Case No. D13/10

Profits tax – gain on disposal of properties – sum of deposits forfeited from cancellation of the sale of a property – whether properties are trading stock or long-term capital investment – section 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Horace Wong Yuk Lun SC (chairman), Andrew S Y Li and Horace Wong Ho Ming.

Dates of hearing: 28 and 31 December 2007.
Date of decision: 14 June 2010.

The Assessor considered that Property A, Property B and Property C were the Appellant's trading stock such that the gain on disposal of Property A and Property B, and the sum of deposits forfeited from cancellation of the sale of Property C should be assessable profits for the year of assessment 1997/98.

The Appellant contended that the gain on disposal and the sum of deposits forfeited of the properties were capital in nature and should not be chargeable to profits tax.

Alternatively, the Appellant contended that if the properties it bought and sold were its trading stock, the diminution in market value of the replacement properties which remained unsold at the balance sheet date should be taken into account in arriving at the correct assessable profits.

Held:

1. Section 14(1) of the IRO makes all assessable profits chargeable to profits tax. The only relevant exception is 'profits arising from the sale of capital assets'.

2. It is for the taxpayer to prove that an asset was a capital asset; it is not for the Commissioner to prove that it was a trading stock.

3. The Appellant has failed to discharge its burden in regard to Property A, Property B and Property C:

   3.1 Property A – Acquired and held with a trading intention as the Appellant disposed of Property A within such a short time (and before it had even completed the purchase).

3.2 Property B – No credible or otherwise satisfactory evidence that supports the long-term investment claim.

3.3 Property C – A trading asset in view of the shortness of time between the time of purchase and the time of sale, and the magnitude of the profit that it would have made.

4. The Appellant had not claimed in its profits tax return that the other properties were acquired by it as trading assets. The Appellant cannot now turn around to alternatively claim that the assessor should have made his assessment on such basis.

Appeal dismissed.

Cases referred to:

Commissioner of Inland Revenue v The Board of Review, exparte Herald International Ltd [1964] HKLR 224
Real Estate Investments (NT) Limited v Commissioner of Inland Revenue [2007] 1 HKLRD 198
Rhesa Shipping Co SA v Edmunds and another [1985] 1 WLR 948
Mok Tsze Fung v Commissioner of Inland Revenue [1962] HKLR 258
All Best Wishes Ltd v Commissioner of Inland Revenue [1992] 3 HKTC 750
Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773
Yau Wah Yau v Commissioner of Inland Revenue [2006] 3 HKLRD 586
Commissioner of Inland Revenue v Common Empire Ltd [2006] 1 HKLRD 942
Li Tin Sand v Poon Bun Chak & others, CACV 153 of 2002
Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196
Commissioner of Inland Revenue v Quitsubdue Limited [1999] 3 HKC 233
Marson (Inspector of Taxes) v Morton & others [1986] 1 WLR 1343

Tse Yue Keung of Settlewise Consultants for the taxpayer.
Eugene Fung Counsel instructed by the Department of Justice for the Commissioner of Inland Revenue.

Decision:

Appeal

1. This is an appeal against the Determination ('Determination') of the Deputy Commissioner of Inland Revenue ('Commissioner') dated 6 September 2007 whereby the Commissioner determined that the Appellant's profits tax assessment for the year of

assessment 1997/98 be reduced from $17,026,233 to $17,002,723, with tax payable thereon reduced from $2,528,395 to $2,524,904.

2. In arriving at the said profits tax assessment, the Commissioner determined that:

(a) the gains derived by the Appellant from the disposals of 2 properties, namely, Shop H, Address J ('Property A') and Flat K, Address L ('Property B') were gains chargeable to profits tax;

(b) the deposits forfeited by the Appellant in respect of the sale of another property, namely, ('Property C') should be chargeable to profits tax.

Agreed facts

3. In the Determination, the Commissioner set out certain facts upon which the Determination was arrived at. By a letter dated 3 December 2007, the Appellant's representative indicated that the Appellant agreed to the facts set out in paragraphs 1(1) to 1(19) of the Determination. We set out these agreed facts (insofar as they are relevant) in paragraphs 4 to 26 below.

4. The Appellant is a private limited company incorporated in Hong Kong on 17 February 1989. At all relevant times, the Appellant's issued and fully paid share capital was $900,000, divided into 900,000 ordinary shares of $1 each. Its directors and shareholders were Mr M, Mr N and Mr P. The Appellant closes its accounts annually on 31 March.

5. By a provisional agreement for sale and purchase dated 26 October 1996, the Appellant purchased Property A at a price of $33,100,000.

6. By a provisional tenancy agreement dated 31 December 1996 ('Shop H1 PTA'), the Appellant agreed to let Shop H1, Address J ('Shop H1') (partitioned from Property A) to a tenant at a monthly rental of $118,000 for a term of two years commencing from 5 May 1997. Shop H1 PTA included, among other things, the following terms:

(a) the agreement should be valid only if the Appellant succeeded in purchasing Property A and became the legal owner of the property. If the Appellant failed to purchase Property A, it was required to refund the paid deposit to the tenant without interest and the agreement would be rescinded [clause 18].

(b) the Appellant agreed that if it sub-sold Property A, the property would be sold together with the tenancy [clause 19].

(c) the tenant agreed to give the Appellant post-dated cheques for rent of twenty-three months when formal tenancy agreement was signed [clause 20].

7. By a provisional tenancy agreement dated 16 January 1997 ('Shop H2 PTA'), the Appellant agreed to let Shop H2, Address J ('Shop H2') (partitioned from Property A) to another tenant at a monthly rental of $128,000 for a term of two years commencing from 5 May 1997. Shop H2 PTA included, among other things, similar terms as the Shop H1 PTA referred to in sub-paragraphs 6(a), (b) and (c) above.

8. By a provisional agreement for sale and purchase dated 25 February 1997, the Appellant, as confirmor, agreed to sell Property A with the above tenancies at a price of $42,000,000. The scheduled completion date was 28 April 1997. The Appellant subsequently rescinded this provisional agreement. It paid compensation to the purchaser and commission to the property agent.

9. By a provisional agreement for sale and purchase dated 18 March 1997, the Appellant, as confirmor, sold Property A together with the above tenancies to a purchaser at a price of $50,000,000.

10. On 28 April 1997, the Appellant completed the purchase of Property A.

11. On 29 April 1997, the Appellant entered into 2 tenancy agreements to let Shops H1 and H2 respectively to the tenants referred to in paragraphs 6 and 7 above.

