Case No. D47/08

Profits tax – capital or trading – sale and purchase of property – sections 2 & 14 of Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Wendy O Chan and Cissy King Sze Lam.

Date of hearing: 24 November 2008.
Date of decision: 9 January 2009.

The appellant objected to the profits tax assessment for the year of assessment 2005/06 raised on him. The appellant claimed that the gain he derived from the sale of a property was a capital gain and should not be chargeable to profits tax.

After entering into agreements to acquire the subject property, the appellant contracted to sell the property within 1 year and before completion of the acquisition. He claimed that his intention at the time of acquisition was to hold the subject property on a long term basis as the residence for himself, the wife, the daughter and the son. The plan did not come to fruition because, contrary to his expectation at the time of acquisition, he subsequently found out that the subject property was not materially larger in size than the former residence.

Held:

1. The Board rejected the appellant's case that he intended to acquire the subject property as the residence for himself and his family. The Board found, *inter alia*, that the appellant agreed to purchase the subject property without having been shown any price list, without having read any sales brochure, without viewing the show flat, without satisfying himself that he was agreeing to acquire a larger flat, without informing himself of the layout of the flat and without paying any attention to information on areas in the formal acquisition agreement.

2. Having followed the approach held by McHugh NPJ in Lee Yee Shing & Yeung Yuk Ching v The Commissioner of Inland Revenue [2008] 3 HKLRD 51, that is to 'make a value judgment after examining all the circumstances involved in the activities claimed to be a trade', the Board concluded that the appellant was doing a deal.

Appeal dismissed.

Cases referred to:

D53/06, (2006-07) IRBRD, vol 21, 1030
D3/92, IRBRD, vol 7, 61
Marson v Morton [1986] 1 WLR 1343
Simmons (as Liquidator of Lionel Simmons Properties Ltd) v Inland Revenue Commissioners [1980] 1 WLR 1196
All Best Wishes Ltd v Commissioner of Inland Revenue 3 HKTC 750
Lee Yee Shing & Yeung Yuk Ching v The Commissioner of Inland Revenue [2008] 3 HKLRD 51

Dustin Chan of Messrs Marie Tsang, Dustin Chan & Co, Solicitors, for the taxpayer.
Hui Chiu Po, Lai Wing Man and Chan Sze Wai for the Commissioner of Inland Revenue.

Decision:

Introduction

1. This is an appeal against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 25 July 2008 by which the profits tax assessment for the year of assessment 2005/06 under charge number X-XXXXXXX-XX-X, dated 12 December 2006, showing assessable profits of $3,469,326 with tax payable thereon of $555,092 was confirmed.

2. By 2 provisional acquisition agreements both dated 1 October 2003, the appellant contracted to buy a residential flat and a car parking space (collectively 'the subject property') which were still under construction at the time. The 2 formal acquisition agreements were both dated 6 October 2003. The total acquisition price was $8,988,800.

3. Funded partly by a bank instalment loan of $3,000,000 which was secured by an equitable mortgage of the subject property, the appellant paid the whole of the balance of the acquisition price on 30 December 2003.

4. By a provisional sub-sale agreement dated 20 September 2004, the appellant contracted to sub-sell the subject property at the sale consideration of $13,000,000.

5. The consent to assign was issued on 15 March 2005. By an assignment dated 26 April 2005, the subject property was assigned by the developer to the sub-purchaser, with the appellant joining in the assignment as the confirmor.

6. The respondent took the view that the net gain of $3,469,326 from the acquisition and sub-sale of the subject property was taxable. The appellant contended that it was a capital gain and, as such, not taxable. There is no dispute on the amount of the net gain.

The agreed facts

7. The following facts in the 'Facts upon which the Determination was arrived at' in the Determination were agreed by the parties and we find them as facts.

8. The appellant has objected to the profits tax assessment for the year of assessment 2005/06 raised on him. The appellant claimed that the gain he derived from the sale of a property should not be chargeable to profits tax.

9. The appellant is married. He and his wife ('the wife'), have two children, a daughter ('the daughter') and a son ('the son') who were born on 10 December 1980 and 18 March 1985 respectively. At all relevant times, the appellant and his family resided at a residential flat at a residential development ('the former residence'). The appellant and the wife purchased the former residence in 2000.

10. At all relevant times, the appellant was a shareholder and director of a limited company ('PrivateCo'), which was a private limited company incorporated in Hong Kong.

