dated 3 October 1992 in the sum of \$459,650 which was bounced on 6 October 1992.
 - (iii) Cheque dated 26 October 1992 in the sum of \$552,160 which was bounced on 27 October 1992.

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- (b) Letter dated 16 March 1994 showing that the Taxpayer gave instruction to C Y Leung & Co Ltd for the marketing of the Property and that the Taxpayer's asking selling price of the Property was \$3,800 per square foot.

19. In response to the assessor's request for copies of all correspondence concerning the returned goods mentioned in 16(c) above, the New Representatives submitted copies of the following documents:

- (a) Original invoice dated 19 September 1992 issued by Company E to Company F showing that of 270 air conditioners sold to Company F, 225 were returned to Company E.

The New Representatives stated in their letter dated 17 June 1998 that at the end only 214 units of air conditioners were returned as Company F finally resorted to keep additional 11 units of air conditioners.

- (b) Original invoice dated 28 September 1992 issued by Company E regarding the sale of air conditioners to Company F at a total price of \$2,150,400 together with cheques issued by Company F to Company E for the payment of the goods.
- (c) Invoice dated 2 November 1992 issued by Company F regarding the sale of air conditioners to Company E at a total price of \$2,112,000.

The New Representatives stated that the invoice in (c) above dated 2 November 1992 did not represent sales made by Company F to Company E but return of the air-conditioners sold by Company E under invoice in (b) above.

20. In reply to the assessor's further enquiries concerning goods returned mentioned in 16(c) above, the New Representatives:

- (a) stated that '... the amount of goods returned from Company F to Company E should read as around \$800,000 ... More precisely, goods in the amount of \$821,030 were sold by Company E to Company F on 22 September 1993 ... The goods were 317 sets of television sets at the unit price of \$2,590. Company F returned the goods to Company E on 25 September 1993, which were valued by Company E at \$2,570 each, that is, for a total of \$814,690 ...'
- (b) submitted a copy of the invoice dated 22 September 1993 issued by Company E regarding the sale of 317 sets of colour TV to Company F at a total price of \$821,030.

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- (c) submitted a copy of stores record card showing the receipt of 317 sets of TV from Company F on 25 September 1993.

21. Regarding the bounced cheques mentioned in 18(a) above, the New Representatives provided the following information in their letter dated 17 June 1998:

- (a) The cheque for \$1,030,000 was re-deposited on 14 September 1992 into a bank account maintained by Company E and later confirmed to be successfully presented.
- (b) After the cheque for \$459,650 was bounced, Company E returned to Company F a cheque for \$1,053,000 dated 5 October 1992 issued by Company F to Company E. Company F settled the total outstanding balance of \$1,512,650 (that is, \$459,650 + \$1,053,000) by paying \$300,000 to Company E, offsetting \$1,101,000 Company E owed Company F and paying a cheque for \$116,330 to Company E.
- (c) The cheque for \$552,160 was bounced on 27 October 1992. At that time, Company E owed Company F \$1,275,000 for purchase of goods on 7 October 1992. Thus, Company E and Company F arranged for the settlement of the matter by offsetting \$1,275,000 Company E owed Company F and by having Company E paying the remaining balance to Company F.

22. At all relevant times, Mr D and Mrs D were directors and shareholders of Company F and Ms C was one of the two directors of Company E.

The determination

23. The Commissioner upheld the assessment because she was unable to accept the Taxpayer's claim that it acquired the Property as a capital asset for its rental income. The reasons for her determination are summarized as follows:

- (a) The Property was purchased on 6 August 1992 and sold on 17 May 1994. Such short period of ownership was inconsistent with a firm commitment to hold the Property on a long term basis.
- (b) The purchase consideration was financed by directors' advance and a bank mortgage loan. There was no evidence that the directors were willing to advance their loans on a long term basis. Indeed, the advances were classified as 'current liabilities' in the Taxpayer's balance sheets.

