Case No. D20/12

Profits tax – properties – whether the profits of disposing some shops assessable – whether the taxpayer acquired those shops as a capital investment or for trading purpose – whether the taxpayer has proved its intention of capital investment in all the circumstances – the Inland Revenue Ordinance ('the IRO') section 14(1).

Panel: Huen Wong (chairman), Diana Cheung and Simon Wing Yin Leung.

Dates of hearing: 5 to 7 December 2011.
Date of decision: 10 August 2012.

The Taxpayer was a limited company with an issued share capital of $10. It acquired all the shop units on the 1/F and a substantial number of units on the 2/F of a dilapidated shopping arcade. The Taxpayer claimed that it intended to purchase those shops to refurbish and redecorate the shopping arcade for long term rental income. After its acquisition, it discovered that there may be problems with its right to redesign and redecorate the common area of the 2/F based on the terms of the Sub-DMC relating to the arcade. It decided to first cause a deed to be executed among its 2/F shops agreeing to the new design. It then caused a number of those shops to be disposed of. It then acquired other shops on the 2/F which it previously had not acquired, and cause these shops to agree to the new design. It claimed that the gain on disposing the 2/F shops was capital in nature and did not report it to be assessable for profits tax. The assessor disagreed and raised profits tax assessment on the gain. The Taxpayer appealed.

Held:

1. In order to consider whether the gain obtained from disposing some of the 2/F shops was assessable in profits tax, it has to be considered whether the gain arose out of a trade, profession or business, as per section 14(1) of the IRO. To decide whether the gain arose out of a trade, it has to be considered the intention of the Taxpayer at the time of the acquisition of those 2/F shops by considering all the circumstances of the case (Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196; Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue [2007] 1 HKLRD 198 at 206 applied).

2. The Board finds the Taxpayer's witnesses credible and accepts their evidence. In particular, it accepts the evidence of one of the Taxpayer's shareholders, Mr B, that he originally interpreted the Sub-DMC to allow the Taxpayer to redesign the common area of the 2/F without acquiring all the shops on the

2/F. However, since some owners had raised objections, it decided to dispose some of the 2/F shops to obtain sufficient money to acquire other 2/F shops to prevent any objection of the Taxpayer's plan to refurbish the shopping arcade.

3. Although the Taxpayer indeed bore some of the badges of trade, the Board concludes that, in all the circumstances of the case, the Taxpayer proved that it acquired the units in the shopping arcade as capital asset for long term investment. Therefore, the subsequent disposal of some of the 2/F shops and the gain obtained therefrom did not fall within section 14 of the IRO.

Appeal allowed.

Cases referred to:

China Map Ltd v Commissioner of Inland Revenue [2007] 4 HKLRD 247 (CA); (2008) 22 IRBRD 1215 (CFA)
Simmons v IRC [1980] 1 WLR 1196 [HL]
Real Estate Investments (NT) Ltd v CIR [2007] 1 HKLRD 198 (CA); (2008) 22 IRBRD 913 (CFA)
Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (Appellate Division)
Wing On Cheong Investment Co Ltd v CIR 3 HKTC 1
Waylee Investment Ltd v CIR [1991] 1 HKLR 237 [PC]
Kirkham v Williams [1991] 1 WLR 863 (CA)
All Best Wishes Ltd v Commissioner of Inland Revenue [1992] 3 HKTC 750
Hudson's Bay Co v Stevens (1909) 5 TC 424 (CA)
CIR v Reinhold (1953) 34 TC 389 (Court of Session)
CIR v Quitsubdue Ltd [1999] 2 HKLRD 481
Chinachem Investment Co Ltd v CIR 2 HKTC 261 (CA)
D74/91, IRBRD, vol 7, 16
CIR v Secan Ltd & Anor (2003) 3 HKCFAR 411
Jones v Leeming [1930] AC 415 [HL]
Commissioner of Taxes v British Australian Wool Realisation Association [1931] AC 244 [PC]
CH Rand v The Alberni Land Company Limited (1920) 7 TC 629
Lee Yee Shing v CIR (2008) 11 HKCFAR 6
D17/95, IRBRD, vol 10, 151
CIR v Hyndland Investment Co Ltd (1929) 14 TC 694 (Court of Session)
Real Estate Investments (NT) Ltd v CIR (2008) 11 HKCFAR 433
Marson v Morton [1986] 1 WLR 1343
Shadford v H Fairweather & Co Ltd (1966) 43 TC 291
CIR v The Board of Review, ex p Herald International Ltd [1964] HKLR 224
Iswera v CIR [1965] 1 WLR 663

D11/80, IRBRD, vol 1, 374
D65/87, IRBRD, vol 3, 66
D129/00, IRBRD, vol 15, 981
D21/01, IRBRD, vol 16, 206
D58/06, (2006-07) IRBRD, vol 21, 1071
D13/10, (2010-11) IRBRD, vol 25, 304
Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD

Chua Guan Hock SC and John K C Hui Counsel instructed by Messrs P C Woo & Co for the Taxpayer.
Stewart Wong SC instructed by Louie Wong Senior Government Counsel of the Department of Justice for the Commissioner of Inland Revenue.

Decision:

Agreed statement of fact

1. Counsel for the Taxpayer, Mr Chua Guan Hock SC ('Mr Chua') and the Revenue Mr Stewart Wong SC ('Mr Wong') have agreed to adopt the facts as stated in paragraphs 1(1) to 1(15) in the Revenue's Determination dated 29 November 2010. The agreed facts of this appeal are as follows:

(1) The Taxpayer had objected to the Profits Tax Assessment for the year of assessment 2005/06 raised on it. The Taxpayer claimed that the gain on disposals of certain properties and the forfeited deposits it received were capital in nature and should not be chargeable to Profits Tax.

(2) (a) The Taxpayer was a private company incorporated in Hong Kong in November 2003. It closed its first set of accounts on 31 December 2004.

(b) At all relevant times, the issued share capital of the Taxpayer was $10.

(c) In the report of the directors of the Taxpayer for the period/year ended 31 December 2004 and 2005, it was stated that (i) the principal activity of the Taxpayer was 'property investment'; and (ii) the Taxpayer acquired investment properties in Hong Kong in order to earn long term rental income.

(3) On divers dates between June 2004 and March 2005, the Taxpayer executed assignments to acquire all the shop units on 1/F and 2/F of a shopping arcade ('the Arcade') located at Building A, Address A. The

Arcade was formerly known as 'Arcade 1' which comprised, among others, 18 shop units on 1/F and 208 shop units on 2/F (collectively 'the Old Shops').

(4) The Taxpayer carried out renovation works to the Arcade and modified and varied its layout and division. It renamed the Arcade as 'Arcade 2' as from 25 January 2005.

(5) By a Supplemental Deed to the existing Sub-Deed of Mutual Covenant ('the Sub-DMC') executed by the Taxpayer on 25 January 2005, all of the Old Shops on 1/F and 157 units of the Old Shops on 2/F were respectively sub-divided into 29 and 360 shop units (collectively 'the New Shops'). As at 31 December 2005, the Arcade comprised, among others, 29 shop units on 1/F and 411 shop units on 2/F.

(6) On divers dates commencing on 25 January 2005, the Taxpayer executed assignments to dispose of various units of the New Shops to purchasers.

(7) The Taxpayer submitted its Profits Tax Returns for the years of assessment 2004/05 and 2005/06 ('the Returns') together with its audited financial statements for the period/year ended 31 December 2004 and 2005 and tax computations.