12. The Appellant's sale of Property A was completed on 16 July 1997.

13. (a) By an agreement for sale and purchase dated 3 October 1995, the Appellant purchased Property B at a price of $4,562,000. The purchase was completed on 2 November 1995;

(b) By an agreement for sale and purchase dated 10 March 1997, the Appellant sold Property B at a price of $7,820,000;

(c) The sale was completed on 28 April 1997.

14. (a) By an agreement for sale and purchase dated 28 August 1997, the Appellant purchased Property C at the price of $9,200,000. The purchase was completed on 20 September 1997;

(b) By a provisional agreement for sale and purchase dated 7 October 1997, the Appellant sold Property C at a price of $15,000,000. The purchaser subsequently cancelled the transaction and the Appellant forfeited the deposits paid by the purchaser in the total amount of $1,500,000.

15. By an agreement for sale and purchase dated 4 June 1997, the Company purchased Shops Q, R, S, T and U, Address V ('Property D') at the price of $90,600,000. The Appellant, as confirmor, subsequently sold Property D at a price of $96,700,000. The sale was completed on 20 October 1997.

16. In its pofits tax return for the year of assessment 1997/98, the Appellant declared that its principal business activity was investment in properties / letting of properties and that its adjusted loss for the year was $1,222,651. In arriving at this figure, the Appellant had, among other things,

(a) included net profit on sub-sale of Property D;

(b) excluded profits on disposal of certain properties (see paragraph 17 below) on the grounds that such properties were its investment properties;

(c) excluded the forfeited deposits of Property C (that is, $1,500,000 as referred to in paragraph 14(b) above) on the grounds that the property was its investment property and that the sum was capital in nature; and

(d) deducted a rebuilding allowance of $4,990 (that is, $249,500 x 2%) for Property C.

17. The Appellant enclosed in its return its audited financial statements and profits tax computation with supporting schedules for the year ended 31 March 1998 which included, among other things, the following:

Profit and loss account

Turnover	$10,996,774
Operating (Loss)/Profit	($2,142,841)
Exceptional items	
Compensation received for cancellation of the agreement for sale of Property C	$1,500,000
Gain on disposal of leasehold/investment properties in continuing operations	$19,604,645
Profit from ordinary activities before taxation	$18,961,804

Note 12 to the account showed that the turnover comprised the following categories of revenue:

Rental income from properties	$4,896,774
Difference between sale and purchase prices for sub-sale of Property D	$6,100,000
	$10,996,774

The Appellant confirmed that the total rental income of $4,896,774 was derived from the rentals received from Property A and Property C, and some other properties held by the Appellant. Insofar as the rentals were derived from Property A and Property C, they were as follows:

Property	Period of letting	Amount
Property A	18-5-1997 – 16-7-1997	$476,129
Property C	20-9-1997 – 31-3-1998	$378,520

Schedule 10 to the audited financial statements further described the reason for disposal of Property A and Property B as follows:

Property	Reason for disposal
Property A	Change of investment portfolio
Property B	Change of residence of a director

18. In response to the assessor's enquiries concerning the purchases and sales of Property A and Property B, Company W alleged [by a letter dated 23 September 1999] the followings:

Property A

(a) The acquisition of Property A was financed by the Appellant's own fund of $12,136,665 and a loan of $23,000,000 from Bank X repayable by 120 monthly installments of $307,139.71 each.

(b) '[The Appellant] is a property investment company owned and run by three brothers who are traditional Chinese merchants. They carried out the feasibility study from time to time by holding meetings among themselves, their bankers and other professionals. The research / study on valuation of the property with regard to the market price and the rate of return on investment was conducted by consulting with professional valuers directly and/or through bankers.'

(c) 'The [Appellant's] directors commenced to look for tenants for Property A immediately after the [Appellant] had entered into the agreement for purchase of Property A in late 1996.'

(d) '... the [Appellant] had succeeded in letting out one of the two shops of Property A in December 1996 at a monthly rental of $118,000 and the other in January 1997 at a monthly rental of $128,000 through [Company Y], which was also agent of the [Appellant] in the purchase of Property A.'

(e) 'The rate of return on investment of 8.4% (that is, ($118,000 + $128,000) x 12 / $35,136,665 x 100%) was absolutely regarded by the property market as a very satisfactory rate of return at the time of acquisition of the property.'

(f) 'In February 1997, the [Appellant] was approached by another property agent, Company Z (which does not have any relationship with the [Appellant's] directors and shareholders), for sale of Property A because there were potential buyers offering $42,000,000 for purchase of Property A. Despite that a provisional agreement for sale and purchase of Property A was entered into on 25 February 1997, the [Appellant] finally rescinded the agreement even though it was required to pay commission of $630,000 and compensation of $1,000,000 as a result of the rescission. This is because the directors of the [Appellant] were then determined to hold Property A for long-term investment (or rental) purposes after having carefully considered that the rate of return on capital was still as high as 7% (that is, ($118,000 + $128,000) x 12 / $42,000,000 x 100%) despite that the market value of Property A had risen from the acquisition cost of $35,136,665 to $42,000,000.'

(g) In March 1997, Company Z recommended the Appellant to sell Property A at a consideration of $50,000,000 and buy another property at Address AA (this property has been referred to in the Determination as 'Property G'. For convenience and in order to avoid confusion, the same will similarly be so referred to in this Decision), at a consideration of $52,900,000.

(h) The Appellant finally entered into a provisional agreement for sale of Property A on 18 March 1997 after considering the following reasons:

(i) The rate of return on Property A dropped from 8.4% to 5.9% (that is, ($118,000 + $128,000) x 12 / $50,000,000 x 100%);

(ii) The Appellant could realize a capital gain of $13,774,710 which amounted to 39.2% of the acquisition cost of $35,136,665 and would otherwise take about 4.6 years for the Appellant to achieve, assuming that the rental income and the interest rate would remain unchanged;

(iii) The number and position of Property G were even better than those of Property A. The area of Property G was about 1,106 square feet, which was about 50% larger than that of Property A. The ceiling of Property G was much higher than that of Property A. Property G included a mezzanine floor with separate title deed but there was no mezzanine floor attached to Property A;

(iv) The purchase consideration of Property G was just $2,900,000 or 5.8% more than the sale consideration of Property A, so the rate of return or investment potential of Property G should be much higher than that of Property A.

(i) After the completion of the sale of Property A on 16 July 1997, the Appellant entered into a provisional agreement for purchase of Property G at a consideration of $52,900,000 on 26 July 1997. Due to the significant decline in property prices after July 1997 and the argument between the Appellant and the vendor of Property G on the existence of unauthorized or illegal structure in the property, the consideration was reduced from $52,900,000 to $34,800,000 with completion date of the transaction postponed to 30 September 1998.