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- (c) The Commissioner was not convinced that the Taxpayer was set up for the purpose of building up a long term business relationship between Mr C and Mr D and that the Property was sold when the Property no longer served the purpose. The business relationship factor was only raised by the New Representatives. The Taxpayer's business was in no way related to those of Mr C and Mr D.
- (d) The incidents of the bounced cheques and repossession of goods could not have affected the business relationship of Mr C and Mr D. Furthermore, they happened long before the Property was sold. The sale could not have been prompted by the deteriorated business relationship.
- (e) Neither could the sale have been prompted by the attractive price offered by the purchaser as the Taxpayer's asked for a price higher than the one at which the Property was sold.
- (f) Although the Property was classified as a fixed asset in the accounts, these accounts could not support the Taxpayer's claim as they were approved five months after the sale of the Property.

The relevant statutory provisions

24. The relevant provisions of the IRO are as follows:

- (a) *Section 2(1) defines 'trade' as including every trade and manufacture, and every adventure concern in the nature of trade.*
- (b) *Section 14(1) provides that profits tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits from such trade, profession or business (excluding profits arising from sale of capital assets).*
- (c) *Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant.*

The established legal principles

25. In Lionel Simmons Properties Ltd v CIR [1980] 35 TC 461, HL Lord Wilberforce said:

'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

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acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and possibly, a liability of tax (cf. Sharkey v Wernher [1956] AC 58). What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review.'

26. Mortimer J (as he then was) in All Best Wishes Ltd v CIR [1992] 3 HKTC 750 summed up the position well:

'The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.'

I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? 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. 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

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

27. In Marson v Morton, Browne-Wilkinson, VC (as he then was) said, at 470-471:

'It is clear that the question whether or not there has been [a trade or] 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. The most that I have been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another. ... For convenience I will refer to them in a moment. But I would emphasise that the factors I am going to refer to are in no sense a comprehensive list of all relevant matters, nor is any one of them so far as I can see 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 badges of trading are as follows:

- (a) That the transaction in question was a one-off transaction ...*
- (b) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on ...*
- (c) The nature of the subject matter ...*
- (d) ... the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature? ...*
- (e) What was the source of the finance of the transaction? ...*
- (f) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? ...*
- (g) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? ...*
- (h) What were the purchaser's intentions as to resale at the time of purchase? ...*
- (i) Did the item purchased either provide ... or produce income pending resale?*

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I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive, I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question ... was the taxpayer investing the money or was he doing a deal?’

The Taxpayer’s case

28. The Taxpayer called two witnesses Mr C and Mr D in support of its case. Both of them had prepared witness statements which were in English.

29. Mr D was the first witness. As Mr D stated in his statement that he knew very little English, he was taken through the contents of statement in Chinese. Mr D gave evidence to the following effect.

30. Mr D, Mrs D, Mr C and Ms C were the shareholders, each holding 25% of the issued shares, and the directors, of the Taxpayer, at all the material times. Mrs D and Ms C seldom involved in the decision making of the Taxpayer. The management was mainly taken care of by Mr D, but he left the accounting matters to the Former Representatives.

31. During the period from 16 April 1992 to 16 April 1997, a unit in Building A (‘Property 1’) was owned by Company G. During the period from 31 December 1991 to 16 April 1997, 2 units in Building A (‘Property 2’ and ‘Property 3’) were owned by Company G. At all the material times, Mr D and Mrs D were owners of the issued share capital of Company G which let Property 1, Property 2 and Property 3 to Company F until 1 June 1996, and thereafter to an automobile company. During the letting, Company F used these properties as its warehouse and offices.

32. At all the material times, Company F was a wholesaler of electrical appliances of various brand names and also a dealer in other brands which were supplied by Company E. Company E and Company F ordered goods from each other but Company E ordered from Company F in smaller volumes.