11. (a) By a Memorandum for Sale dated 1 October 2003 ('the provisional acquisition agreement'), the appellant purchased a residential flat ('the flat') at a development under construction ('the subject property development') at a consideration of $8,608,800. On 6 October 2003, the appellant signed the Sale and Purchase Agreement ('the formal acquisition agreement'). At the time of purchase, the flat was still under construction.

(b) By another Memorandum for Sale also dated 1 October 2003, the appellant purchased a car parking space at the subject property development ('the carpark') at a consideration of $380,000. At the time of purchase, the carpark was still under construction.

12. On 30 December 2003, to finance the purchase of the flat, the appellant obtained a mortgage loan of $3,000,000 from a bank with interest rate charged at 2.35% per annum. The loan was repayable by 120 monthly instalments of $28,076.90 each.

13. By a Provisional Agreement for Sale and Purchase dated 20 September 2004 ('the provisional sub-sale agreement'), the appellant through an estate agent ('the estate agent') sold the flat and the carpark (collectively 'the subject property') for a total consideration of $13,000,000. On 26 April 2005, the appellant, in the capacity of a confirmor, completed the purchase and sale of the subject property.

14. By an Agreement for Sale and Purchase dated 14 September 2006, the appellant and the wife purchased another residential flat at the subject property development and 2 car parking spaces (collectively 'the current residence') at a total price of $25,850,000. The current residence was assigned to the appellant and the wife on 16 November 2006.

15. In his Tax Return – Individuals for the year of assessment 2005/06, the appellant did not declare the sale of the subject property.

16. The assessor issued a questionnaire to the appellant in respect of the purchase and sale of the subject property. A firm of certified public accountants, on behalf of the appellant, stated, among others, the following:

(a) The subject property was intended to be used for long term investment holding.

(b) '[The subject property was sold because it was] not according to expectation'.

(c) To finance the purchase of the subject property, the appellant took out a mortgage loan of $3,000,000 from a bank and the balance was financed by the appellant's dividend and salary income from the business profits generated by PrivateCo.

(d) The appellant made a gain of $3,469,326 from the purchase and sale of the subject property which was computed as follows:

		$	$
Sale proceeds			13,000,000
Less:	Purchase cost		
	- The flat [paragraph 11(a)]	8,608,800	
	- The carpark [paragraph 11(b)]	380,000	8,988,800
Gross profit			4,011,200
Less:	Expenses		
	Legal fee on purchase	10,499	
	Stamp duty on purchase	322,830	
	Bank interest	24,677	

Legal fee on sale	22,850	
Forfeited deposits[1]	31,018	
Agency commission on sale	130,000	541,874
Net profit		3,469,326

17. The assessor was of the view that the purchase and sale of the subject property by the appellant amounted to an adventure in the nature of trade. He raised on the appellant the following profits tax assessment for the year of assessment 2005/06:

Assessable profits [paragraph 16(d)]	$3,469,326
Tax payable thereon	$555,092

18. A firm of solicitors[2] ('the solicitors'), on behalf of the appellant, objected against the above assessment on the following grounds:

(a) 'At the time of acquisition of [the subject property] in October 2003, [the appellant] intended to use it for his family's residence and treated it as a personal long term investment.'

(b) '[The appellant] owns a packaging business in Hong Kong. He is married and his household includes his wife, son, daughter and a domestic helper. His family has been residing at [the former residence] for a rather long period of time.'

(c) '[The former residence] is about 1,300 square feet and it is of an old fashion. [The appellant] has been looking for a larger and more comfortable flat for his family for some time. Finally in October 2003, he decided to purchase [the subject property].'

(d) 'The purchase price of [the subject property] is HK$8,988,800.00. Full payment had been made by [the appellant] in December 2003, 30% of which came from bank's mortgage loan.'

(e) '[The subject property] was an uncompleted flat when [the appellant] purchased it in October 2003. Only until about the end of 2004 he had the opportunity to inspect the show flat of [the subject property]. It was out of his expectation that the usable size of [the subject property] was only about 1,400 square feet, which was only slightly larger than [the former residence]. It was

[1] Neither the appellant nor the respondent could tell us what it was. Be that as it may, there was no dispute on the net amount of gain.

[2] The firm also represented the appellant at the hearing of this appeal.

then clear that [the subject property] was not large enough to provide a spacious and comfortable accommodation for his family.'

(f) 'In 2004, [the daughter] finished her study overseas and returned to Hong Kong. Since then, she decides to stay permanently in Hong Kong. She has a full time job here and lives with her parents.'

(g) 'Since [the appellant] was not satisfied with the size of [the subject property] and he wished to offer a more desirable living environment for his family, he decided to sell [the subject property] in 2004 and looked for another larger flat.'