(a) In the Returns, the Taxpayer declared the following Adjusted Loss:

	2004/05	2005/06
	$	$
Adjusted Loss	(9,912,661)	(15,219,277)

(b) The Adjusted Losses declared by the Taxpayer in the Returns were arrived at after deducting or excluding among others, the following items:

	2004/05	2005/06
	$	$
Commercial building allowance	6,324,977	6,861,481
Gain on disposals of investment properties	-	140,937,722
Forfeited deposit from disposal of investment properties	-	15,790,288

(c) The Taxpayer computed the commercial building allowance as follows:

		2004/05 $	2005/06 $
Commercial building allowance previously claimed	[A]	-	6,324,977
Property price of Arcade 2:			-
Additions		280,800,000	152,340,000
Disposals		-	(147,267,600)
		280,800,000	5,072,400
One-half of property price		140,400,000	2,536,200
Commercial building allowance @4%	[B]	5,616,000	101,448
Leasehold improvements:			
Additions		17,724,423	29,943,599
Disposals		-	(19,067,208)
		17,724,423	10,876,391
Commercial building allowance @4%	[C]	708,977	435,056
Total allowance claimed [A+B+C]		6,324,977	6,861,481

(d) The Taxpayer computed the gain on disposals of investment properties for the year of assessment 2005/06 as follows:

	$	$
179 shops of Arcade 2		
Sales proceeds		330,143,554
Less: Cost of property		(157,478,443)
Leasehold improvements	19,067,208	
Less: Depreciation	(1,417,954)	(17,649,254)
Commission paid to property agents		(14,078,135)
Gain on disposals		140,937,722

(e) The Taxpayer did not make any adjustment for balancing charges in respect of the disposals of investment properties for the year of assessment 2005/06.

(8) (a) The detailed profit and loss account of the Taxpayer for the period/year ended 31 December 2004 and 2005 showed, among other things, the following particulars of turnover:

Period/year ended 31 December	2004	2005
	$	$
Rental income	-	4,310,965

(b) The financial statements of the Taxpayer for the period ended 31 December 2004 reported the following balances of bank overdraft and mortgage loan which were secured by the Taxpayer's properties held for resale:

	$
Current Liabilities	
Bank Overdraft – Secured	32,151,122
Mortgage Loan – Secured	65,020,000
Non-Current Liabilities-Mortgage Loan	55,980,000

(9) On the basis of the Returns submitted, the Assessor of the Revenue ('the Assessor') issued to the Taxpayer the following Statements of Loss for the years of assessment 2004/05 and 2005/06:

	2004/05	2005/06
	$	$
Adjusted Loss for the year [Fact (7)(a)]	9,912,661	15,219,277
Add: Loss brought forward	-	9,912,661
Loss carried forward	9,912,661	25,131,938

(10) By a letter dated 24 April 2007, the Assessor, through Messrs Chan Chee Cheng & Co ('the Representatives'), requested the Taxpayer to furnish, among other things, the following information and documents:

(a) a breakdown of the investment properties purchased and sold up to 31 December 2005 showing in respect of each property the respective dates and prices of purchase and sale;

(b) details of the additions to and disposals of leasehold improvements up to 31 December 2005 together with documentary evidence in support;

(c) details of forfeited deposit from disposal of investment properties for the year ended 31 December 2005.

Despite reminder sent, the Taxpayer did not respond to the Assessor's request.

(11) In the absence of the requisite information, the Assessor did not accept the Taxpayer's claim for exclusion of the gain on disposals of investment properties and the forfeited deposits from disposal of investment properties for the year of assessment 2005/06. Accordingly, the Assessor raised on the Taxpayer the following Profits Tax Assessment for the said year:

	$
Loss per return [Fact (7)(a)]	(15,219,277)
Add:	
Gain on disposals of investment properties [Fact (7)(b)]	140,937,722
Forfeited deposit from disposal of investment properties [Fact (7)(b)]	15,790,288
Assessable profits	141,508,733
Less: Loss set-off [Fact (7)(a)]	(9,912,661)
Net assessable profits	131,596,072
Tax payable thereon	23,029,312

(12) The Representatives, on behalf of the Taxpayer, objected to the above Assessment in the following terms:

'Please note that the original intention of restructuring the shops in [Arcade 2] were to earn rental income for long term investment purpose. The disposals was [sic] made by reason that the Taxpayer was lack of fund to continue their development project in [Arcade 2], thus they must dispose part of shops in [Arcade 2] to support their further development project. Now, all the shops in [Arcade 2] are letting out to earn rental income, please refer the financial statements of the Taxpayer. In view of this, the gain on the disposal of the shops and forfeit deposit for disposal of the shops were considered as capital in nature.'

(13) By a letter dated 28 December 2007, the Assessor, through the Representatives, requested the Taxpayer to supply the same information

and documents as mentioned in Fact (10) as well as documentary evidence for its alleged intention of restructuring the shops at the Arcade. Despite repeated requests, neither the Representatives nor the Taxpayer replied to the Assessor's enquiries.

(14) The Assessor has ascertained the following:

(a) In respect of the shop units at the Arcade sold by the Taxpayer during the year of assessment 2005/06, the agreements for sale and purchase signed between the Taxpayer and the purchasers were, for the most part, made in November 2004.

(b) The shop units at the Arcade held by the Taxpayer as at 31 December 2005 included units in respect of which agreements for sale were entered into by the Taxpayer in November and December 2004 but the sale was ultimately cancelled or not completed by purchasers.

(c) During the year of assessment 2006/07, the Taxpayer re-purchased 17 units of the New Shops which were disposed of by it during the year of assessment 2005/06.

(15) The Assessor did not accept the Taxpayer's claim that the shop units at the Arcade were its capital assets. She considered that the Statement of Loss for the year of assessment 2004/05 and Profits Tax Assessment for the year of assessment 2005/06 should be revised as follows:

	2004/05	2005/06
	$	$
Loss per return [Fact (7)(a)]	(9,912,661)	(15,219,277)
Add: [Fact (7)(b)]		
Commercial building allowance	6,324,977	6,861,481
Gain on disposals of investment properties	-	140,937,722
Forfeited deposit from disposal of investment properties	-	15,790,288
	(3,587,684)	148,370,214
Less:		
Depreciation of leasehold improvement [Fact (7)(d)]	-	1,417,954
Assessable profits / (Adjusted Loss)	(3,587,684)	146,952,260
Less: Loss set-off		(3,587,684)
Net assessable profits		143,364,576

	2004/05	2005/06
	$	$
Tax payable thereon		25,088,800

Profit tax assessment for the year of assessment 2005/06 under Charge Number X-XXXXXXX-XX-X, dated 28 November 2007, showing Net Assessable Profits of $131,596,072 (after set-off of loss brought forward of $9,912,661) with tax payable thereon of $23,029,312 was thereby increased to Net Assessable Profits of $143,364,576 (after set-off of loss brought forward of $3,587,684) with tax payable thereon of $25,088,800.

The appeal

2. The Revenue did not accept the Taxpayer's claim that the properties at the Arcade were its capital assets. Accordingly, the Revenue determined that the Taxpayer was not entitled to commercial building allowance for the years of assessment 2004/05 and 2005/06, and the gain derived by and the deposit forfeited to the Taxpayer on disposal of its properties should be assessable for the year of assessment 2005/06.

3. The Taxpayer's objection as mentioned in paragraph 1(1) above therefore failed. The Revenue determined that the Profit Tax Assessment for the year of assessment 2005/06 was revised as per Fact (15) above ('the Determination').

4. The Taxpayer now appeals to this Board against the Determination.

Other facts not disputed

5. At the beginning of the hearing for this appeal, Counsel for the Revenue had helpfully prepared some charts and documents which were summaries and analyses of the transactions relating to the units at the Arcade which had been purchased, sold and re-purchased by the Taxpayer at the relevant time. The information contained in these documents was agreed by the parties ('the Information').

6. The Information included details of the purchase of 18 shops on the 1/F and 157 shops on the 2/F that is a total of 175 of the Old Shops at the Arcade ('the Bought Units') by the Taxpayer between March and December of 2004. These purchases were carried out either directly by the Taxpayer or through its nominees and/or trustees or companies the shares of which the Taxpayer had acquired. It should be noted that the said period spanned from the date of the provisional or formal Sale and Purchase Agreement of the first purchase to the date of the Assignment of the last purchase of the Bought Units.

7. The Information also revealed that between October 2004 and April 2005, the Taxpayer either sold or entered into provisional or formal Sale and Purchase Agreements

relating to 257 of the New Shops at the Arcade ('the Sold Units'). It should be noted that the said period spanned from the date of the provisional or formal Sale and Purchase Agreement of the first sale to the date of the Assignment of the last sale of the Sold Units.