33. Mr D claimed that as both Hong Kong and China were then going through an economic boom, there were huge demands for electrical appliances especially those of Japanese brands. It was a seller’s market. Profit was almost a certainty if supply of goods could be secured. Company E was a good supplier to Company F. Mr C was a veteran dealer in the industry. In order to foster the good business relationship with him, Mr D promoted and formed an association of electrical appliances (‘the Association’) in October 1991. Mr C on behalf of Company E was appointed the president and Mr D on behalf of Company H a vice president. Consequently, through working together on the affairs of the Association, Company E supplied more goods to Company F on credit.

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34. Knowing that one day they would cease to be office bearers of the Association, Mr D invited Mr C to purchase the Property jointly with him so as to maintain the good business relationship. The Property was then subject to a tenancy agreement with a company for a term of 3 years commencing on 1 April 1992 with a monthly rent of \$209,500.

35. Mr D claimed that the Property was a good investment with a good tenant and a good rental income. Although he could go for it on his own, he wanted to share the investment with Mr C. By doing so, he would have many opportunities to see Mr C such as on occasions of signing cheques and reviewing matters with him. Mr D was hoping that he would have larger supplies of two brandnames' products of which Mr C was a wholesaler. Furthermore, the Property was in the same block as his other properties, which could be used for his future business expansion or Mr C could move his office to the Property.

36. Eventually Mr C and Mr D formed a limited company and purchased the Property. They each paid an equal amount towards the purchase price and arranged a bank loan of \$15,300,000. The term of the loan repayment was 7 years with a monthly repayment of about \$220,000 to \$230,000. Thus, after receipt of the rent of \$204,000 per month, each of the four shareholders had to contribute about \$7,000 per month towards the monthly repayment. Mr D viewed the monthly repayment of \$7,000 per shareholder as nominal since both Company E and Company F were doing business to the tune of tens of millions dollars.

37. Mr D told the Board that after the purchase of the Property, his relationship with Mr C improved and every month the business turnover was over \$10,000,000. This lasted for more than a year. However, when the relationship turned sour, the business declined. The relationship started to change after three post-dated cheques issued by Company F to Company E bounced. The goods were sold to Company F on credit. Mr C was upset with the bounced cheques and even took steps to repossess the goods sold to Company F by Company E. Mr D asserted that Mr C regarded the bounced cheques as 'a big matter' while he too regarded the repossession of goods 'a big matter'. From then onward he ceased ordering goods from Company E, and when there were cheques to be signed jointly by them, Mr C would only send them to Mr D for signing. Finally, Mr D, without consulting Mr C, instructed C Y Leung & Company Ltd to sell the Property. When a prospective buyer was found, Mr D asked his manager to call Mr C who at first refused to sell. Mr D waited for three or four days, and asked a member of his staff to call Mr C again and say that if he refused to sell the Property, he and Mrs D would sell their shares in the Company to an outsider. After three or four days Mr C gave his consent to sell the Property.

38. Mr D stressed that he did not understand English nor accounting. Neither did he understand the terms 'current liabilities' and 'directors' advance'. As and when the Taxpayer was short of funds, he and Mr C would each write out a cheque for \$50,000 or \$100,000 but they never thought of having repayment of those sums.

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39. In cross-examination, Mr D explained that he believed the Property was a good investment because it was in the same block as his own properties which would facilitate future expansion of his business. The price was only \$1,000 per square foot. The user of the Property had been changed from industrial to commercial. It could be used as both warehouse and office. It had a high ceiling and was located in a district which was suitable for wholesale business. Another option was that Mr C could move his office to the Property.

40. Mr D said he had no liquidity problem when the Property was sold. He simply wanted to sever his relationship with Mr C. When he instructed C Y Leung & Company Ltd to sell, he had no idea of the prevailing market price of the Property. He wanted to sell the Property even if the price was bad.