(h) 'Finally in September 2006, [the appellant] purchased a more suitable property … [the current residence]. Purchase of [the current residence] was completed in November 2006. The size of [the current residence] is about 2,500 square feet and is [then] under renovation. [The appellant] and his family are prepared to move into [the current residence] upon completion of the renovation.'

(i) '[The son] will also return to Hong Kong and live with his parents after completion of his study overseas by the end of [the year 2007].'

(j) 'The purchase price of [the current residence] is HK$25,850,000.00, about 60% of which has been paid by [the appellant] with his own money.'

(k) 'In the circumstances, [the appellant] did not intend to dispose of [the subject property] at a profit when he acquired it in October 2003. It was purchased with the intention for his family's residence and for his personal long term investment. Owing to the fact that the size of [the subject property] was not large enough as a comfortable accommodation for his family, [the appellant] sold [the subject property] and purchased [the current residence] in substitution. Hence, the sale of [the subject property] does not constitute a trading transaction or an adventure in the nature of trade and no profit tax can be chargeable in relation thereto.'

19. In response to the assessor's enquiries, the solicitors, on behalf of the appellant, claimed the following:

(a) The daughter left Hong Kong for study overseas in July 1998. She finished her study and returned to Hong Kong from overseas in January 2005.

(b) The son left Hong Kong for study overseas also in July 1998. It was expected that the son would finish his study and return to Hong Kong from overseas at the end of the year 2007.

(c) The date when the developer of the subject property notified the appellant of the issue of the occupation permit was 12 April 2005.

(d) The appellant approached the estate agent to sell the subject property in July/August 2004.

(e) 'The asking price of [the subject property] was fixed with reference to the then market value of [the subject property]. [The appellant] obtained information about the then market value of [the subject property] from the agent.'

(f) 'It took about one week to negotiate the sale of [the subject property] with the purchaser.'

20. The assessor ascertained from the formal acquisition agreement dated 6 October 2003 [paragraph 11(a)] that the subject property had a floor area of about 125.749 square metres (or 1,353 square feet) with three bedrooms.

21. The assessor maintained the view that the gain derived by the appellant from the disposal of the subject property was a trading profit and therefore should be subject to tax. The assessor wrote to the solicitors explaining his view and requested the appellant to consider withdrawing the objection.

22. The appellant refused to withdraw the objection. The solicitors, on behalf of the appellant, put forth the following contentions:

(a) '[The appellant] acquired [the subject property] because of [his] predominant family need for a more spacious and comfortable accommodation. At the material time, [the subject property development] was viewed as a fashionable and elegant development. [The appellant] had great expectation on (*sic*) it though it was being constructed when he acquired it in October 2003.'

(b) '…[T]he saleable area shown in the Sales and Purchase Agreement alone could not give a full and accurate picture of the actual usable area and layout of [the subject property]….[The former residence] was of an old fashion and that [the appellant] intended to offer a more comfortable accommodation for his children when they returned from overseas study.'

(c) '…[A]t the very beginning it was the estate agent who solicited [the appellant] to sell [the subject property] in 2004. However, …[he] had not determined to sell [the subject property] at that moment until he and [the wife] had inspected the show flat later.'

(d) 'Since the inspection of the show flat took place more than 3 years ago, [the appellant] does not remember exactly when he did the inspection. He therefore gave a rough estimation … that he did it about the end of 2004 [paragraph 18(e)]. But the material fact is that he determined to sell [the subject property] AFTER he and [the wife] had inspected the show flat.'

(e) '[The wife] did not participate in the process of acquiring [the subject property] until she returned to Hong Kong from [overseas] in 2004 when she had the first opportunity to inspect the show flat of [the subject property]. She was dissatisfied with its usable area and layout, particularly those of the master bedroom. As a result, she determined that she would rather stay in [the former residence] and would not move in [the subject property]. [The appellant] had no alternative but had to sell [the subject property] and looked for another in substitution.'

(f) 'As a (*sic*) further evidence to show that [the appellant] acquired [the subject property] with the intention for his family's residence, kindly note that at the material time [the appellant] had instructed our firm as solicitors acting for him in the purchase of [the subject property] to prepare a Nomination (intended to be completed on completion of the purchase of [the subject property]) nominating [the wife] to be the joint owner of [the subject property]. A copy of the draft Nomination signed by [the wife] in escrow retrieved from our old file is enclosed ...'

(g) '[The appellant] would also like to draw your attention to the fact, …, that full payment of the purchase price of [the subject property] had already been made in December 2003 when it was still being constructed.'