8. It should also be noted that the number of the Bought Units and that of the Sold Units did not reflect the actual areas of the Arcade being purchased or sold. It was because the Old Shops had been subdivided into smaller shop units as mentioned in Fact 1(5) above.

The Taxpayer's case

9. The Taxpayer was a private company with several business partners as its directors and beneficial shareholders. Its principal activity as stated in its audited accounts was property investment. Since 2004, the Taxpayer had been engaged in a property investment project concerning the Arcade which the Taxpayer called it the Arcade 2 Project ('the Project'). Mr B, a solicitor, was a director of the Taxpayer from 16 April to 29 October 2004 and had at all material times been actively involved in the Project.

10. The Arcade was a self-contained property with the Old Shops separate from other parts of Building A, with its own G/F entrance facing Road D. Before 2004, the Arcade had been vacant, closed down, and dilapidated for at least six years since 1998.

11. In 2004, the Taxpayer purchased a substantial number of shop units that is the Bought Units such that it owned the whole of the 1/F and a substantial part of the 2/F. The Taxpayer did not purchase all the shop units in Arcade 1 as this was considered unnecessary, and it did not have the funds to do so.

12. With the support of the majority of the owners of shop units and the Owners Corporation of Arcade 1, the Taxpayer commenced the Project in 2004. The objective was to refurbish and transform the shopping arcade into a popular and attractive shopping area in Area C.

13. The Project was financed largely by funds from shareholders and related companies. Some of the Taxpayer's finance came from bank credit and seven-year mortgage loans.

14. Numerous contemporaneous documents showed that immediately after the Taxpayer's purchase of various shop units in Arcade 1 commencing on 17 March 2004, it spent considerable time, effort, and resources towards its long-term goals for the Project, including:

(a) Renaming the shopping arcade, 'Arcade 2';

(b) Internal design, and refurbishment;

(c) Complete reconfiguration of the layout of the shop units and the common areas;

(d) Installing a Mega TV on the external wall, and constructing glass external walls;

(e) Advertising, marketing and promotion; and

(f) Appointing leasing agents.

15. In about September 2004, the Taxpayer realized that the new and reconfigured layout of the shop units on 2/F that it proposed to use might cause a significant legal problem. As the Taxpayer did not own 100% of the undivided shares in Arcade 2, the proposed changes to layout plans, shop units, and the common areas had not been agreed by all owners. Without the unanimous consent of all owners, there was a risk that the validity of the new layout plans might be challenged, especially by any disgruntled owner, and might become the subject of litigation.

16. However, the Taxpayer did not have the funds to purchase all the shop units on the 2/F. To solve that potentially serious legal problem, which would have grave implications for the Project, the Taxpayer came up with the following solution, upon legal advice:

(a) In its capacity as the owner of the shop units it had already purchased, the Taxpayer executed a Supplemental Sub-Deed of Mutual Covenant dated 25 January 2005 (the 'Supplemental Sub-DMC'), confirming *inter alia*, the new layout plans for the 2/F.

(b) The Taxpayer then sold various units on 2/F, Arcade 2 (the 'Sold Units') that it had purchased earlier in 2004. The Taxpayer began entering into agreements for sale in November 2004 with completion in January 2005.

(c) Simultaneous with the sale of the Sold Units, the Taxpayer purchased between November 2004 and February 2005, the remaining 51 shop units on 2/F, Arcade 2 (the '51 Units') that it had not already owned. The 51 Units were purchased for the total consideration of HK$164,750,000.

(d) After completing the purchases of the 51 Units, the Taxpayer, as owner of these shop units, subsequently executed a Second Supplemental Sub-Deed of Mutual Covenant (the 'Second Supplemental Sub-DMC') dated 28 February 2006, which *inter alia*, confirmed the new layout plans for the 2/F shops and common areas.

17. During 2007 to 2008, the Taxpayer continued to repurchase some of the shop units it had sold in January 2005.

18. Up till the time of the appeal, the Taxpayer still held a substantial majority of the shop units in Arcade 2 – which had become a highly successful shopping arcade in Area C. The Taxpayer's revenue was rental income from leasing out shop units in Arcade 2.

19. In short, the Taxpayer contended that its original intention was to acquire the shop units on 1/F and 2/F of Arcade 2 that is including the Sold Units as a long-term investment in order to earn rental income. Its disposal of the Sold Units was out of practical necessity. That is to say, the Taxpayer required sufficient funds to purchase the remaining 51 Units at the Arcade so as to achieve the result that all the shop units on the 2/F and the common areas would confirm the proposed new layout plans.

The Revenue's case

20. Although the Taxpayer asserted that its original intention was to restructure the shops in the Arcade to earn rental income for long term investment purpose, despite the Assessor's requests, the Taxpayer had failed to supply the requisite information regarding the properties acquired and disposed of by it. In particular there was 'not one iota of evidence' in support of the Taxpayer's stated intention towards the restructuring of the Arcade.

21. On the other hand, the available facts pointed to the conclusion that the Taxpayer's intention for selling the properties at the Arcade already existed at the time of its acquisition and the properties in question were the Taxpayer's trading stocks. In particular:

(a) The Taxpayer contracted to sell units of the New Shops as early as in November 2004. The sales were made shortly after the Taxpayer's acquisition of the Old Shops and even before the sub-division of the Arcade was completed in January 2005. Such a quick sale was a strong indicator pointing towards a trading intention.

(b) The restructuring of the Arcade was a large-scale project involving hundreds of shop units and substantial amount of investment. Given that the issued share capital of the Taxpayer was only HK$10, it was hardly conceivable that the necessary financing arrangements for a long-term investment were not made before the commencement of the project. The assertion that the Taxpayer lacked funds to continue the project plainly indicated that the Taxpayer's stated long-term intention was not realistic and not realisable.

(c) A large part of the mortgage loan taken out by the Taxpayer was repayable in the short-term. The mortgage was secured by properties which were described by the Taxpayer as 'held for resale'. This cast

doubts as to whether the Taxpayer did have a genuine intention to hold the properties at the Arcade on a long-term basis.

The issues for the Board to determine

22. Counsel for both parties had accepted that this was not a case of 'change of intention' in the sense that property purchased and held as capital asset had been since a later time held as trading asset or that an adventure in the nature of trade had been embarked on it.

23. Hence, this Board has to decide whether the Taxpayer's intention when it first acquired the Bought Units in 2004 was to hold them for long term rental income and there was a good reason for it to decide to sell the Sold Units within only a few months. In other words, the Board has to decide whether the Taxpayer intended at the time it acquired the Bought Units (that is including the Sold Units) was to hold them as capital assets or trading stock.

The authorities

24. The Taxpayer produced the following authorities in support of its case:

(1) China Map Ltd v Commissioner of Inland Revenue [2007] 4 HKLRD 247 (CA); (2008) 22 IRBRD 1215 (CFA)

(2) Simmons v IRC [1980] 1 WLR 1196 [HL]

(3) Real Estate Investments (NT) Ltd v CIR [2007] 1 HKLRD 198 (CA); (2008) 22 IRBRD 913 (CFA)

(4) Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (Appellate Division)

(5) Wing On Cheong Investment Co Ltd v CIR 3 HKTC 1

(6) Waylee Investment Ltd v CIR [1991] 1 HKLR 237 [PC]

(7) Kirkham v Williams [1991] 1 WLR 863 (CA)

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

(9) Hudson's Bay Co v Stevens (1909) 5 TC 424 (CA)

(10) CIR v Reinhold (1953) 34 TC 389 (Court of Session)

(11) CIR v Quitsubdue Ltd [1999] 2 HKLRD 481

(12) Chinachem Investment Co Ltd v CIR 2 HKTC 261 (CA)

(13) D74/91, IRBRD, vol 7, 16

(14) CIR v Secan Ltd & Anor (2003) 3 HKCFAR 411

(15) Jones v Leeming [1930] AC 415 [HL]

(16) Commissioner of Taxes v British Australian Wool Realisation Association [1931] AC 244 [PC]

(17) CH Rand v The Alberni Land Company Limited (1920) 7 TC 629

(18) Lee Yee Shing v CIR (2008) 11 HKCFAR 6

(19) D17/95, IRBRD, vol 10, 151

(20) CIR v Hyndland Investment Co Ltd (1929) 14 TC 694 (Court of Session)