41. Upon being questioned by the Board as to whether Mr C and Mr D had any future plans for the Property, Mr D said perhaps they would form a new company for wholesale of electrical appliances. When the tenant left, they could use the Property for their new company. As to whether they had any arrangement for the repayment of the monthly mortgage repayment, he said since the shortfall was minimal, there was no arrangement. They simply wrote out cheques for \$50,000 or \$100,000 as and when funds were needed. They intended that this would go on for 7 years, the term of the mortgage repayment. Mr D could not recall whether there were other bounced cheques, apart from the ones mentioned previously and he could not recall exactly when repossession of goods took place but it happened after the bounced cheques. As to whether instructions were given to the Former Representatives that the Property was sold because of the good price, Mr D said he had never given such instructions to the Former Representatives. As to whether the Former Representatives knew about their worsening relationship, Mr D said that they knew they were not on good terms but they did not know it was so bad. As the bounced cheques happened shortly after the purchase of the Property, Mr D was asked whether the purchase of the Property caused the shortage of cash. Mr D explained that his funds were tied up in the other goods he purchased.

42. Mr C was called as the second witness for the Taxpayer. He had also prepared a witness statement which was put in as part of the evidence-in-chief. Mr C corroborated Mr D's evidence. He claimed that Mr D invited him to jointly invest in the Property for rental income purpose and after inspecting the Property, as a gesture of good-will, he agreed. He also claimed that after the purchase of the Property, Company F failed to honour its cheques on various occasions and he and Mr D had several quarrels over the dishonoured cheques and he even sent trucks to repossess goods from Company F's office. As a result, Mr D talked to him less and less and eventually Mr D suggested the sale of the Property. When he refused, Mr D threatened to sell his and his wife's shares to a third party. Finally, he agreed to sell. He was not involved in the accounting matters of the Taxpayer and he did not pay attention to the classification of the directors' loans as 'current liabilities'. He could not recall when repossession of goods took place, perhaps a few months after the purchase of the Property. He claimed that business was good for both of them for quite some time after the purchase of the Property. He agreed that they

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had no arrangement regarding the mortgage repayment as he regarded the repayment quite nominal. He also claimed that he had a two-pronged approach to this investment, if the tenant moved out, he and Mr D could form a company and start a business or he could rent the Property from Mr D.

The Respondent's (the Revenue's) case

43. The Respondent emphasized the short period of ownership of the Property by the Taxpayer. As opposed to the Taxpayer's stated intention, the Taxpayer only held the Property for 21 months.

44. Mr D wanted the trust and support of Mr C. Mr Chiu representing the Respondent submitted that if Mr D wanted to impress Mr C, he could not have done it by the Property's good rental yield but by its good trading yield.

45. The Respondent argued that the bounced cheques and repossession of goods could not have prompted the sale of the Property. Those incidents were common in the trade of electrical appliances.

46. The Respondent submitted that it was apparent from the facts that the Taxpayer was 'doing a deal' and that no other conclusion was possible or substantiable. The Respondent took us through the badges of trade as enumerated by Sir Nicolas Browne-Wilkinson and submitted that each and every one of them was satisfied in the present appeal.

The evidence and our findings

47. The relevant legal principles are well established. In considering whether the transaction was an adventure in the nature of trade, one asks the crucial question what the person's intention was at the time of acquisition of the asset (Simmons v CIR 35 TC 461). Furthermore, one bears in mind that the onus is on the taxpayer to prove that the assessment appealed against is incorrect.

48. We have considered the detailed and careful submission of Mr Lee representing the Taxpayer. We accept that when the taxpayer is a company, it is only through the ascertainment of the intention of those who control it, can the intention of the company be ascertained. Accordingly, Mr C and Mr D, being the driving force behind the Taxpayer, their intention would be relevant and crucial in the present appeal.