23. In response to the assessor's enquiries concerning the sale of the subject property, the estate agent provided the following information:

(a) The appellant appointed it to sell the subject property on 13 July 2004.

(b) The asking price of the subject property from the appellant was $13,000,000 throughout the appointment period.

24. In response to the assessor's enquiries, the developer of the subject property, provided the following information:

(a) A sales brochure including the floor plan of the flat. The plan showed that the flat had a gross floor area of 1,688 square feet and a saleable area of 1,410 square feet[3] (including balcony area of 62 square feet, bay window area of 38 square feet and utility platform area of 18 square feet).

(b) Show flat preview was available on 1 October 2003 when the appellant acquired the subject property[4].

25. In reply to the assessor's further enquiries, the solicitors, on behalf of the appellant, made the following assertions:

(a) '[The daughter] finished her study [overseas] near the end of 2004. Her graduation ceremony was held in December 2004. She returned to Hong Kong in January 2005. [Since then, she had] stayed with [the appellant and the wife]. She took up full time job on 1 November 2005.'

(b) 'Renovation of the current residence was completed in July/August 2007.'

(c) 'After completion of renovation, [the current residence] was used by [the appellant, the wife and the daughter].'

(d) 'Purchase of [the subject property] was completed in a rush. [The appellant] recollected that most probably he had <u>not</u> read the sales brochures before he committed to purchase the subject property.'

(e) 'When [the wife] came back to Hong Kong from [overseas] at the end of year 2003 during the term break of [the daughter], [the wife] then had a chance to see the show flat. As [the wife] was not satisfied with the usable size of [the subject property], she then started looking for properties of larger size and inspected various potential target properties of larger size recommended by several estate agents….'

Copies of statements signed by 3 estate agents were also supplied.

Grounds of appeal

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[3] 1,410 – 38 – 18 = 1,354. We assume that the difference of 1 square foot from 1,353 square feet referred to in paragraph 20 above arose from rounding up or down when converting from square metres to square feet.

[4] Mr Dustin Chan, solicitor for the appellant, told us that he accepted the truth of this statement and we find as a fact that show flat preview was available on 1 October 2003 when the appellant acquired the subject property.

26. As formulated by the solicitors, the grounds of appeal are as follows:

> ' 1. There was sufficient evidence to prove that the gain dervied (*sic*) by the Appellant from the purchase and sale of the property in question should not be chargeable to Profits Tax.
>
> 2. The Commissioner has failed to consider all the facts of the case.
>
> 3. The Appellant was not carrying on a trade, profession or business in Hong Kong in respect of the alleged profit at the material time.
>
> 4. The gain was not profit arising or derived from trade, profession or business carried on by the Appellant.
>
> 5. The property in question was acquired as the residence for the Appellant and his family and also for the purpose of a long term investment.
>
> 6. The alleged profit was just a capital gain.
>
> 7. The commissioner erred in not admitting into evidence the written statements from the estate agents.
>
> 8. It was wrong, incorrect, unfair and unsafe to hold that the property in question was acquired by the Appellant as a trading asset for the purpose of resale for profit.'

The hearing

27. Mr Dustin Chan, solicitor, represented the appellant at the hearing of the appeal. The respondent was represented by Ms Hui Chiu Po, an assessor.

28. Mr Chan called the appellant, the wife, the daughter and 3 estate agents to give evidence. Ms Hui did not call any witness.

29. The appellant's list of authorities reads as follows:

> ' (a) Case No D53/06 IRBRD[5]
>
> (b) Simmons v IRC [1980] 1 WLR 1196[6]

[5] There is no page number, whether in the list or in the copy of the case provided by the solicitors.
[6] The copy case provided by the solicitors was not a copy of the Weekly Law Reports.

(c) Case No D3/92 IRBRD[7]

(d) Marson v Morton [1986] 1 WLR 1343[8]'

30. The respondent furnished us with a copy of the following authorities:

1. Inland Revenue Ordinance, Chapter 112, sections 2(1), 14 & 68 and Schedule 5 Part I.

2. Simmons (as Liquidator of Lionel Simmons Properties Ltd) v Inland Revenue Commissioners [1980] 1 WLR 1196.

3. All Best Wishes Ltd v Commissioner of Inland Revenue 3 HKTC 750.

Authorities on capital or trading/business issue

31. Section 2 of the Ordinance defines 'business' as including 'agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government' and 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'.