25. The Revenue produced the following authorities in support of its case:

(1) Real Estate Investments (NT) Ltd v CIR (2008) 11 HKCFAR 433

(2) Marson v Morton [1986] 1 WLR 1343

(3) Shadford v H Fairweather & Co Ltd (1966) 43 TC 291

(4) CIR v The Board of Review, ex p Herald International Ltd [1964] HKLR 224

(5) Iswera v CIR [1965] 1 WLR 663

(6) D11/80, IRBRD, vol 1, 374

(7) D65/87, IRBRD, vol 3, 66

(8) D129/00, IRBRD, vol 15, 981

(9) D21/01, IRBRD, vol 16, 206

(10) D58/06, (2006-07) IRBRD, vol 21, 1071

(11) D13/10, (2010-11) IRBRD, vol 25, 304

The evidence

26. The parties produced their respective bundles of documents for the purpose of this appeal. As mentioned above, Mr Wong had very helpfully put together a number of schedules of the transactions relating to the purchase of the Bought Units and sale of the Sold Units. A number of discrepancies in the exact dates of provisional and formal Sales and Purchase Agreements and Assignments and the identities and exact number of shop units had been clarified and/or rectified with the assistance of those who instructed Mr Chua and Mr Wong. The Taxpayer called two witnesses to give evidence on its behalf. They were Mr B and Mr E.

Mr B

27. At the material time Mr B was a solicitor working in a solicitors' firm, Company F. His main practice area was conveyancing.

28. In his examination in chief, Mr B confirmed his witness statement produced by him and gave evidence in relation to the background of the Taxpayer and the Project. According to Mr B, the Taxpayer was formed by several people including a Mr G and a Mrs G who acquired a company named Company H. This company owned 60% of the Taxpayer. The other 40% was owned by another company Company J, which in turn was owned by Mr B and 13 other people. According to Mr B, they were all his personal friends. Mr B and Mr G had been friends for 28 years.

29. During cross examination, Mr Wong pointed out that there was at one point another investor, a company named Company K. Mr B said he did not know who owned this company. It might have been a nominated company owned by Mr G. This company was said to have dropped out of the picture at an early stage. Mr Wong further pointed out that between 23 February 2004 and 15 March 2004, there was another director of the Taxpayer Ms L. Mr B admitted that she was in fact a Mrs M, a celebrity in Hong Kong. Ms L was on Mr G's side in the Project but later dropped out of the picture. Mr B said he understood that Ms L took her husband's advice to avoid any involvement in the Project or the name of Building A. Mr B said he was not concerned with Ms L. As far as he was concerned, he was dealing with Mr G only.

30. According to Mr B, the investors in Company J were business people and professionals with different skills and experience, some of whom were retired people. Among them, there were a retired senior engineer of the Hong Kong Government, a real estate manager and an information technology person. All were said to have something to contribute to the Project. As for Mr G, his primary role was to provide necessary capital and funding. Mr G was not at any stage involved in the day-to-day management of the Taxpayer. Mr B gave advice to Mr G on planning strategies and conveyancing matters in the acquisition of the Bought Units. There was no evidence of the Taxpayer having been involved in any trading in property before. Mr B said in his witness statement that the

Taxpayer was incorporated for the purpose of property investment for long term rental income.

31. The Taxpayer began to purchase shop units in the Arcade in March 2004. It purchased the Bought Units in two major lots from two major owners of the Arcade. The first lot included all the shops on the 1/F except two units. The second purchase included the remaining two shops on the 1/F and various units on the 2/F. Mr B said it was necessary for the Taxpayer to acquire all the shop units on the 1/F in order to gain access to the 2/F to make a successful shopping mall. There remained only the 51 Units not acquired by the Taxpayer.

32. The Taxpayer also acquired the exterior wall of the Arcade in the first purchase. The exterior wall which was facing Road D and Road N was for advertising in order to attract passers-by to visit the mall.

33. Mr B testified that at the time of the formation of the Taxpayer with a view to investing in the Project, all the investors anticipated a lot of hard work in order to make it successful. The Arcade had been shut down for some six years before the Taxpayer did the acquisition. The Arcade was said to be like a haunted place with rats running around.

34. Mr B was referred to records of meetings at diverse dates in 2004. The minutes of meetings mentioned planning for building management, renovation and design works. Those records demonstrated that the Taxpayer was planning to lease the premises, setting out leasing strategy and the critical dates for the promotion of the Project. The plan was to start inviting tenants in September 2004 so as to meet the Christmas season.

35. At the hearing, several documents were produced including leasing agreements and promotional materials for the Arcade. Evidence showed that there were leases for terms ranging from three to six years entered into with some big names including Company P, Company Q and Company R. Again, this was said to demonstrate that the Taxpayer took a long term view in developing the Arcade.

36. Mr B said that initially he took the view that according to the Sub-DMC of the Arcade, the Taxpayer should have the right to carry out the sub-dividing and reconfiguring of all the Bought Units. At least, that was his opinion upon his own interpretation of the Sub-DMC.

37. However, in about July or August 2004, Mr B identified a potential legal problem: since the Taxpayer did not own all the shops of the Arcade, it was possible that some owners might challenge the Taxpayer's alteration of the layout of the Arcade. Although the majority of the owners of the arcade were supportive to the Project, some owners had raised objections. Mr B referred to the minutes of a meeting of the Owner's Committee of the Arcade dated 9 August 2004. The minutes recorded that some owners voted to object spending money to renovate the Arcade.

38. Mr B testified that in the course of the acquisition of some of the Bought Units, he had instructed his solicitor friends to represent the Taxpayer, and discussed the Project with them including the plan of sub-dividing the Bought Units, the new layout plan and his interpretation of the provisions in the Sub-DMC. The views of these solicitors were divided. There were different interpretations giving rise to various arguments over the provisions in the Sub-DMC.

39. In order to avoid the risk that opposing owners might bring litigation against the Taxpayer and/or the Owners Corporation of the Arcade by challenging the legality and validity of the new layout plan, the Taxpayer, having obtained legal advice and conducted internal discussions, decided to adopt a strategy to solve the problem.

40. The strategy was, as outlined in paragraph 16 above, for the Taxpayer to cause a Supplemental Sub-DMC to be executed in respect of all the shops that it had already owned as at the date of the Supplemental Sub-DMC. It gave effect to the renaming of the Arcade to Arcade 2, adopting the new layout plan of the 2/F of the Arcade and the sub-allocating of the undivided shares of some shop units.

41. Since the Supplemental Sub-DMC only affected the shop units the Taxpayer owned as at 25 January 2005, the Taxpayer had to purchase all the remaining 51 Units so as to make them to be subject to the terms of the Supplemental Sub-DMC as well. Mr B said that as the Taxpayer lacked additional funding to implement this strategy, it had no practical choice but to sell some of the Bought Units on the 2/F in order to come up with the requisite funds to implement the strategy.

42. After the Taxpayer had purchased all the remaining 51 Units, it executed the 2nd Supplemental Sub-DMC which confirmed all the terms of the Supplemental Sub-DMC.

43. Mr B testified that it was for the execution of the strategy that the Taxpayer sold a total of 177 Bought Units for the consideration of about HK$330 million. At about the same time, the Taxpayer purchased the 51 Units for the total consideration of about HK$164 million. Mr B said that when the Taxpayer purchased the Sold Units in early 2004, it had no intention to re-sell within a short time for profit. He said that but for the strategy, there was no reason for the Taxpayer to sell and purchase the relevant units which were of the same type of shop units on the same floor contemporaneously between November 2004 and February 2005. Many of the completion dates of the sale of the Sold Units were later than the completion dates of the purchase of the 51 Units. The average purchase price per square foot of the 51 Units was higher than the average selling price of the Sold Units. No units on the 1/F had been sold, the reason being that selling any units on the 1/F would not help to solve the problem of the validity of the new layout plan on the 2/F. The Taxpayer repurchased 17 shop units on the 2/F at the consideration of about HK$32.6 million in 2006 and one shop units for about HK$17.4 million in 2008. Since early 2005, the Taxpayer had not sold any shop units in the Arcade despite the buoyant property market in the following years. Mr B said this was in line with the Taxpayer's strategy to operate and manage a successful shopping arcade.