(j) After completion of purchase of Property G, the Appellant entered into two tenancy agreements in early October 1998 for letting out two shops of Property G at the rate of return of 5.9% (that is, ($90,000 + $80,000) x 12 / $34,800,000 x 100%). Despite the market value of Property G falling from $34,800,000 to about $18,000,000, the Appellant still held the property and the current rate of return was as high as 11.33% (that is, $170,000 x 12 / $18,000,000 x 100%).

(k) No written record was kept in respect of the feasibility study for Property A or the directors' meetings in relation to investment decisions.

Property B

(l) Purchase cost and sale price of Property B were $4,687,455 (included purchase consideration of $4,562,000 and stamp duty of $125,455) and $7,820,000 respectively;

(m) The acquisition of Property B was financed by a loan of $3,193,000 from Company AB repayable by 180 monthly installments, a loan of $912,400 from the property developer repayable by 144 monthly installments starting from October 1998, and the Appellant's own fund of $582,055;

(n) The usage of Property B was as follows:

Period covered	Usage
2-11-1995 – 31-8-1996	Director's residence
1-9-1996 – 31-3-1997	Let out for rental income
1-4-1997 – 28-4-1997	Vacant

19. In response to the assessor's further enquiries concerning the alleged usage of Property B, Company W asserted [by letter dated 13 June 2003] that:

(a) none of the Appellant's directors had reported Property B as quarters in their individual tax files;

(b) Property B was used by the Appellant for providing temporary residence to several major Taiwanese suppliers of the Company when they visited Hong Kong;

(c) Property B was let to a related company during the period from September 1996 to 31 March 1997. No tenancy agreement was signed.

20. Concerning Property A and Property B (and 2 other properties with which this appeal is not concerned), Company W further contended that:

(a) The Appellant purchased the properties with an intention for long-term investment purposes. Such intention could be evidenced by its borrowing of long-term bank loans to finance the purchases; by its classification of the properties as investment properties or leasehold properties in the financial statements; by its long period of ownership and by its plenty of effort to look for desirable tenants when the properties were vacant;

(b) The rental income earned was at arm's length basis and had been subjected to profits tax;

(c) The properties were not sold for profit-making purpose but just for releasing the funds and the Appellant's borrowing capacity tied up therein so as to finance the purchase of Property C and four other properties. All of them were still held by the Appellant for long-term rental income proposes, as directors' quarters and as offices of the Appellant and its related companies;

(d) The past history of the Appellant indicated that it was not a speculator of properties but a long-term investor of properties.

21. The Assessor considered that Property A, Property B and Property C were the Appellant's trading stock. Hence the profits arising from the sales of Property A and Property B, and the deposits forfeited from cancellation of the sale of Property C were revenue in nature and chargeable to profits tax. Accordingly, the Assessor issued to the Appellant a profits tax assessment for the year of assessment 1997/98 which included, inter alia, the gain made by the Appellant on disposal of Property A and Property B, and the amount of deposits forfeited from cancellation of the sale of Property C.

22. On behalf of the Appellant, Company W objected [by letter dated 16 April 2004] to the profits tax assessment issued by the Assessor on the grounds, inter alia, that the gain on disposal of Property A and Property B and the deposits $1,500,000 forfeited from cancellation of the sale of Property C were capital in nature and should not be chargeable to profits tax (there was also another ground of objection in respect of the adjustment of the rebuilding allowance in respect of Property A, but this is no longer an issue in the present appeal).

23. In support of the objection, Company W and Settlewise Consultants ('SC'), jointly acting on behalf of the Appellant, furnished further documents and made the following assertions and submissions to the Commissioner:

Property A

(a) The intention of the Appellant at the time of acquisition of Property A was for long-term investment purpose despite that the holding period was about six months;

(b) The supplementary clause 18 to the provisional tenancy agreements for Shops H1 and H2 was insisted upon by the respective tenants to protect their right. Besides, it protected the Appellant from being claimed by the tenants if the purchase of Property A by the Appellant could not be completed (which was not uncommon at that time because the vendors might rescind the agreement if they considered that their properties had been sold at a price lower than the market price);

(c) The supplementary clause 19 to the provisional tenancy agreements for Shops H1 and H2 was insisted upon by the respective tenants to protect their right;

(d) The supplementary clause 20 to the provisional tenancy agreements for Shops H1 and H2 indicated that the Appellant intended to hold Property A for long-term purpose;

(e) There was no need for the Appellant to incur expenses for writing up formal feasibility study reports as investment in the property did not involve complicated calculations and the Appellant was just a small property investment company;

(f) '... when the rental income increased with respect to the increase in value of the property, it would be sufficient to cover the loan repayment later. It's unfair to argue that the Appellant cannot keep the property as a long-term investment simply because the rental income received was less than the monthly installment of the mortgage loan at the early stage.'

(g) ‘The monthly installment of the mortgage loan of $307,139.71 just exceeded the monthly rental income of $246,000 by $61,139.71. This shortfall could easily be covered by income from the other business of the [Appellant’s] directors.’

(h) ‘A company has properties held for long-term investment purposes can also have properties for sale according to the investment portfolio theory. We therefore cannot see how the only sub-sale of [Property D] can have any effect on the intention of acquisition of Property A, not to mention that the [Appellant] had acquired many more properties for long term investment purposes instead of for trading.’

(i) ‘The sale of Property A just 3 to 4 months after the purchase of the same property at a large profit also does not necessarily mean that it is contrary to the [Appellant’s] intention to hold Property A for long term purpose. There can be change of intention in the course of business. Indeed, it is commercially sound to sell a property with a good return instead of holding it for a long period of time if there is a purchaser willing to pay a higher price to acquire the property.’

(j) On 28 April 1997, the Appellant completed the purchase of Property A and had since incurred expenditure of $62,000 to partition the property into Shop H1 and Shop H2 for the purpose of letting. To divide Property A into the two shops by partitioning was not making it more saleable but just for making it easier to let, which was consistent with the Appellant’s long-term investment purpose.

(k) Property A’s eligible cost ranking for rebuilding allowance had already been excluded in the calculation of rebuilding allowance in the Company’s profits tax computation for the year of assessment 1997/98.

Property B

(l) ‘During the period from 2 November 1995 to 31 October 1996, Property B was used as temporary residence for the [Appellant’s] several major Taiwanese suppliers when they visited Hong Kong. As the Appellant’s business of trading in cloths was taken over by a related company, [Company AC] …... such that the Appellant became a purely property investment company with effect from 1 April 1996, monthly rental of $25,000 was charged by the Appellant on [Company AC] for the period from 1 April 1996 to 31 October 1996.’