32. Section 14 is the charging provision on profits tax. Sub-section (1) provides that:

> '*Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment ... 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.*'

33. Section 68(4) provides that the 'onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'.

34. Lord Wilberforce recognised in Simmons v IRC [1980] 1 WLR 1196 at page 1199, that intention may be changed and at page 1202 that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention:

[7] There is no page number, whether in the list or in the copy of the case provided by the solicitors.
[8] The copy case provided by the solicitors was not a copy of the Weekly Law Reports.

> *'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] A.C. 58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status - neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review.' (at page 1196)*

> *'Finally as to the decision of the Court of Appeal, the judgment, delivered by Orr L.J., contains a clear account of the facts, and, in my respectful opinion, a generally correct statement of the law. In particular, it is rightly recognised that a sale of an investment does not render its disposal a sale in the course of trade unless there has been a change of intention.' (at page 1202)*

In the Court of Appeal, Orr L J stated the general principles in these terms:

> *'It is also clearly established that on appeal to the Commissioners the burden is on the taxpayer to displace the assessment, and in these circumstances the burden in the present case was clearly on the taxpayers to establish that the sales in question gave rise to a surplus on capital account and not to a trading profit (Norman v Golder 26 TC 293, at page 297, and Shadford v H Fairweather & Co Ltd 43 TC 291, at page 300). On the other hand it is also clear that if an asset is acquired in the first instance as an investment the fact that it is later sold does not take it out of the category of investment or render its disposal a sale in the course of trade unless there has been a change of intention on the part of the owner between the dates of acquisition and disposal (Eames v Stepnell Properties Ltd 43 TC 678). The question, moreover, whether an item is held as capital or as stock-in-trade is not concluded by the way in which it has been treated in the owner's books of account (CIR v Scottish*

Automobile and General Insurance Co Ltd 16 TC 381, at page 390) or by the Revenue in past years (Rellim Ltd v Vise 32 TC 254).' [l980] 53 TC 461 at pages 488 & 489.

35. In Marson v Morton [1986] 1 WLR 1343 at pages 1347 –1349, Sir Nicholas Browne-Wilkinson VC stated that:

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

- The purpose of authority is to find principle, not to seek analogies on the facts.

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

- The most that his Lordship had 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 and that the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate. The matters which are apparently treated as a badge of trading are as follows:

  '*(i) The transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.*

  (ii) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.

  (iii) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the chairman of the commissioners quoted from Inland Revenue Commissioners v. Reinhold, 1953 S.C. 49. For example, a large bulk of whisky or

toilet paper is essentially a subject matter of trade, not of enjoyment.

(iv) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?

(v) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.

(vi) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.

(vii) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.

(viii) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(ix) Did the item purchased either provide enjoyment for the purchaser, for example a picture, or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no

> *income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment.'*

- 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?

36. Mortimer J (as he then was) pointed out in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771 that – 'was this an adventure and concern in the nature of trade' is a decision of fact and the fact to be decided is defined by the Statute.

> *'Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.' (at page 770)*

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

> *I am unable to accept that submission quite in its entirety. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute - was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things 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.' (at page 771)

37. Neither party cited the judgment of the Court of Final Appeal in Lee Yee Shing & Yeung Yuk Ching v The Commissioner of Inland Revenue [2008] 3 HKLRD 51, a case on share dealing activities.

38. Bokhary PJ and Chan PJ emphasised at paragraph 38 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances. McHugh NPJ thought that ultimately, the issue is one of fact and degree[9].

39. On the question of 'trade', McHugh NPJ stated that:

(a) No principle of law defines trade. Its application requires the tribunal of fact to make a value judgment after examining all the circumstances involved in the activities claimed to be a trade. (paragraph 56)

(b) The intention to trade to which Lord Wilberforce referred in *Simmons* is not subjective but objective: *Iswera v. Commissioner of Inland Revenue* [1965] 1 WLR 663 at 668. It is inferred from all the circumstances of the case, as Mortimer J pointed out in *All Best Wishes Ltd v. Commissioner of Inland Revenue* (1992) 3 HKTC 750 at 771. A distinction has to be drawn between the case where the taxpayer concedes that he or she had the intention to resell for profit when the asset or commodity was acquired and the case where the taxpayer asserts that no such intention existed. If the taxpayer concedes the intention in a case where the taxing authority claims that a profit is assessable to tax, the concession is generally but not always decisive of intention: *Inland Revenue Commissioners v. Reinhold* (1953) 34 TC 389. However, in cases where the taxpayer is claiming that a loss is an allowable deduction because he or she had an intention to resell for profit or where the taxpayer has made a profit but denies an intention to resell at the date of acquisition, the tribunal of fact determines the intention issue objectively by examining all the circumstances of the case. It examines the circumstances to see whether the 'badges of trade' are or are not present. In substance, it is 'the badges of trade' that are the criteria for determining what Lord Wilberforce called 'an operation of trade'. (paragraph 59)

(c) What then are the 'badges of trade' that indicate an intention to trade or, perhaps more correctly, the carrying on of a trade? An examination of the

[9] See paragraph 40(c) below.

many cases on the subject indicates that, for most cases, they are whether the taxpayer:

1. has frequently engaged in similar transactions?