44. Mr Wong questioned the Taxpayer's decision in the purchase of the 51 Units when Mr B had mentioned that the majority of the shop owners were in support of the Project. It would have been more sensible just to buy out those dissenting owners and get those in support to give their consent to the new layout. Mr B's explanation was that although there were only a few dissenters, once the Taxpayer bought out one or two, the other owners would start causing trouble until they were all bought out.

45. As for the reasons for entering into contracts for the sale of the Sold Units for HK$330 million rather than a lower sum given that the Taxpayer only intended to sell no more than what was required to purchase the 51 Units, Mr B's explanation was that the Taxpayer had no control of how much it could fetch in the sale. Its target was to sell enough to support its purchase of the 51 Units. However, the Taxpayer might face challenges in selling the property that is requisitions being raised on the same concerns the Taxpayer had over the reconfigured layout. As it turned out, there were eight to ten purchasers who raised a lot of requisitions and challenges on the title. The Taxpayer repaid their deposits either in full or in part. There were also deposits being forfeited, amounting to HK$15.79 million as a result of the purchasers failing to complete for different reasons. When questioned whether the Taxpayer made any estimate as to the number of units it planned to sell in order to raise sufficient funds, Mr B said that they were expecting to sell half of the 360 New Units so as to fetch a sum of HK$120 million to 180 million or even HK$200 million, in which case they would use the surplus to put towards the renovation costs.

46. Mr Wong referred Mr B to records of the sale of the Sold Units. Mr B testified that the Taxpayer put a price tag on all Bought Units on the 2/F and the estate agent put them all to the market. The sale was apparently very successful and a lot of units were sold within hours. Most of the Sold Units were sold on 4 and 5 November. Mr B testified that upon the initial success he had personally told the estate agent to stop promoting and either he or someone else told the agent to stop selling the units.

47. Mr Wong pointed out that the Sale and Purchase Agreements for certain units were signed at a much later stage such as 16 and 23 to 25 of November. He queried the reasons for these sale contracts being signed so late, bearing in mind that Mr B had confirmed that the usual time gap between signing a Provisional Agreement and a Sale and Purchase Agreement was two weeks. Mr B explained that it was probably due to the delay in the signing of agreements on certain occasions where purchasers swapped their purchased units. One of these cases happened as late as February in the following year.

48. Mr B was extensively cross-examined on his interpretation of the relevant parts in the Sub-DMC. He was queried about his own opinion on whether the Taxpayer would have the right to reconfigure the Bought Units including appropriating the common areas and making them part of the reconfigured shop units. Mr B testified that despite doubts cast by his solicitor friends and a chamber-mate of Mr Wong at the time, and the fact that the Taxpayer eventually bought the 51 Units, he still held the view that his opinion was correct. However, he said that what a lawyer believed in was not the same as what a

businessman would consider right to do. The Taxpayer could not risk the potential challenges from prospective tenants and according to Mr B, certain estate agents who did not get to be appointed by the Taxpayer started spreading rumours that the reconfiguration of the layout of the Arcade might not be able to be carried out. As a result of these potential challenges, the Taxpayer obtained an opinion from a London silk, Mr John Cherryman QC, who specialized in conveyancing matters. His opinion turned out to be consistent with Mr B's. The English Silk's opinion was supported by a local Senior Counsel Mr Clifford Smith to the extent that there were not any aspects of Hong Kong law that might cause a different view to be taken from that expressed by Mr Cherryman. Mr B said that armed with this opinion, the Taxpayer was able to deal with many requisitions raised on the title of the Arcade.

49. For the purpose of establishing the state of mind of Mr B at the time of the acquisition of the Bought Units, the Board did not look into the opinion of the English Silk which came about at a later stage. Rather, the Board concentrated on Mr B's own interpretation of the relevant provisions in the Sub-DMC and why he so interpreted the provisions at the time. Mr Wong contended that it was incredible that as an experienced conveyancing solicitor, Mr B would read the Sub-DMC in a way that he was certain that the Taxpayer could appropriate the common areas in the reconfiguration exercise. The Board was invited to reject Mr B's evidence in this regard. Extensive examination and analysis of the relevant parts of the Sub-DMC were conducted at the hearing. It is necessary to reproduce the relevant parts of the Sub-DMC here. The relevant parts dealing with the rights enjoyed by the shop owners in the Arcade and the common areas were contained in Sections III and Section IV of the Sub-DMC:

> ' <u>Section III – Exclusive Rights Reserved Unto The Second Confirmor</u>
>
> (1) The Second Confirmor shall have the exclusive right and privilege to design and determine and to alter change and modify from time to time the general and specific layout, division or subdivision or the user of the whole or any part or parts of all that /those Unit or Units which may from time to time be held, owned or controlled by it or in or to which it may otherwise from time to time have any title, estate, interest, claim or right (whether alone or jointly with other party or parties), including but not limited to the exclusive right and privilege to design and determine and to alter change and modify and to remove, limit, restrict or extend or improve from time to time all and any entrances, doors, passage, corridors, staircases, escalators, lift, toilets and other fixtures, fittings and facilities which may from time to time be situate within or installed in such Unit or Units provided that in the exercise of its rights under this clause, the Second Confirmor shall take all reasonable steps not to interfere with the quiet enjoyment of any Unit owned by any other Owner exclusively. Provided that nothing in this Clause shall release the Second Confirmor from any of its duties and obligations to comply with

all building and other applicable laws and regulations and the Arcade Rules as may from time to time be prescribed by the Arcade Manager.

(2) The Second Confirmor (and its successors and assigns of such rights) shall have the following rights:-

(a) the exclusive right to carry out at any time and from time to time any demolition, construction, rebuilding, refurbishment, renovation and other works of any description within any Units in or to which the Second Confirmor may at any time and from time to time retains any title, estate, interest, claim or right (whether alone or jointly with other party or parties) or any part of the Shopping Arcade which is not owned by any owner exclusively;

(b) For the purpose of exercising any of the rights conferred by this Sub-Deed upon the Second Confirmor, the right to enter, upon reasonable prior notice, into and upon any part of the Shopping Arcade, whether exclusively owned by any Owner or not, with or without any contractors, surveyors, workers, employees or agents, and with or without any equipments, tools, machinery or material(s). Provided that the Second Confirmor shall comply with the Arcade Rules as may from time to time be prescribed by the Arcade Manager and shall take all reasonable steps to minimize the interference with the quiet enjoyment of such part by the exclusive Owner thereof (if any) which may be caused thereby, but otherwise the Second Confirmor shall not be liable for any loss or damages which any Owner or any other party or parties may suffer from any such works;

(c) the exclusive right to name and to rename the Shopping Arcade at any time and from time to time as the Second Confirmor may in its discretion think fit and without being liable to any Owner or its tenant licensee or any other party or parties for any costs, expenses, fees, or charges which may result directly or indirectly from such naming or renaming of the Shopping Arcade.

(3) The Second Confirmor shall be entitled to at any time and from time to time assign and/or transfer all or any of the rights and privileges conferred by this Sub-Deed upon it to any third party whether absolutely or temporarily, upon such terms and in such manner as the Second Confirmor may deem fit and without any reference to any other Owner or any other party or parties who may be interested in any part of the Shopping Arcade in any way whatsoever and without the necessity of making any such other Owner or any such other party or parties to any such assignment, transfer or other transaction. The assignee or

transferee to whom any of the aforesaid rights and privileges may be assigned or transferred as aforesaid shall be entitled to enforce the rights and privileges so assigned and transferred as if they were a party to this Sub-Deed.

Section IV Arcade Common Areas

(1) The Owner of any Unit for the time being, his tenants, servants, agents and licensees (in common with all persons having the like right) shall have the full right and liberty to go pass or repass over and along and to use the Arcade Common Areas for all purposes connected with the proper use and enjoyment of the Unit he owns, subject always to this Sub-Deed.