(m) ‘The exact dates on which (the Taiwanese suppliers) moved in / out from Property B when they visited Hong Kong cannot be ascertained now as the Appellant did not keep any such records which were then regarded as meaningless by the directors of the Appellant.’

(n) 'As the Taiwanese suppliers visited Hong Kong less and less frequently in the late 1996, [Company AC] ceased to rent Property B based on a commercial point of view';

(o) 'No tenancy agreement was signed between the [Appellant] and [Company AC] and no specific terms of tenancy were agreed. The rental paid was mutually agreed and determined with reference to market rental.'

(p) 'During the vacant period from 1 November 1996 to the date of disposal, Property B was occupied by the children of the directors for study purposes as the need might arise because no suitable tenant could be found.'

(q) Photocopies of electricity, water and gas bills for the period from November 1995 to December 1996 were provided by the Appellant to the Revenue.

(r) 'The [Appellant] explained that the electricity, water and gas bill proved that Property B had been occupied for use by the [Appellant] either in receiving its Taiwanese supplier family members (who were in-law of the [Appellant's] directors) or for casual use by the family members of the [Appellant's] own directors ... On the contrary, the Appellant explained that the charges were plainly not incurred in attracting buyers for Property B.'

(s) A schedule of comparison between the monthly loan repayment and the rental income in respect of Property B for the period from 2 November 1995 to 28 April 1997 was provided to the Revenue.

(t) The excess of monthly installment of the mortgage loan over monthly rental income was financed by income from other business of the Appellant's directors.

(u) The Appellant decided to sell Property B because no suitable tenant could be found and it was too expensive and not necessary to keep the property for the study purpose of its directors' children in the long term.

(v) The second mortgage loan from the developer caused the purchase price to be about 5% higher than the normal purchase price. If the Appellant had the intention for short-term speculation at the time of acquisition of Property B, there was no need to bear such 5% additional cost of purchase.

Property C

(w) Property C had been held for long-term rental purpose and classified as investment property in the Appellant's accounts. The deposits forfeited were capital in nature and therefore should not be chargeable to profits tax.

24. By a letter dated 19 March 2007, the Assessor issued a statement of facts to Company W for comment.

25. In its reply dated 5 June 2007, SC, amongst other things:

(a) reiterated that Property A, Property B and Property C should not be considered as acquired by the Appellant for trading purposes; and

(b) argued alternatively that even assuming the Appellant had embarked upon a property dealing business in the year of assessment 1997/98, the correct assessable profits for the said year of assessment should be ascertained in accordance with ordinary commercial accounting principles. Hence, the assessable profits should take into account the fall in the market values of other properties which had also been acquired in the year of assessment 1997/98 but remained unsold at the end of this basis period.

26. The Assessor maintains that Property A, Property B and Property C were the Appellant's trading stock and hence the gains on disposal of Property A and Property B and the deposits forfeited from cancellation of sale of Property C should be chargeable to profits tax. Since the Assessor agrees with the Appellant's claim concerning the rebuilding allowance for Property A (a matter which is not an issue in the present appeal), he accordingly proposed to revise the profits tax assessment previously issued to $17,002,723 (with revised tax payable thereon at $2,524,904).

27. By the Determination, the Commissioner rejected the objection of the Appellant and determined that the 1997/98 profits tax assessment be reduced to $17,002,723 as proposed by the Assessor.

Grounds of appeal

28. The Appellant's Grounds of Appeal are as follows:

'(1) The gain on disposal of the properties and a sum of deposits forfeited from cancellation of a sale of property as determined by the [Commissioner] as assessable profits were capital in nature and should not be subject to tax; the [Appellant] sold the properties in question in order to improve its property investment portfolio and subsequent [sic] purchased certain replacement properties.

(2) If the properties bought and sold by the [Appellant] were its trading stock, so were the replacement properties which remained unsold at the balance sheet date. Hence the diminution in their market value at the balance sheet date should be taken into account in arriving at the [Appellant's] correct assessable profits.

(3) In determining the objection, the [Commissioner] steps into the shoe of the assessor who is under a statutory duty to assess the correct amount of the assessable profit. The reasons ....given by the [Commissioner] to the effect that *"the [Appellant] has never argued that they (the replacement properties) were trading stock, it follows that the diminution in the market value of them, if any, remains the [Appellant] loss of capital"* is oppressive and erroneous in law: whether they remain a loss of capital does not depend on whether the [Appellant] has argued this point; and if the [Appellant] has not argued this point, the [Commissioner] would not have given such reasons.

(4) The assessment as determined by the Deputy Commissioner is excessive or otherwise incorrect.'

The appeal hearing

29. At the hearing of the appeal, the Appellants were represented by Mr Tse Yue-keung of SC. The Respondent was represented by Mr Eugene Fung of counsel.

30. Only one witness was called by Mr Tse to give evidence on behalf of Appellant. The witness called by him was Mr N, a director and shareholder of the Appellant.

31. Mr Fung did not call any witness.

Board's decision

Onus of Proof

32. By virtue of section 68(4) of Inland Revenue Ordinance ('IRO'), the onus of proving that the assessment appealed against is excessive or incorrect shall be on the Appellant.

33. Mr Fung has referred us to the well-known case of Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224. In a frequently quoted judgment, Blair Kerr J made the following observations with regard to the burden of proof (at pages 229 and 237):

'*According to section 68(3) the assessor attends the hearing before the Board "in support of the assessment", but the onus of proving that "the assessment as*

determined by the Commissioner…. is excessive" is placed fairly and squarely on the appellant by section 68(4)…..

The question for the Board of Review is not whether the Commissioner erred in some way, but whether the assessment is excessive. As Mr. Sneath so aptly put it:-

"The question is: 'Did the Commissioner get the correct answer'; not 'did the Commissioner get the correct answer by the wrong method'."

And the onus of proving that the assessment is excessive lies on the taxpayer-appellant.'