49. Mr Lee submitted that it was the intention of Mr C and Mr D to acquire the Property as a long term investment. He claimed that their expressed intention was supported by the facts that the Property was purchased with a sitting tenant with a rental yield of 11.5%. It was held for 21 months and was sold with the sitting tenant. It was also immediately above the property owned by

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Mr D who desired that the Property could be used in case of future expansion of Company F. Finally, it was also supported by Mr D's primary aim that the business relationship with Mr C could be strengthened through the Property. In our view, those facts did not necessarily support the Taxpayer's expressed intention. A property with a good rental yield serves equally well as a trading stock. The Property with its stated qualities could be a sound investment as well as a good trading stock. The Taxpayer sold the Property with the same sitting tenant after 21 months of ownership. This action was at odds with its expressed intention. The principle that a company is a separate entity from its shareholders is well known. The claim that Mr D desired the Property to be used in Company F's future expansion, is not supportive of the expressed intention. This factor would be meaningful if Mr D owned the entire share capital of the Taxpayer. As it was, the Property was owned by the Taxpayer. Thus it was of no consequence to Mr D. As to Mr D's primary aim that the Taxpayer's ownership of the Property could strengthen his relationship with Mr C, we view that the Property could serve the same purpose whether it was acquired as a long term investment or a trading stock. Our attention was also drawn to the fact that the Property was classified as fixed assets in the Taxpayer's financial statements. Since those financial statements were self-serving documents and, as rightly pointed out by Mr Chiu, they were prepared after the sale of the Property, we should test them against the other evidence available.

50. Mr Chiu asked us to note the accounting treatment of the directors' loans which had been classified as current liabilities in the Taxpayer's financial statements. Since Mr C and Mr D had no knowledge of accounting, perhaps they really did not appreciate the significance of such classification of the directors' loans. That being the case, we should also test this piece of evidence against the surrounding facts.

51. When the Board asked whether there were minutes regarding the purchase of the Property by the Taxpayer, the Taxpayer produced a copy of the minutes of a directors' meeting held on 4 August 1992, resolving that the Property should be purchased by the Taxpayer at the price of \$21,952,100 and that Mr C and Mr D should sign the agreement for sale and purchase of the Property on behalf of the Taxpayer. There was no mention whether the Property was acquired as a trading stock or as a long term investment. There were no other contemporaneous records indicating that the Property was acquired as a long term investment.

52. Both Mr Lee and Mr Chiu took us through the various badges of trade. They are general indicators which may or may not apply in every case. We do not intend to go through them here again but needless to say, we have carefully considered each and every factor urged upon us.

53. As Sir Nicholas Browne-Wilkinson, VC said in the Marson case '*... in order to reach a proper factual assessment in each case, it is necessary to stand back, having looked at those matters and look at the whole picture and ask the question ... was the taxpayer investing the money or was he doing a deal?*' With this in mind, we now turn to the evidence given by Mr C and Mr D.

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54. Mr C and Mr D were business associates. They were doing business together and formed an association in October 1991, of which they were office bearers. After the formation of the Association, their orders of goods from each other were substantial. Mr D claimed that in the hope of strengthening their business relationship, in about August 1992 he invited Mr C to purchase the Property jointly with him, as a long-term investment. Mr C as a gesture of good-will, accepted his invitation. These are self-serving statements. Are they credible? Mr C and Mr D were two seasoned businessmen. Their relationship was purely on a business level. On Mr D's evidence, the relationship was one which needed to be cultivated. Mr Chiu contended that if Mr D wished to win Mr C's trust and good-will, a property with a good trading yield would be more impressive than a property with a good rental yield. Mr C claimed that he acquired the Property for its rental income. Although the Property was producing rental income of \$204,000 per month, not only was Mr C unable to pocket his share of the rental income, he was required to pay out not less than \$7,000 per month towards the mortgage repayment. Thus, Mr Chiu's submission that they were doing a deal, is more persuasive. Furthermore, the ad hoc arrangements on the mortgage repayments seem to suggest that the Property was not for a long term.

55. Mr D claimed that he had alternate plans for the Property which could be used for Company F's future expansion, a new company with Mr C or Mr C's office. Were these plans genuine realistic and realisable? These plans were not mentioned to the assessor by the Former Representatives nor the New Representatives during the course of investigation. Moreover, when Mr D decided to sever his relationship with Mr C, no attempts were made by Mr D to acquire Mr C's share of the Property even though, as submitted by Mr Lee, the Property had its added value to Mr D because it was over his other properties in the block. Instead, he quickly gave instructions to sell.