(2) So long as the Second Confirmor retains any title, estate, interest, claim or right in or to any Undivided Share (Whether alone or jointly with other party or parties), it shall (notwithstanding any other provision herein to the contrary) have the exclusive right to extend, alter, change, modify and vary the Arcade Common Areas at any time and from time to time by declaring and designating the whole or any such part or parts of the Unit or Units which may at any time and from time to time be held owned or controlled by it or in or to which it may otherwise at any time and from time to time have any title, estate, interest, claim or right (whether alone or jointly with other party or parties) as additional or new Arcade Common Areas or otherwise. Upon such declaration and designation, all that/those Unit or Units or part or parts thereof so declared and designated shall thereafter for all purposes of this Sub-Deed form part of the Arcade Common Areas and be governed by all provisions herein applicable thereof and the Owners shall contribute to the management expenses incurred for the maintenance and upkeep of such new Arcade Common Areas or part thereof as if they were part of the Arcade Common Areas, subject however to any easement, right, privilege or power which the Second Confirmer may thereupon reserve in respect of such new Arcade Common Areas or any part thereof.'

50. Under cross-examination, Mr B was asked how he arrived at his opinion on the Taxpayer's plan regarding the reconfiguration of the shop units in the Arcade. Mr B testified that he relied on the wording in Section III (1) which said '…the exclusive right and privilege to design and determine and to alter, change and modify and to remove, limit, restrict or extend or improve from time to time all and any entrances, doors, passage, corridors, staircases, escalators, lift, toilets and other fixtures, fittings and facilities which may from time to time be situate within or installed in such Unit or Units….'

51. Mr B interpreted the above wording in such a way that the words in the Sub-DMC allowed the Taxpayer to change and modify the common areas including

entrances, doors, passage, corridors etc. He opined that the words '…be situate within or installed in such Unit or Units…' only qualified the words '…other fixtures, fittings and facilities' since there could not be any escalators or lift to be installed within any shop unit.

52. Mr Wong however referred Mr B to the beginning of Section III which stated that 'The Second Confirmor shall have the exclusive right and privilege to design and determine and to alter change and modify from time to time the general and specific layout, division or subdivision or the user of the whole or any part or parts of all that/those Unit or Units which may from time to time be held, owned or controlled by it or in or to which it may otherwise from time to time have any title, estate, interest…'. Mr Wong put it to Mr B that the rights mentioned in the first eight lines of Section III only concerned the units which were held, owned or controlled by the Taxpayer or in which the Taxpayer had an interest. Hence, what followed was not additional or any extension of those rights. They were just an explanation of what some of those rights involved. Mr Wong contended that as an experienced conveyancer that should have been the only way Mr B had read the relevant provisions. Mr B disagreed.

53. Mr Wong then referred Mr B to Section IV of the Sub-DMC which dealt with 'Arcade Common Areas'. In paragraph (2) of this Section, it stated that '…the Second Confirmor … shall have the exclusive right to extend, alter, change, modify and vary the Arcade Common Areas at any time and from time to time, by declaring and designating the whole or any such part or parts of the Unit or Units which may at any time and from time to time be held owned or controlled by it or…have any title, estate, interest, claim or right… as additional or new Arcade Common Areas or otherwise….'. Mr Wong suggested that Section IV only allowed the Taxpayer to add to the common areas. He further contended that as an experienced conveyancer, Mr B should have referred to Section IV which governed common areas rather than Section III, and that Section IV did not give the right to do what the Taxpayer intended to do, that is to appropriate and redesign so that part of the common areas would become parts of a unit. Mr B disagreed and pointed out that there were also words '…to alter, change and modify…'. He further said that that was the reason why he relied more on Section III which assigned the right to the Taxpayer.

54. Mr Wong put it to Mr B that he did have doubts whether the Taxpayer had sufficient right and power to proceed with the reconfiguration of the layout of the Arcade. Hence, the Taxpayer intended to acquire all the shops at different stages whilst knowing that it had to sell some of the shops acquired so as to finance the acquisition of the 51 Units. Mr B did not accept that proposition.

55. As regards the renovation work done to the Bought Units, Mr Wong suggested that it could be both for enhancing the rental return of the units the Taxpayer intended to keep as well as for the resale value of the units it intended to sell all the time. Mr B disagreed and repeated that the work was done with the intention to turn the Arcade into a modern and attractive shopping mall to enhance rental income only.

56. In Mr B's witness statement, he sought to explain that although the Taxpayer's issued share capital was only HK$10, it was amply financed by loans from its shareholders and related parties. According to the Taxpayer's financial statements, these loans amounted to HK$68,857,006 and HK$151,966,480 respectively as at 31 December 2005.

Mr E

57. Mr E referred to his witness statement and gave evidence in relation to the audit work he did for the Taxpayer.

58. Mr E testified that when he performed the financial audit on the Taxpayer for the tax year of 2004, he was informed by its directors including Mr G, Mr B and other representatives that the shops were purchased for long-term investment. However, Mr E admitted that he had not been involved in any decision-making process regarding the strategy and business model of the Taxpayer. Nor had he been shown any documents such as board minutes or minutes of any meeting showing the intention of the Taxpayer. However, Mr E did attend shareholders' meetings at which matters relating to the decoration of the Arcade and how the Arcade was to be leased were discussed. He recalled having heard the discussion of letting out all the shops. In his statement, Mr E referred to the overall business model and strategy of the Taxpayer including decorating the Arcade, subdividing the shop units, building an escalator and attracting tenants. Mr E said that the classification done by him was based on the overall objectives of the Taxpayer's directors although he admitted that he relied mainly on what he was told by the Taxpayer.

59. Sometime towards the end of 2005 when he was preparing the Taxpayer's audit work for December 2004, Mr E was informed by Mr G and Mr B of the sale of the Sold Units and the reasons for doing so, that is to raise funds to purchase the remaining units of the 2/F in order to legalize the subdivision of the shops.

60. When questioned why he did not reply to the Revenue's letters seeking information regarding the disposals by the Taxpayer, Mr E explained that he could not gather all the information in time although he had asked his staff to contact the Taxpayer to obtain the requisite information.

61. Mr E was asked about the reference in the financial statements to 'the banking facilities including bank overdraft and mortgage loan are secured by the company's properties held for resale'. Mr Wong questioned why such a reference was used when it was already known that there had been contracts entered into for the sale of those properties as at 31 December 2004, some of which were eventually sold. Mr E explained that that reference was for the benefit of the bank and the shareholders only. In particular, Mr E had the bank in mind so that it would know the loan it had granted was secured by the properties which were held for resale. Mr E did not agree that the only proper way to describe the property was 'investment property' with a footnote stating that 'sale contracts had been entered into' as suggested by Mr Wong. Mr E also disagreed that 'held for resale' was correct only in the sense that the property was always held by the Taxpayer for resale.

The legal principles

62. The legal principles to apply to determine whether a property was acquired as capital asset or for trading purposes are well established. Mr Chua and Mr Wong did very helpfully refer the Board to a host of authorities mentioned in paragraphs 24 and 25 above.

63. Mr Wong referred the Board to section 14(1) of the Inland Revenue Ordinance (Chapter 112) ('the Ordinance') which provides that:

> *' Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.'*

64. Mr Wong submitted that profits tax was chargeable on profits arising from a 'trade, profession or business' and whatever was the ambit of the words 'trade' or 'trading', if the gain was otherwise made from a 'business', which had a wider meaning than 'trade', the gain was chargeable (unless it arose from the sale of capital assets). He cited Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD.

65. Mr Wong argued that there could be no doubt that the Taxpayer did carry on activities in an organized manner and used its assets to make profits. At all times it carried on a 'business', and the profits in issue, being the gain from the sales of the Sold Units, and the forfeited deposits, were therefore chargeable to profits tax under section 14(1) as profits arising in or derived from a business carried on in Hong Kong, unless the Taxpayer brought the matter within the only stated exception, namely that the profits arose from the sale of capital assets. The Board was referred to Real Estate Investments (NT) Ltd v Commissioner of Inland Revenue [2007] 1 HKLRD 198.

66. The Board was referred to section 68(4) of the Ordinance which provided that:

> *' The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.'*

67. Mr Wong submitted that the question was whether the Revenue's assessment was excessive or incorrect, and not whether the analysis in the Determination was incorrect. He relied on Kerr J's judgment in Commissioner of Inland Revenue v The Board of Review, ex p Herald International Ltd [1964] HKLR 224. He continued to argue that the question in this appeal was: 'Did the Commissioner get the correct answer'; not 'did the Commissioner get the correct answer by the wrong method?'