34. In the context of profits tax, as Andrew Cheung J put it in his judgment in Real Estate Investments (NT) Limited v Commissioner of Inland Revenue [2007] 1 HKLRD 198 at 214E-G:

'*Section 14(1) of the Inland Revenue Ordinance (Cap.112) makes all assessable profits chargeable to profits tax. The only relevant exception is "profits arising from the sale of capital assets." Section 68(4) places the burden of proving an assessment incorrect on the taxpayer. In other words, it is for the taxpayer to prove that the profits in question arose from the sale of a capital asset, and therefore they were not chargeable to tax and thus the assessment was wrong. If he fails to prove that the asset in question was a capital asset, his appeal against the assessment must fail. Put another way, for the purpose of an appeal, it is for the taxpayer to prove that an asset was a capital asset; it is not for the Commissioner to prove that it was a trading stock – he may, if he so chooses, simply sit back and put the taxpayer to proof.* ***Commissioner of Inland Revenue v. Common Empire Ltd.*** *[2006] 1 HKLRD 942.' (underline added)*

35. As the onus of proving that the assessment is excessive or incorrect rests with the taxpayer, failure to discharge the onus would be decisive against him: see, Rhesa Shipping Co SA v Edmunds and another [1985] 1 WLR 948, Mok Tsze Fung v Commissioner of Inland Revenue [1962] HKLR 258, All Best Wishes Ltd v Commissioner of Inland Revenue [1992] 3 HKTC 750, Cheung Wah Keung v Commissioner of Inland Revenue [2002] 3 HKLRD 773, Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue (supra).

36. As Tang JA (as he then was) observed in Yau Wah Yau v Commissioner of Inland Revenue [2006] 3 HKLRD 586 (at 607D-E), if a taxpayer presented a case which, if believed, established a prima facie case, the Board was not bound, even in the absence of contrary evidence from the Commissioner, to accept the taxpayer's case as proven.

37. Further, the Board of Review is not always bound to make a finding of fact one way or the other and may decide a case on the burden of proof. That this is so is now firmly established: see, Rhesa Shipping Co SA v Edmunds and another (supra), Commissioner of Inland Revenue v Common Empire Ltd [2006] 1 HKLRD 942, and Li Tin Sand v Poon Bun Chak & others (unreported CACV 153 of 2002, 18 November 2002, Court of Appeal).

The applicable legal principles

38. Section 14(1) of IRO provides that profits tax shall be charged 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 from such trade, profession or business (excluding profits arising from the sale of capital assets). Section 2 of IRO defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade.'

39. In Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196, Lord Wilberforce, in an oft-quoted passage, stated as follows (at page 1199):

> '*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. 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 to tax: see* ***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 the commercial operations, namely that situations are open to review.*'

40. Hence the starting point of the inquiry is to ascertain the intention of the taxpayer at the time of the acquisition of the asset. However, one must not forget that intention may change: cases such as Commissioner of Inland Revenue v Quitsubdue Limited [1999] 3 HKC 233 provide examples of such change of intention. However, in a case where there has been no change of intention throughout, the intention at the time of acquisition is, *ex hypothesi*, the same as that at the time of the disposal of the property.

Hence it is right that *normally* the question to be asked is whether the taxpayer has the intention to trade at the time of the acquisition of the asset.

41. It is sometimes said that the intention of a person is as much a fact as his digestion. Indeed it is. Intention being a question of fact, it can only be ascertained by looking at all the circumstances. As Mortimer J observed in the case of All Best Wishes Ltd v Commissioner of Inland Revenue [1992] 3 HKTC 750 at 771, the intention of the taxpayer can only be judged by considering the whole of the surrounding circumstances, including things said and things done:

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

42. In looking at all the circumstances of the case, it is legitimate to consider what is sometimes referred to as the 'badges of trade' (as summarised in the final report of the Royal Commission on the Taxation of Profits and Income (Cmd 9474, 1955). As pointed out by Cheung JA in the Real Estate Investments case referred to above (at page 206H, paragraph 25 of his judgment), the badges of trade are merely 'convenient categorisation of the relevant factors when one considers the circumstances of the case.' There is therefore no inconsistency between Lord Wilberforce's statement in the Simmons case and the badges of trade approach. In deciding whether the asset in question is a capital asset or a trading asset, it is important to ascertain the intention of the taxpayer. The intention at the time of acquisition is normally important, for unless there is a subsequent change of intention, whether the taxpayer intended to acquire the asset for the purpose of trading would determine whether he intended to hold the asset as a trading asset or a capital asset. In ascertaining the intention of the taxpayer, one looks at all the circumstances, including any badges of trade that may be present. None of these badges of trade is conclusive in itself, and one may have more weight than the others depending on the circumstances of each case.

43. In Marson (Inspector of Taxes) v Morton & others [1986] 1 WLR 1343, Sir Browne-Wilkinson V-C said:

> *'It is clear that 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 facts 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.... But I would emphasize 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....' (at page 1348 B-C)*

And after referring to various badges of trade, his lordship continued at page 1349C:

> *'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 – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?'*

44. We also remind ourselves that the mere fact that an asset is sold for more than its cost price does not in itself constitute trading. A capital asset does not turn into trading stock merely because it is sold – the gain on disposal may be a capital gain or a trading profit and the bare fact of sale at a higher price is no indication of one way or another (see, Simmons (supra) at page 1202E-F and 1203H). Further, merely because the asset is not income producing during the period of ownership is not decisive, for properties could be acquired with a view to capital gain or with contemplation of capital appreciation, but not with an intention to trade: see Marson v Morton at page 1350B-D.

Some general considerations

45. Before we deal with each of Property A, Property B and Property C individually and consider whether they were capital or trading assets of the Appellant, there are certain considerations that are common to all 3 properties which may conveniently be dealt with at this point.

46. The first point relates to the treatment of the properties in the Appellant's accounts. In the supporting schedules to the Appellant's accounts, Property A and Property C were described as 'Investment Properties' (see, for example, Schedule 5). Property B was described as part of the 'Leasehold Properties' owned by the Appellant (see, Schedule 10). Both Investment Properties and Leasehold Properties were included as the Fixed Assets in the Balance Sheet of the Appellant (see paragraph 2 of the Notes to the Financial Statements). In the Notes to the Financial Statements, it is stated that 'Investment Properties' 'included in fixed assets represent interests in land and buildings in respect of

which construction work and development have been completed and which are held for long-term rental purposes.'

47. The classification of the properties in the Appellant's accounts as fixed assets (and not trading stock) is a relevant factor for our consideration but it is certainly not a conclusive factor. As Yuen J (as she then was) pointed out in the case of Commissioner of Inland Revenue v Quitsubdue Ltd (supra), 'these assertions by the taxpayer [in its own accounts] are of course not conclusive, and it may be said (as the Board did) that they are self-serving, but they remain primary direct evidence of the taxpayer's treatment of these properties' (see, also the Real Estate Investments case (supra), at page 211D-G per Cheung JA). The Appellant's own accounting treatment of the properties must be looked at together with other objective circumstances. Before one can ascertain if the self-stated intention of the Appellant was genuinely held, one must look at the whole picture and the surrounding circumstances.