56. During the course of investigation, the Former Representatives explained to the assessor that the Property was sold because of the good price but after the change of tax representatives, the New Representatives explained that the Property was sold because of the dispute between the two groups of shareholders. Mr D alleged he decided to sell the Property after the relationship between him and Mr C turned sour because of a few dishonoured cheques issued by Company F to Company E and repossession of goods by Company E. They were cheques dated 15 August 1992, 3 October 1992 and 26 October 1992 respectively. As to the repossessions of goods, both Mr C and Mr D could not remember when they took place but they were after the dishonoured cheques. From the information supplied to the assessor during investigation, the repossessions took place in September and November 1992 and in September 1993. In cross-examination, Mr Chiu asked Mr D whether or not he found the purchase price of the Property attractive and whether or not he cared if it was not a good price. We find Mr D's answers to these questions most evasive and less than frank. His answers were: 'I sold mainly because of bad relationship', 'with that incident I don't want to see him. That is why I want to cut off my ties with him. That is why I want to sell.' 'When I ask Mr Leung's company to sell it, I don't know what is the asking price in the market.' Mr D finally confirmed to Mr Chiu that he would sell the Property even if the selling price was bad. Mr D was trying so hard to impress upon

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us that he was so fed up with the situation that he wanted out immediately regardless of the cost. This sentiment does not seem to accord with the reality of the matter. On the evidence, Mr C and Mr D fell out with each other as a result of the bounced cheques issued in August and October 1992 and the repossession of goods in September and November 1992 and in September 1993. These incidents took place long before Mr D's instructions to C Y Leung & Company Ltd to sell the Property. When Mr D was questioned by the Board as to whether Mr Eric Li of the Former Representatives, knew about the worsening relationship between him and Mr C, Mr D replied that Mr Li knew that they were not on good terms but did not know it was so bad. Indeed, we accept that there was a fallout but not one that would cause two shrewd businessmen to throw caution to the winds. The bounced cheques took place in August and October 1992, the repossession of goods in September and November 1992 and September 1993 and the instructions to C Y Leung & Company Ltd in March 1994. With the time gaps between the incidents, it is difficult to perceive that the sale of the Property was prompted by the dishonoured cheques and repossessions of goods. We observe from the letter of C Y Leung & Company Ltd to the Taxpayer of 16 March 1994 that prior to that letter, there was a meeting between the writer of the letter and Mr D and Mrs D and instructions to sell were given as a result of the meeting. The letter confirmed Mr D's instructions for the intended sale of the Property, the marketing strategy and campaign and the sale price and other sale terms. The intended sale appeared to be well planned and was not as hasty and cavalier as Mr D would like us to believe.

57. Mr D claimed that the management of the Property was not functioning properly as a result of their worsening relationship, which was also a reason prompted the sale. Since the Property was tenanted, the tenant's rents and mortgage repayments were auto-paid through banks, there left very little to be managed. The management factor which also prompted the sale is unconvincing.

58. Mr C was present while Mr D was giving his evidence. Mr C's evidence simply corroborated that of Mr D. As it is, there is nothing in it which would affect our finding as aforesaid.

59. The Taxpayer's case is that the Property was acquired as a long term investment. Its stated intention is not decisive and has to be tested against the whole of the evidence. Taking all the factors into accounts and giving full weight to Mr Lee's able arguments, we are of the view that there is insufficient evidence to establish that the Property was acquired as a long term investment. Moreover, the resale of the Property was not satisfactorily explained. We therefore conclude that the Property was purchased by the Taxpayer as a trading stock with the intent to dispose it at a profit at an appropriate time.

60. The above decision is reached by this Board with two members against one. Accordingly, the appeal is dismissed and the assessment is hereby confirmed.

61. We would like to record our appreciation of the careful and detailed submissions of both Mr Lee and Mr Chiu in this appeal.