68. It was well-established by numerous authorities that the burden of disturbing the assessment on an appeal under the Inland Revenue Ordinance from an assessment rests on the taxpayer, as stipulated in section 68(4) of the Ordinance and pointed out in All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750.

69. As to the correct approach that the Board should adopt in the present case, both Counsel referred the Board to a number of leading authorities in the area. The first was on Lord Wilberforce's remark in Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196:

> ' *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?'*

70. Mr Wong referred to D65/87, IRBRD, vol 3, 66. After citing from Simmons, the Board in that case said:

> ' *In deciding whether there was an intention to trade, all the circumstances must be examined, bare assertions of an intention to hold as a long term investment being of little weight. One should examine whether the transaction bore any of the badges of trade (see Simon's Taxes B3212 and Marson v. Morton [1986] STC 463). In each case, it is necessary to stand back having looked at all matters and look at the whole picture and to ask the question – was this an adventure in the nature of trade?*
>
> *We see no inconsistency between Lord Wilberforce's statement in Simmons and the badges of trade approach. For there to be an adventure in the nature of trade, an intention to trade is required. In deciding whether there was such an intention, one must look at all the circumstances and examine whether the transaction bore any of the badges of trade. If the transaction bore the badges of trade, it would mean that an intention to trade was present notwithstanding protestations by the Taxpayer to the contrary.*
>
> *In Marson v Morton one of the matters examined was that purchaser's intentions as to resale at the time of purchase. This was said to be in no sense decisive in itself. In our view, this is consistent with Lord Wilberforce's statement which refers to an intention to trade. In deciding whether the purchaser had an intention to **trade** [emphasis by the Board], his intention concerning **resale** [emphasis by the Board] is relevant but not decisive.'*

71. Mr Wong further referred to the judgment in Real Estate Investments (NT) Ltd v CIR [2007] 1 HKLRD 198, 206:

> ' *25. The question then becomes: which approach should one adopt in deciding whether the transaction was a sale of a capital asset and not a trading activity? It is clear from a reading of the judgment of* Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196 *that although Lord Wilberforce focused on the question of the taxpayer's intention at the time of the acquisition of the property, this issue cannot be dealt with in isolation and has to be considered by examining all the circumstances of the case. As often said the state of a man's mind is as much a question of fact as the state of his digestion. One needs to consider all the circumstances in order to ascertain a person's intention. Once this point is clear then there really is no conflict between the approach in* Simmons *and the badges of trade approach. Both approaches will lead to the same destiny, namely, the answer to the question of whether profits arise from the sale of a trading stock or a capital asset. This is because both involve a consideration of the circumstances of the case. The badges of trade are convenient categorisation of the relevant factors when one considers the circumstances of the case. The intention to trade or to hold the property as an investment is one of the circumstances to be considered in deciding whether the property that is eventually disposed of is a capital property. At the same time if after considering all the circumstances one can conclude on the nature of the intention then this will help to answer the question posed in the enquiry.'*

72. Mr Chua also referred to Real Estate Investments (NT) Ltd (supra) in which Andrew Cheung J (as he then was) held (at 216):

> ' *That said, day one (that is the time of acquisition) must remain a special day worthy of special attention, speaking generally. By the nature of things, it should be the best time to find out the intention of the taxpayer. The Newtonian law of inertia suggests that there must have been a reason to prompt the taxpayer to acquire the asset in the first place – and that reason would, generally speaking, provide the answer or clue to whether he intended to acquire the asset for capital investment or as a trading stock – thus the character of the asset. That explains, in my view, the emphasis of Lord Wilberforce in Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196 on the taxpayer's intention at the time of acquisition.'*

73. The Board takes the view that there are no substantial differences in the principles applicable to this appeal as advocated by both Counsel. The legal principles in relation with this appeal are well established. The Board does not find it necessary to refer to all the authorities cited by both parties. The authorities suggest that no single test is sufficient to prove a case. The question to ask is 'what was the intention of the Taxpayer at

the time it acquired the Sold Units?' That intention must be viewed in the light of all the objective facts and circumstances. Any subjective declaration of what the Taxpayer intended was certainly not decisive. As stated in the case All Best Wishes Ltd: '*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. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.*'

74. The burden is on the Taxpayer to prove that the 257 Sold Units were capital asset so that it could bring itself within the exclusion to the charge under section 14. The question posed for the Board is therefore whether the Taxpayer has discharged its burden by satisfying the Board that the original intention of the Taxpayer in its acquisition of the Bought Units was to hold them as capital asset and for long term investment and there were good reasons for the Taxpayer to dispose of the Sold Units other than selling them as trading asset for profit.

The conclusion

75. As mentioned in paragraph 22 above, Counsel for both parties had agreed that it was not a case of a change of intention on the part of the Taxpayer. The Revenue's contention was that the Taxpayer had not shown that the relevant shops were capital asset in the first place. In particular, the Revenue argued that the Taxpayer acquired the Bought Units in 2004 intending to keep only a part of them as capital asset and to sell the rest.

76. In the evidence of Mr B, he asserted that the original intention of the Taxpayer was to purchase the shops in the Arcade with the intention of renovating and upgrading the Arcade and to lease the shops out on a long term basis for rental income. There were contemporaneous documents showing that the Taxpayer was discussing plans relating to the renovation, reconfiguration and promotion of the Arcade. As mentioned above, the authorities clearly show that any declaration of intention itself is not sufficient. Mr Wong submitted that such documentary evidence was self-serving. However, it would be unfair for the Board to ignore the amount of documents demonstrating that the Taxpayer was engaged in renovating the Arcade supported by promotional materials. At the same time, the Board bears in mind that any renovation work could be as much for letting as for selling. In this regard, Mr E also testified that the original intention of the Taxpayer in the acquisition of the shops was for long-term investment and it was on that basis that he

classified the shops in the relevant audited accounts as fixed and non-current assets. Since Mr E admitted that he did not possess any personal knowledge in the business strategy nor was he involved in any decision-making process of the Taxpayer, the Board can only attach little weight to his evidence in this regard. The Board therefore need to go into further evidence to find if the assertions of Mr B and Mr E were the truth of the matter and the Board need to look into all the surrounding circumstances.

77. As mentioned above, Mr B was heavily cross-examined on his interpretation of the relevant parts of the Sub-DMC. Mr Wong contended that it was necessary to ascertain the state of mind of Mr B at the time when the Taxpayer first acquired the shops in question, that is February 2004. This is in line with the approach stated in the Simmons case and followed by Real Estate Investments (NT) Ltd. The question to ask is therefore: 'Did Mr B at that time truly believe that his interpretation of the relevant provisions in the Sub-DMC (that is the Taxpayer had the right and power to reconfigure the layout of the Arcade) was correct?'

78. Mr Wong submitted that it was incredible that as an experienced conveyancing solicitor, Mr B would read the Sub-DMC in such a way that he was certain that the Taxpayer could appropriate the common areas in order to carry out the reconfiguration of the Arcade. The Board was invited to reject Mr B's evidence in this regard. That would mean Mr B was not that certain, or he had at least some doubts on his mind as regards the reconfiguration plan right from the beginning. That would further mean that the Taxpayer had all along intended to sell at least some of the shop units in order to acquire the 51 Units to implement the reconfiguration plan.

79. The Board agrees that Section III of the Sub-DMC is not well drafted. It is open to different interpretations of the provisions therein. Mr Wong did put forward a forceful argument that Section III paragraph (1) should be interpreted to mean that it only conferred upon the Taxpayer 'the right and privilege to (*inter alia*) design and determine, alter, change, modify the layout, division or subdivision…of **any part or parts of all that/those Unit/Units** … **be held, owned or controlled by it** …' (emphasis added). However, the Board equally accepts Mr B's submission that the remaining part of paragraph (1) can also be read to mean that 'the exclusive right and privilege first mentioned also included but not limited to the exclusive right and privilege to design and determine and to alter change and modify and to remove, restrict or extend…all and any entrances, doors, passages, corridors, staircases, escalators, lift, toilets and **other fixtures, fittings and facilities which may from time to time be situated within or installed in such Unit or Units** …' (emphasis added), and that the reference to '…be situate within or installed in such Unit or Units' can be interpreted to govern only the references to '… other fixtures, fittings and facilities' and not the other installations such as 'corridors, escalators, lift and toilets'. Given the particular setting and set-up of the Arcade and the shop units therein, it is against common sense that there would be corridors, escalators or lift installed within a Unit or Units.