48. The second point relates to what Mr Tse submits as the 'track record' of the Appellant. Evidence has been given by Mr N of other landed properties (both residential and commercial) acquired by the Appellant, and Mr N has stated in his evidence that those other properties were acquired and held by the Appellant as capital investments. It is submitted by Mr Tse that the Commissioner has not alleged or determined that those other properties were trading assets of the Appellant. Indeed, in respect of 2 other properties (described in the Determination as 'Property E' and 'Property F' respectively), the Assessor has accepted that the gains on disposal of these 2 properties were capital in nature (see paragraph 1(14) of the Determination). Mr Tse submits that this shows that the Appellant has a 'track record' of being an investor and not a trader. He invites us to take into account of such track record to hold that Property A, Property B and Property C were similarly capital assets of the Appellant.

49. We agree that if there is indeed a consistent 'track record', it may be relevant as showing the *modus operandi* of the taxpayer, but again one must look at all the surrounding circumstances. Such 'track record' argument obviously has its limits. An investor with a track record of capital investments may decide to trade when an opportunity arises or when the market suits him in doing so. As is often said, there is a first time to everything in life. Hence even if the business practice of the taxpayer is to make capital investments, one must still consider the particular circumstances surrounding the acquisition and holding of a particular property before one can decide if the taxpayer intended to trade with the property in question. It is trite that even a one-off transaction can be an adventure in the nature of trade (see Marson v Morton, supra, at 1347H).

50. At the hearing of the appeal, Mr Tse was at pains to emphasise that the Appellant was not a professional speculator. It is not necessary for us to determine the question whether the Appellant was a professional or habitual speculator or not. The issue in this appeal is whether the Appellant has discharged its burden in showing that the assessment is incorrect or excessive and, in the context of the present case, in showing that Properties A, B and C (or any of them) were the capital assets and not trading stock of the Appellant.

51. In the present case, we do not accept that the Appellant has a consistent track record as an investor. It is an agreed fact that in respect of at least one property, namely Property D referred to above, the Appellant had intended to trade with the same. It is accepted by the Appellant that Property D was acquired with an intention to trade and, as a matter of fact, that property was resold within a short time by the Appellant for a quick profit. The Appellant has accepted that the gains it made on disposal of Property D was chargeable to profits tax and it has included the same in its profits tax return for the year of assessment 1997/98 (see paragraph 16 above).

52. Property D was purchased by the Appellant in June 1997 and sold in October 1997. The acquisition and disposal of this property took place in the year of assessment 1997/98. Like Property A and Property C, but unlike Property B, it was a commercial property.

53. In our view, the trading in Property D illustrates the point well that a property investor such as the Appellant may well see fit to acquire properties for trade when an opportunity arises for a profitable adventure, or when he sees that the market suits him in making such trading ventures. That was what happened with Property D, which was quite close in time to the transactions surrounding Property A, Property B and Property C. Whether Property A, Property B and Property C (or any of them) was acquired and held by the Appellant with an intention to trade would require examination of the facts and circumstances surrounding each of the properties, to which we shall now turn. But we cannot accept that the Appellant has shown such a consistent track record as to enable it to say that it has always acted as an investor and never as a trader.

Mr N's oral evidence

54. As pointed out above, Mr N was the only witness called by the Appellant. We have considered his evidence and observed his demeanour carefully. We regret to say that we do not find him to be a credible witness. We shall deal with various aspects of his evidence in greater detail below.

Property A

55. As can be seen from the Agreed Facts set out above, the Appellant contracted to purchase Property A on 26 October 1996. The relevant provisional sale and purchase agreement provided for completion to take place on or before 28 April 1997.

56. It was alleged by the Appellant, and Mr N stated in his oral evidence, that the Appellant purchased Property A as a long-term investment with a view to earning rental yields.

57. The fact, however, is that even before the purchase of Property A was completed on 28 April 1997, the Appellant had agreed to sell the property, initially by a provisional agreement dated 25 February 1997 (which was subsequently cancelled) and

then by another provisional agreement dated 18 March 1997 (which was completed by the Appellant).

58. That the Appellant would choose to dispose of the property within such a short time (and before it had even completed the purchase) is *prima facie* inconsistent with its alleged intention to hold the property as a long-term investment, and is an indication that the Appellant had originally acquired the property with an intention to trade. Such indication however can only be *prima facie.* In some cases there may be perfectly good reasons why properties purchased as capital investments are disposed of within a relatively short time. For example, an investor may decide to dispose of a capital investment shortly after it was purchased in order to free the capital to purchase another investment thought to be more satisfactory. This would not involve an operation of trade, whether the first investment is sold at a profit or at a loss: see, Simmons case above at page 1199B, per Lord Wilberforce.

59. This is precisely the reason given by Mr N for selling Property A within a short time. According to Mr N, the Appellant sold Property A in order to buy Property G, which was considered by the Appellant to be an even better investment.

60. The reason purportedly given by Mr N has obvious difficulties. On the face of the documents, Property G was only acquired, or agreed to be acquired, by the Appellant quite a long time after the Appellant had agreed to sell Property A. As noted above, the Appellant entered into a provisional agreement to sell Property A on 25 February 1997 ('the 1st Sale'). The 1st Sale was cancelled by the Appellant (as a result, the Appellant had to pay compensation to the purchaser and commission to the property agent). On 18 March 1997, the Appellant entered into another provisional agreement to sell Property A again ('the 2nd Sale'). It was not until several months later (on about 26 July 1997) when the Appellant entered into a provisional agreement to purchase Property G at the price of $52,900,000.

61. In his testimony before us, Mr N explained that in February 1997, and before the Appellant agreed to the 1st Sale, the owners of Property G had orally promised to sell Property G to the Appellant. It was only after the Appellant had obtained this oral promise that it agreed to enter into the 1st Sale. However, the owners of Property G allegedly reneged on their promise and refused to sell the same. Accordingly, the Appellant decided to cancel the 1st Sale and had to pay compensation to the purchaser. Mr N told us that he was disappointed by the conduct of the owners of Property G (in reneging on their promise). Despite that, the owners of Property G subsequently indicated (through the property agent) that they were prepared to sell Property G at $54,000,000, which the Appellant successfully negotiated down to $52,900,000. It was only after the Appellant had 'struck a deal' with the owners of Property G – again orally – that the Appellant agreed to enter into the 2nd Sale to sell Property A in March 1997.