2. has held the asset or commodity for a lengthy period?

3. has acquired an asset or commodity that is normally the subject of trading rather than investment?

4. has bought large quantities or numbers of the commodity or asset?

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

6. has sought to add re-sale value to the asset by additions or repair?

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

8. has conceded an actual intention to resell at a profit when the asset or commodity was acquired?

9. has purchased the asset or commodity for personal use or pleasure or for income? (paragraph 60)

(d) In some cases, the source of finance for the purchase may also be a badge of trade, particularly where the asset or commodity is sold shortly after purchase. But borrowing to acquire an asset or commodity is usually a neutral factor. (paragraph 61)

40. On the question of 'business', it has long been recognised that business is a wider concept than trade, per Bokhary PJ and Chan PJ at paragraph 17. McHugh NPJ is of the same view, stating in paragraph 68 that business is a wider term than trade. McHugh NPJ went on to state that:

(a) What then is the definition or ordinary meaning of 'business'? The answer is that there is no definition or ordinary meaning that can be universally applied. Nevertheless, ever since *Smith v. Anderson* (1880) 15 Ch D 247, common law courts have never doubted that the expression 'carrying on' implies a repetition of acts and that, in the expression 'carrying on a business', the series

of acts must be such that they constitute a business: *Smith v. Anderson* (1880) 15 Ch D 247 at 277 – 278 per Brett LJ. Much assistance in this context is also gained from the statement of Richardson J in *Calkin v. Commissioner of Inland Revenue* [1984] 1 NZLR 440 at 446 where he said 'that underlying … the term "business" itself when used in the context of a taxation statute, is the fundamental notion of the exercise of an activity in an organised and coherent way and one which is directed to an end result'. In *Rangatira Ltd v. Commissioner of Inland Revenue* [1997] STC 47, the Judicial Committee said that it found these words of Richardson J 'of assistance'. (paragraph 69).

(b) Ordinarily, a series of acts will not constitute a business unless they are continuous and repetitive and done for the purpose of making a gain or profit: *Hope v. Bathurst City Council* (1980) 144 CLR 1 at 8 – 9 per Mason J; *Ferguson v. Federal Commissioner of Taxation* (1979) 79 ATC 4261 at 4264. However, as Lord Diplock pointed out in *American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia)* [1979] AC 676 at 684 'depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between'. Exceptionally, a business may exist although the shareholders or members cannot obtain any gain or profit from the activities of the business: *Inland Revenue Commissioners v. Incorporated Council of Law Reporting* (1888) 22 QBD 279 (law reporting body prohibited by its constitution from dividing profits among members). It may exist even though the object of the activities is to make a loss: *c.f. Griffiths v. JP Harrison (Watford) Ltd* [1963] AC 1 (dividend stripping operation). And a corporation, firm or business may carry on business in a particular country even though its profits are earned in another country: *South India Shipping Corp Ltd v. Export-Import Bank of Korea* [1985] 2 All ER 219. (paragraph 70)

(c) While engaging in activities with a view to profit making is an important indicator, and in some cases an essential characteristic, of a business, a profit making purpose does not conclude the question whether the activities constitute a business. Whether or not they do depends on a careful analysis of all the circumstances surrounding the activities. Some may indicate the existence of a business; some may indicate that no business exists. Ultimately, the issue is one of fact and degree. But, as *Edwards v. Bairstow* [1956] AC 14, *Hope v. Bathurst City Council* (1980) 144 CLR 1 and *Lewis Emanuel & Son Ltd v. White* (1965) 42 TC 369 show, the issue becomes one of law and not fact where the only reasonable conclusion to be drawn from the facts found or admitted is that the activities in question did or did not constitute the carrying on of a business. In such a case, an appellate court, although

> debarred from finding facts, may reverse the finding of the tribunal of fact and hold that a business was or was not being carried on. (paragraph 71)

Capital or trading – analysis

41. The appellant's stated intention was to hold the subject property on a long term basis as the residence for himself, the wife, the daughter and the son. Why did that plan not come to fruition? It was, according to the appellant, because, contrary to his expectation at the time of acquisition, he subsequently found out that the subject property was not materially larger in size than the former residence. He intended to get and thought he was getting a larger residence.