80. As for Section IV of the Sub-DMC, again it is difficult to accept that the only possible interpretation of this Section is that the Taxpayer can do no more than 'adding to the Arcade Common Areas'. This interpretation will severely limit 'the exclusive right to extend, alter, change, modify and vary the Arcade Common Areas'. Any alteration, change, modification or variation of the common areas will unavoidably involve some 'appropriation' of but 'adding back' to the common areas so as to become 'new Arcade Common Areas' mentioned in that Section.

81. As submitted by Mr Chua, the hearing was not a trial about the real effect of the relevant provisions in the Sub-DMC. The Board is more concerned with the credibility of the witness and his state of mind at the material time. Mr B being a solicitor is expected to tell the truth to the best of his recollection but of course he is subject to the fallibilities of recollection which affect everyone.

82. The Board finds Mr B a credible and truthful witness. In view of the findings mentioned above, there is no reason for the Board not to accept that Mr B did truly believe in his own interpretation of the legal effects of those provisions in the Sub-DMC at the time of the acquisition of the shop units. Mr B was absolutely adamant about his opinion on the legal effects of the relevant provisions. That also explains why he did not seek independent legal advice in the beginning. Although the opinion of Mr John Cherryman, QC came much later, it confirmed Mr B's view. The opinion of Mr Cherryman, QC is a useful reference for the Board to the extent that it supports the Board's finding that Mr Wong's interpretation of the Sub-DMC is not the only possible interpretation for an experienced conveyancing lawyer. The Board finds it difficult to accept Mr Wong's contention that Mr John Cherryman's opinion was plainly wrong.

83. The Board finds Mr Chua's argument convincing in that he said if the Taxpayer did foresee right from the beginning difficulty in implementing the reconfiguration of the layout on the 2/F of the Arcade without securing the consent of all the owners, it would be hard to imagine the huge financial and legal risks involved in embarking upon a plan of buying only a portion of the Units with a view to selling some and utilizing the proceeds to acquire the remaining ones. Given the volatile property market and the dilapidated state of the Arcade, such a business strategy could lead to a total disaster. The evidence of Mr B also supports this argument.

84. The Board also accepts Mr Chua's submission that it is not up to Mr Wong to suggest what the best solution to the legal problem might have been, that is by simply buying out the dissenters and asking the other owners to consent to the new layout. It is always easy to be wise after the event. The Board is satisfied by the evidence of Mr B that buying out some owners would trigger off other problems including more owners starting to make trouble until they were all bought out.

85. Mr Wong submitted that if Mr B's evidence was true regarding the discovery of a potential serious legal problem which might derail the Project, there should exist some contemporaneous documents recording discussions or decisions on this matter. Mr B's

explanation was that the Taxpayer did not put their worries in writing. He testified that when they discussed about the issues, they did so not so much as holding a solicitor-and-client type of meetings but rather direct discussions between Mr B and Mr G. Other investors were also told of the situation by Mr B. Given that Mr G left the day to day management to Mr B and that the Taxpayer was not a big developer but a collection of close friends, the Board finds it credible that decisions could be made without going through the formalities of holding meetings and keeping minutes.

86. On the issue of the delay in the Taxpayer's replying to the letters sent by the Revenue, the Board accepts Mr E's evidence that he and his staff had been waiting for relevant information from the Taxpayer which caused the delay. The Board notes that the Revenue was asking for a substantial amount of information including a breakdown of all the investment properties purchased and sold by the Taxpayer up to 31 December 2005 with the exact dates and prices. The vast volume of records of land searches and other information produced at the hearing demonstrated that it would take a lot of time and effort to compile the data sought by the Revenue. Although it would have been better, as suggested by Mr Wong, that Mr E could or should at least deal with some of the questions raised, the Board finds that Mr E only made a wrong decision in waiting for the information and the delay does not make the evidence of witnesses not credible.

87. There were some inconsistencies as to the exact time when Mr E became aware of the existence of the legal problem in the evidence of Mr B and Mr E. The Board does not find these inconsistencies significant or serious enough to destroy the credibility of either witness given that the event happened some seven years before.

88. The Board accepts that under cross-examination Mr E gave a satisfactory explanation of the reason for his stating the Sold Units as being 'held for resale' in the relevant audited accounts.

89. The Board was invited by Mr Wong to refer to the badges of trade as mentioned in the Lee Yee Shing case. Whilst the Board has taken that into account in its deliberation of this appeal, it also finds that it is useful to follow the approach to be adopted in ascertaining the intention of the Taxpayer at the time of acquisition of the Sold Units as stipulated in the All Best Wishes Ltd case by considering the whole of the surrounding circumstances, including things said and things done before and after the acquisition in question.

90. The Taxpayer indeed bore some of the badges of trade. It had no previous trading history. It was only a $10 company set up a few months before the commencement of the Project. The main business of the Taxpayer was real property which no doubt was normally the subject of trade in Hong Kong. The Taxpayer did acquire a large number of shops in the Arcade, some of which were sold within a short time after their acquisition. There was work done to the Sold Units so that their value had been enhanced.

91. The Board however has to take into consideration all other relevant facts it found in the hearing of this review. The Board has the following facts before it. It finds the evidence of the two witnesses of the Taxpayer credible. They both testified to the intention of the acquisition of the shop units for long-term investment. The shop units were treated as such in the relevant audited accounts. There were contemporaneous documents which pointed to the Taxpayer intending to develop the Arcade into a successful shopping mall by renovation, refurbishment, reconfiguration, renaming and marketing the Arcade for leasing. There was no mention in these documents about sale of the shop units. As stated in D129/00 (2001), the stated intention of the Taxpayer at the material time cannot be decisive but the absence of any stated intention of the Taxpayer at the material time is a factor the Board need to take into consideration.

92. It appeared that the Taxpayer had sufficient funding to carry into effect their intention to develop the Project. The evidence showed that the Taxpayer's plan in the Project was realistic and realisable until the discovery of the legal problem.

93. The evidence before the Board is that there are credible reasons for the Taxpayer to sell quickly the Sold Units as a practical solution to a potential legal problem. The Taxpayer disposed of the Sold Units contemporaneously with the purchase of the 51 Units. Some of the completion dates for the disposal of the Sold Units were later than those for the purchase of the 51 Units. The average sale price for the Sold Units was much higher than that for the purchases. No shop unit on the 1/F of the Arcade was sold at any time. Mr B gave credible explanations of the 'oversale' resulting in total sale proceeds together with the forfeited deposits exceeding the cost of the acquisition of the remaining units. The Taxpayer later repurchased 17 shop units at a price higher than the sale price it had fetched. There is evidence that to date other than the Sold Units, the Taxpayer has not sold any unit in the Arcade and remained the registered owner of a majority of the shop units. There is no evidence of any intention on the part of the Taxpayer to sell any shop units since 2005. The Taxpayer's audited accounts demonstrated that up to 2009 the Taxpayer had only paid dividends out of profits generated from rental income rather than from disposal of the Sold Units.

94. Having reviewed the evidence and considered all the factors and submissions put to the Board by both parties and upon the findings stated above, the Board is satisfied that the Taxpayer had discharged its duty to prove that the Sold Units were acquired as capital asset for a long term investment purpose so that it could bring itself within the exclusion to the charge under section 14 of the Ordinance. The appeal by the Taxpayer is therefore allowed.

95. As suggested by Mr Wong, there will be necessary adjustments made to commercial building allowance in the tax computations of the relevant years of assessment, the matter is hereby remitted to the Revenue for such and other adjustments in line with this decision.

96. The Board is obliged to Counsel on both sides for their very able assistance lent to the Board in the conduct of this appeal.