62. We find Mr N's evidence in this regard incredible. We have no doubt that his evidence was designed to try to explain away the inconsistencies in the timings of the relevant provisional agreements, and we do not believe in his explanation. The allegation that the Appellant only entered into the 1st Sale after it had obtained the oral promise from the owners of Property G (to sell the property to the Appellant) is one which emerged for the

first time at the hearing. A wholly different reason was given by the Appellants' tax representatives in their letter dated 13 June 2003. Moreover, it seems to us to be wholly incredible that having been disappointed by the owners of Property G once, the Appellant would nonetheless be contented with another oral promise from the same owners and proceeded to sell Property A again without first securing a written provisional agreement with the owners of Property G. Mr N has given no good reason at all to explain why the Appellant would have acted in this manner if the reason for selling Property A was merely to enable the Appellant to buy Property G as a replacement property. His only explanation was that he believed that the price of $52,900,000 was good enough to keep the owners of Property G to their promise. We do not find that explanation to be satisfactory. In a rising market, there is no such thing as a good enough price. If the market continued to rise, there is nothing to prevent the owners of Property G to renege on their oral promise again. The only way to bind them to their promise was to have a written agreement signed.

63. We have no hesitation in rejecting the explanation of Mr N.

64. Property A was never a self-sustaining property in the hands of the Appellant. The Appellant alleged that it purchased the property as an investment vehicle to earn rental income. The property was subject to a mortgage of $23,000,000 from Bank X and the Appellant had to make monthly installment repayment in the sum of $307,139.71, which grossly exceeded the amount of rental income that the Appellant could earn from the property ($118,000 for Shop H1 and $128,000 for Shop H2, making a total of $246,000).

65. Moreover, at the hearing of the appeal, it was alleged that the acquisition of Property A was also partly financed by a loan from an associate company (said to be one Company AC, although there is no direct documentary evidence to show that such a loan was in fact made by Company AC). It is claimed that Company AC and the Appellant have the same shareholders. Be that as it may, presumably the Appellant would have to repay Company AC for the inter-company loan. If not, the same shareholders would ultimately still be hurt in their pocket. Company AC may also have its own creditors (we have no detailed evidence on that).

66. In any event, it is plain that Property A was not a self-sustaining property and no explanation has been given as to why the Appellant would want to acquire and keep such a 'bleeding' property as a long-term investment. Whether or not the Appellant was able to fund the bleeding 'by income from the other business of the [Appellant's] directors' (see, letter dated 16 April 2004 of Company W) is beside the point. It simply makes no commercial sense for the Appellant to do so.

67. Mr Tse submitted that the Appellant expected that in due course the rental income from the property would increase and claimed that the Appellant had conducted a 'feasibility study'. There is no evidence before us to show that the rental income of Property A would increase, and if so, by how much and at what time. We have no evidence to show that eventually (and if so, when) Property A would become a self-sustaining property. Apart from a bare allegation, there is no documentary evidence to support the alleged feasibility study at all. There were no minutes of meeting, records of discussions or any

other documents relating to the alleged feasibility study. Mr Tse explained that the Appellant was a family company controlled by 3 brothers and the brothers did not see the need to have written records. The fact remains however that there is no evidence before us on when and how the alleged feasibility study was carried out, what precisely were the findings or results of the study, and in what way did the study impact upon the decision to acquire Property A. It was nothing but a bare allegation – and one without any substantive contents at all.

68. Mr Tse further relied on the fact that the Appellant had incurred costs to partition Property A into Shop H1 and H2 as a matter indicating that the Appellant intended to hold the property as a long-term investment. We do not agree with Mr Tse on this. That the Appellant had to incur these partition costs was inevitable – it had entered into the Shop H1 PTA and Shop H2 PTA to lease out Property A to different tenants as two shops. The Appellant was required to partition Property A into 2 shops in order to comply with its contractual obligations under the relevant tenancies. The invoice for the partitioning work was dated 29 April 1997, after the Appellant had already contracted to sell Property A (subject to the 2 tenancies). The partition was simply a matter of obligation for the Appellant, not a matter of choice. It was no indication at all of the Appellant's intention in acquiring the property in question.

69. For the above reasons, we are not satisfied that the Appellant has discharged its burden in showing that Property A was acquired and kept by it (until it was sold) as a capital asset. Indeed, we are quite satisfied that Property A was acquired and held by the Appellant with a trading intention.

70. Having come to such conclusion, it is not necessary for us to deal with the other points made by Mr Fung, who has pointed to Clause 15(a) in the Formal Agreement for Sale and Purchase executed by the Appellant dated 4 December 1996, and also Clause 18 of the Shop H1 PTA and Shop H2 PTA in support of his argument that the Appellant had exhibited its intention to sub-sell the property before completion. Suffice for us to say that we are not convinced by Mr Fung's arguments in this regard, and we are of the clear view that such arguments are not necessary to our conclusion that the Appellant has failed to discharge its burden, as far as Property A is concerned, in this appeal. We would not rely on those clauses as a ground for our decision.

Property B

71. Property B was assigned to the Appellant on 2 November 1995. It was agreed to be sold by the Appellant on 10 March 1997. There was an intervening period of about 17 months.

72. The Appellant claimed that Property B was acquired for long-term investment. There is, however, no evidence that supports this claim.

73. It is relevant to look at the actual use that the Appellant had put Property B to during the intervening period of about 17 months. In Schedule 10 of the Appellant's audited

financial statements and profits tax computation for the year ended 31 March 1998, it was stated that the reason for disposal of Property B was 'change of residence of a director'. This suggests that the property had been used as residence of a director of the Appellant. Further, by a letter dated 23 September 1999, Company W informed the Revenue that Property B was 'for directors' residence and then for rental purposes'. This was apparently not true for Property B was never in fact used by any of the directors of the Appellant as residence. By a letter dated 13 June 2003, Company W informed the Revenue, inter alia, as follows:

> 'Property B was used by the Company for providing temporary residence to several major Taiwanese suppliers of the Company when they visit Hong Kong. We sincerely apologize that a senior member of our firm's staff who was then new to this client had committed an inadvertent error on this point in the course of drafting our letter dated 23 September 1999….. Property B was let to a related company for the period from 1 September 1996 to 31 March 1997. No tenancy agreement was signed.'