Although there was some mention of 'comfort' in the correspondence, it is plain from the context that it was comfort arising from a larger and more spacious residence. There was no allegation that it meant anything else. The reason is simple – there is no allegation of the appellant being disappointed had it meant 'comfort' in any other sense. His current residence is also at the subject property development.

42. The appellant gave evidence to the effect that:

(1) Prior to acquiring the former residence, he had acquired 2 other residential units in that development, progressing from 500 plus square feet in size to 800 plus and then to 1,300 for the former residence.

(2) He had been told by the estate agent that the area of the subject property was 1,695 square feet.

(3) On the day he signed the provisional agreement, he had walked through the show room which had no partition and he thought the flat was shown by the whole carpeted area, not paying attention to a tape on the floor which marked the boundary of the flat.

(4) He said he wanted to surprise and please his wife by buying a residence with a floor number which was the same as the date of her birth.

(5) He had not read any sales brochure and had not been shown any price list.

(6) He was in a rush because he was not often in Hong Kong.

43. The wife said that she and the appellant had been discussing about a change to another flat, that she had been planning to purchase every time she came back from overseas and that she inspected the show flat around Christmas in 2003 and concluded that there was not much difference between the subject property and the former residence.

44. The estate agent who introduced the subject property development to the appellant said that the designer show flat was there to attract buyers and that it had partitions delineating the area of the flat although the show flat might not have some internal partitions so as to give viewers the impression of a more spacious unit.

45. The stated intention was to acquire a larger residence.

46. According to the sales brochure, the subject property had a gross area of 1,688 square feet and saleable area of 1,410 square feet including bay window, balcony and utility platform. The provisional acquisition agreement was silent on the area of the subject property. Schedule 3 to the formal acquisition agreement stipulated that the saleable area of the subject property was 'approximately 125.749 square metres of which approximately 5.749 square metres belong to the balcony' as saleable area of the unit with 2 other items, i.e. 'approximately 1.693 square metres for the utility platform' and 'approximately 3.511 square metres for the bay window'. According to the floor plan, the subject property had 1 *en suite* bedroom and 2 other bedrooms. According to the solicitors' letter of objection dated 8 January 2007, 'the usable size of the [subject property] ... was only slighter larger than' the former residence[10].

47. According to the objection letter[11], the appellant had not viewed the show room or flat before signing the provisional or formal acquisition agreements:

> ' [The subject property] was an uncompleted flat when [the appellant] purchased it in October 2003. Only until about the end of 2004 he had the opportunity to inspect the show flat of [the subject property]'.

48. On the appellant's own testimony, he did not read any sales brochure and he had not seen any price list[12].

49. If the appellant had intended to acquire a larger flat, what he contracted to buy was, at best and on his case, 'only slighter larger'.

50. We asked Mr Chan what steps, if any, were taken by the appellant to satisfy himself that he was acquiring a larger flat.

51. Mr Chan reminded us of the appellant's evidence on the show flat and on having been told about the area of the subject property.

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[10] See paragraph 18(e) above.
[11] See paragraph 18(e) above.
[12] Thus it is immaterial whether there was any price list and, if there was, whether it contained any information on the area.

52. The appellant's evidence lacked particularity, was vague, often evasive and not credible or reliable. So was the wife's evidence. The estate agent shifted her evidence on whether she had viewed the show flat of units of the size of the subject property.

53. If the appellant had 'walked through' the show room, there was no reason why there was no mention in the correspondence of his visit whatsoever. It was contradicted by the allegation in the objection letter that he had no opportunity to do that until about the end of 2004, i.e. after the making of the provisional and formal acquisition agreements. There was no explanation, whether in the correspondence or in his testimony, for the inconsistent versions.

54. Faced with the absence of any explanation, Mr Chan drew our attention to another allegation in the objection letter, the one quoted in paragraph 18(g) above and sought to rely somehow on what he contended was an inconsistency. We must confess we have some difficulty following his argument. An inconsistency is not explained by pointing to another inconsistency. Any further inconsistency, if material, should be explained. In any event, we fail to see any inconsistency between sub-paragraphs (e) and (g) in paragraph 18 above.

55. In our decision, the 'walking through' of the show room before the making of the acquisition agreements was a recent invention. We also reject his testimony on the absence of a partition marking the boundary of the unit. Although we are not impressed by, and reject the estate agent's evidence on viewing of the show flat, we accept her evidence that the show flats were designed to attract buyers and conclude that it is more probable than not that the show flat was designed to show an impressive home, not a carpeted area with no wall/partition.

56. The allegation by the appellant that the estate agent said that the area of the flat was 1,695 square feet does not take the appellant's case any further. He did not say whether the estate agent was talking about gross area or saleable area or usable area. Nor did he say he had asked. Nor did he tell us anything about what that area included. On his own testimony, he had experience of acquiring at least 3 residential properties before. In short, there is no allegation that he took any step to satisfying himself on what the saleable or usable area was.

57. The appellant's reason for the rush was that he was not in Hong Kong often. We reject it. The objective fact is that he was in Hong Kong on 1 October 2003. On his case, he and his wife had been planning for a larger residence for some time. They resided in the former residence which they owned and which was more than ample for their then purposes, with both children studying abroad for at least one more year. Put simply, there was no reason for any rush.

58. Indeed, there was no allegation that the appellant had concerned himself with the layout of the flat. Nor did he tell us what his expectation was.

59. Opting for full payment of the purchase price before completion of the construction of the subject property development and completion of the acquisition of the subject property was

relied on as a factor in favour of capital acquisition. We accept that this is a factor in the appellant's favour. However, the balancing factor is that, compared with full payment only on completion of the subject property development, there was a discount of the price. There is no evidence on what the discount was and there is thus no evidence that interest on the balance of the acquisition price exceeded the discount.

60. The appellant also relied on the search as from early 2004 for a larger residential unit. The evidence according to the wife and the 3 estate agent witnesses was that the couple was looking for a residence with 2 *en suite* bedrooms and 2 other bedrooms and that this meant flats with more than 2,000 square feet in area. We do not think this assisted the appellant's case. If anything, this evidence shows that the appellant should have been looking for flats with more than 2,000 square feet in area, having 4 bedrooms (2 of them *en suite*) had he been looking for a larger residence instead of doing a deal.

61. In summary, the appellant agreed to purchase the subject property without having been shown any price list, without having read any sales brochure, without viewing the show flat, without satisfying himself that he was agreeing to acquire a larger flat, without informing himself of the layout of the flat and without paying any attention to information on areas in the formal acquisition agreement.

62. We do not think the floor number took the appellant's case any further. The floor number is a number regarded by some as an auspicious one. Flats with auspicious numbers cannot fare worse than those without.

63. Nor do we think the draft nomination takes the appellant's case any further. It has not been signed by the appellant, by reason of which it does not constitute evidence of the appellant's intention. Even if it evidences the appellant's intention at the time of signing by the wife of the form, it is no evidence of the appellant's intention at the time of signing of the provisional acquisition agreements. In our view, having regard to the frequent overseas trips, it is prudent for the solicitors, as conveyancers, to ask the wife to sign such a form just in case it should be needed.

64. For completeness, we turn now to the 'badges of trade' listed by McHugh NPJ and quoted by us in paragraph 39(c) above. This is not a mechanical exercise of counting the number of scores. What we are required to do, in the words of McHugh NPJ, is to 'make a value judgment after examining all the circumstances involved in the activities claimed to be a trade'.

(a) Whether the appellant has frequently engaged in similar transactions – no.

(b) Whether the appellant has held land for a lengthy period – no. The appellant contracted to sell within 1 year and before completion of the acquisition.

(c) Whether the appellant has acquired an asset that is normally the subject of trading rather than investment – land can be the subject of trading or investment.

(d) Whether the appellant has bought or acquired large quantities of land – there is no evidence of buying or acquisition of large quantities of land.

(e) Whether the appellant has sold the asset (or parts thereof) for reasons that would not exist if he had an intention to resell at the time of acquisition – no.

(f) Whether the appellant has sought to add re-sale value to the asset by additions or repair – no. He sold it before he completed his acquisition.

(g) Whether the appellant has conceded an actual intention to resell at a profit when the asset was acquired – no.

(h) Whether the appellant has acquired the asset for personal use or pleasure or for income – no, his case on acquisition of the subject property as the family residence is rejected by us.

65. It is a question of fact whether the appellant' s stated intention of acquiring the subject property as the residence for himself and his family was his actual intention. We decide against the appellant on this factual issue.

66. On the materials before us, we conclude that the appellant was doing a deal.

Conclusion

67. The appeal fails and must be dismissed.

Disposition

68. We dismiss the appeal and confirm the assessment appealed against as confirmed by the Acting Deputy Commissioner.