74. However, having corrected the error allegedly made by a senior staff of Company W, the Appellant's case regarding the use of Property B continued to evolve. By a letter dated 16 April 2004, Company W informed the Revenue, inter alia, that:

> '1. During the period from 2 November 1995 to 31 October 1996, Property B was used as temporary residence for the Company's several major Taiwanese suppliers when they visited Hong Kong. As the Company's business of trading in cloth was taken over by a related company, [Company AC] …. such that the Company became a purely property investment company with effect from 1 April 1996, monthly rental of $25,000 was charged by the Company on [Company AC] for the period from 1 April 1996 to 31 October 1996. The exact dates on which the suppliers moved in/out from Property B when they visited Hong Kong cannot be ascertained now as the Company did not keep any such records which were then regarded as meaningless of the Company.
>
> 2. …… During the vacant period from 1 November 1996 to the date of disposal, Property B was occupied by the children of the directors for study purposes as the need might arise because no suitable tenant could be found. As the Taiwanese suppliers visited Hong Kong less and less frequently in the late 1996, [Company AC] ceased to rent Property B based on a commercial point of view.
>
> 3 …… No tenancy agreement was signed between the Company and [Company AC] and no specific terms of tenancy were agreed. The rental paid was mutually agreed and determined with reference to market rental.'

75. Mr N however contradicted the information provided by Company W during his evidence given at the hearing. He told us that the Appellant only carried on cloth business for a 'very short period' in 1991-92, and in 1995 the Appellant did not carry on any cloth business at all. So in 1995 when Property B was purchased, it could not have been intended for use by the Appellant's suppliers as their temporary residence. It is also not true that the Appellant's cloth business was only taken up by Company AC in April 1996, as suggested by Company W. When pressed by Mr Fung during cross-examination, Mr N agreed that Property B was not acquired for leasing, as indicated by the following question and answer:

> 'BY MR FUNG: So at no time in 1995 was it decided by [the Appellant] that this property would be acquired for leasing, is that right?
>
> A. It was not intended for leasing.'

76. According to Mr N's evidence at the hearing, during the period when Property B was held by the Appellant, it was used:

(a) as the temporary residence of Company AC's (not the Appellant's) suppliers when they visited Hong Kong;

(b) recreational purposes for Company AC's staff (Mr N gave the example of barbecues);

(c) recreational purposes for the directors' children.

77. We have grave doubts of the Appellant's case in this regard, not least because it has been constantly changing throughout the years and Mr N's version at the hearing is inconsistent with those put forward by the Appellant's tax representatives in the past.

78. We regret to find Mr N's explanation somewhat disingenuous. The Appellant alleged that Company AC had paid rental to the Appellant during the period from 1 April 1996 to October 1996. We have however been provided with copy of rental receipt for one month only and it is not clear from that rental receipt whether the rental was paid by Company AC. More importantly, however, before 1 April 1996 (if Mr N's evidence is to be believed), Company AC had already been using the property to house its Taiwanese suppliers when they visited Hong Kong. Yet, admittedly no rental was paid by Company AC before 1 April 1996. Mr N was not able to provide any satisfactory explanation.

79. On the evidence we are not satisfied that the intention was to lease out the property for use by Company AC. Company AC did not in fact pay any rent to the Appellant before April 1996, or after October of that year. The occasional or casual use by the staff for barbecues or the children for the alleged recreational purposes, even if true, does not show that the property was intended to be acquired and kept as long-term investment.

80. There is no evidence to show what efforts might have been made (if there had been any) by the Appellant to put the property in the market for lease. Indeed, as noted above, Mr N has admitted in his oral evidence that Property B was not acquired for leasing.

81. Moreover, Property B – like Property A – was not a self-sustaining property. It was acquired on mortgage finance with a monthly repayment of $34,802.20. Hence, even during the very short period when the Appellant was allegedly receiving rental in the sum of $25,000, there was a shortfall which the Appellant had to cover from other sources. If the property was, as admitted by Mr N, acquired not for leasing, it does not seem to us that there is any prospect of the property becoming a self-sustaining property in the future. In our view, no credible or otherwise satisfactory explanation has been given by Mr N for purchasing this property for long-term investment purpose.

82. We are not satisfied that the Appellant has discharged its burden in showing that Property B was a capital asset held by it at the time when it sold the same in March 1997.

Property C

83. The Appellant contracted to purchase Property C on 28 August 1997. The purchase was completed on 20 September 1997. Barely 17 days later, the Appellant agreed to sell the same at $15,000,000. The purchaser however cancelled the purchase subsequently and the Appellant forfeited the deposit of $1,500,000.

84. Mr N's evidence at the hearing is that the Appellant agreed to sell Property C because it was a 'surprise offer'. The offer may have been a surprise, but if the property was purchased as a long-term investment, Mr N has not explained why the Appellant had agreed to accept the offer.

85. We accept Mr Fung's submission that '[I]n view of the shortness of time between the time of purchase and the time of sale, and the magnitude of the profit that it would have made, the natural inference that [we] should draw is that Property C was acquired by [Appellant] as a trading asset'. We also accept Mr Fung's submission that the mere fact that the sale and purchase of Property C fell through subsequently in the later part of 1997, or that the Appellant retained the ownership of Property C until 2006, is immaterial. The clear pointer of the intention to trade – an intention to grab a quick profit – is the fact that the property was disposed of extremely speedily after its purchase.

86. For the above reasons, we agree with Mr Fung that the Appellant has failed to discharge its burden in regard to Property C as well.

Appellant's alternative case

87. Mr Tse seeks to run an alternative case at the hearing. The alternative case is encapsulated in a letter dated 5 June 2007 sent by the Appellant's tax representative to the Revenue, in which it was stated (inter alia), as follows:

> 'The Company considered that even the assessor took the view that the Company had embarked upon a property dealing business in 1997/98, in raising the assessment for 1997/98, the assessor should take into account the losses in the valuation of the other properties acquired but had remained unsold due to a fall in the property market pending future recovery. The Company relies on the Secan case for this treatment as the starting point in ascertaining assessable profits, reference has to be made to commercial accounting principles – which include that closing stock is valued on the lower of cost or market value. The Company considered that it was unfair for the assessor merely to assess profits but ignore losses.'

88. As rightly pointed out by Mr Fung, it appears that the tax representative suffered from a clear misunderstanding of the assessor's position. The assessment that we are concerned in this case was issued on the basis that the 3 properties (that is, Property A, B and C) were trading properties of the Appellant. The assessment was not issued on the basis that the Appellant had 'embarked upon a property dealing business in 1997/98'. The Commissioner has not made any determination that the Appellant was a habitual or professional speculator and the assessment was not issued on any such basis.

89. Certainly the assessor was not treating all the properties disposed of by the Appellant in the relevant year of assessment as trading assets. In the profits tax return, the Appellant had not claimed that the other properties were acquired by it as trading assets. We do not see how the Appellant can now turn around to claim that the assessor should have made his assessment on the basis that these other properties were the trading assets of the Appellant.

Decision

90. For reasons set out above, the appeal is dismissed.