Case No. D90/04

Profits tax – whether or not the Property was the appellant's trading stock – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO') – whether the stated intention was in fact the intention of the appellant at the time of acquisition of the Property is a question of fact – whether or not the stated intention was genuinely held.

Panel: Kenneth Kwok Hing Wai SC (chairman), Carlson Tong and Lily Yew.

Dates of hearing: 28 January and 4 February 2005.
Date of decision: 10 March 2005.

The appellant is a shelf company acquired on 22 July 1996 for the sole purpose of purchasing a residential unit in Private Residential Estate C (hereinafter referred to as 'the Property'). Mr A and Mrs A are the only two directors and the shareholders of the appellant. On 20 September 1996, the appellant signed a provisional agreement to purchase the Property from the developer. On 11 July 1997, the appellant completed the purchase of the Property upon receiving notice of project completion from the developer. On 13 July 1997, Agent N was appointed as the exclusive agent to dispose the Property. On the same day, the appellant signed a provisional agreement to sell the Property. In the audited accounts of the appellant, the gain derived from the sale of the Property was reported as exceptional profit and in the balance sheet, the purchase and subsequent disposal of the Property was treated as movements in 'Fixed Assets'. The appellant became dormant after the disposal of the Property.

The assessor was of the view that the Property was the appellant's trading stock and the gain should be assessable to profits tax. The appellant's case was that Mr A and Mrs A changed their minds on 11 July 1997, the day they obtained possession of the Property, and decided to sell the Property because of 'fung shui' reasons and because of the unpleasant environment of the District.

Held:

1. Section 2 of the IRO, defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade.' Section 14(1) excludes profits arising from the sale of capital assets. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant. The onus of disturbing the assessment lies on the appellant, failure to

discharge the onus may be decisive against the appellant.

2. Whether the stated intention was in fact the intention of the appellant at the time of acquisition of the Property is a question of fact. Having considered the evidence in the present case, the appellant has not shown on a balance of probabilities that the stated intention was in fact the intention. The Board is not satisfied that the stated intention was genuinely held. The appellant has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect.

Appeal dismissed.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750
Mok Tze Fung v Commissioner of Inland Revenue 1 HKTC 166
Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224
Li Tin Sang v Poon Bun Chak & Others, unreported, CACV 153 of 2002, 18 November 2002, the Court of Appeal

Yeung Siu Fai and Tang Hing Kwan for the Commissioner of Inland Revenue.
Taxpayer represented by its director.

Decision:

1. This is an appeal against the determination of the Deputy Commissioner of Inland Revenue ('the Deputy Commissioner') dated 7 May 2004 whereby the profits tax assessment for the year of assessment 1998/99 under charge number 1-1121587-99-0, dated 27 February 2003, showing assessable profits of $1,369,784 and tax payable thereon of $219,165 was confirmed.

The agreed facts

2. The following facts were agreed by the appellant and the respondent and we find them as facts.

3. The appellant is a shelf company acquired by Mr A and Ms B ('Mrs A') on 22 July 1996 for the sole purpose of purchasing a residential unit in Private Residential Estate C.

4. The appellant has two issued shares, of which one share is held by Mr A and the other share is held by Mrs A. Mr A and Mrs A, the only two directors of the appellant, are hereinafter collectively referred to as 'the Directors'.

5. Mr A is a professional accountant and has been working as a finance executive in Company D, a property company in District E, since April 1994.

6. Mrs A is a professional accountant and was employed by the Group F at the relevant time. Her position and place of work were as follows:

	Period	**Position**	**Office Address**
(i)	18 May 1995 - 31 Dec 1997	Accounting Manager, Company G	Address I in New Territories
(ii)	1 Jan 1998 - 17 Aug 1998	Finance Manager, Company G	As above
(iii)	18 Aug 1998 - 31 March 1999	Senior Finance Manager, Company H	Address J on Hong Kong Island

7. In June 1993, the Directors purchased Address K in Private Residential Estate L on Hong Kong Island (the '1st Property') from the developer for $2,573,800 on stage payment terms. The 1st Property was a property under construction at the time of purchase and was physically delivered to Mrs A as the registered owner in May 1994. The 1st Property became the place of residence for the Directors when they married in September 1994.

8. On 20 September 1996, the appellant signed a provisional agreement to purchase from the developer Address M in Private Residential Estate C in New Territories (the 'Property') for $3,903,700. The formal sale and purchase agreement was signed on 24 September 1996. The payment terms were:

(i)	Initial deposit of 10% upon signing of the provisional agreement	$390,370
(ii)	Second deposit of 10% within 14 days of signing of the formal agreement	$390,370
(iii)	Third deposit of 5% on or before 1 November 1996	$195,185
(iv)	Fourth deposit of 5% on or before 1 January 1997	$195,185
		$1,171,110
(v)	70% balance consideration within 14 days of the date of notification to the appellant that the developer is in a position to assign	$2,732,590

the Property to the appellant	
	$3,903,700

9. Commencing March 1997, the 1st Property was put up for sale through a property agent in Private Residential Estate L, Agent N.

10. On 11 July 1997, the appellant completed the purchase of the Property upon receiving notice of project completion from the developer. The mortgage loan of $2,732,000 from Bank O was drawn [on] to pay for the completion monies.

11. On 13 July 1997, Agent N was appointed as the exclusive agent to dispose [of] the Property. A prospective purchaser was identified by Agent N on that day.

12. On 13 July 1997, the appellant signed a provisional agreement to sell the Property with the prospective purchaser for $5,600,000. The formal sale and purchase agreement was signed on 23 July 1997. Completion of the sale took place on 6 October 1997.

13. The gain of $1,447,669 so derived was reported in the audited accounts of the appellant for the year ended 30 June 1998 as exceptional profit. In the balance sheet, the purchase and subsequent disposal of the Property was treated as movements in 'Fixed Assets'. The appellant became dormant after the disposal of the Property.

14. In July/August 1997, the Directors withdrew [the 1st Property] from the property agents.

15. Pregnancy of Mrs A was confirmed with the gynaecologist in September 1997. The first child of the Directors was born in May 1998.

16. In May 1999, the Directors moved their place of residence to Address P in Private Residential Estate L on Hong Kong Island. The property, having a gross floor area of approximately 1,100 square feet, was rented by the Directors during the period from May 1999 to March 2001.

17. In April 2001, the Directors moved their place of residence to Address Q in Private Residential Estate R on Hong Kong Island. The property, having a gross floor area of approximately 1,100 square feet, was rented by the Directors during the period from April 2001 to July 2004.

18. The 1st Property, having a gross floor area of 745 square feet, was leased out for rental income from June 1999 to July 2002. Provisional agreement was entered on September 2002 to dispose [of] the property for $1,890,000. Completion took place on 13 November 2002

and the Directors realised a loss of $683,800 versus the historical purchase price of $2,573,800. Agent S was the property agent in the transaction.

19. On 6 December 2003, the Directors entered into a provisional agreement to purchase from the developer Address T in Private Residential Estate U on Hong Kong Island (the '3rd Property') for $7,017,600. The formal agreement was signed on 15 December 2003 and completed on 8 January 2004.

20. The Directors subsequently moved their place of residence to the 3rd Property in July 2004 and had been [residing] there since then.

The grounds of appeal

21. The assessor was of the view that the Property was the appellant' s trading stock and the gain should be assessable to profits tax.

22. Having failed in its objection, the appellant gave notice of appeal by letter dated 6 June 2004 on the following grounds (written exactly as it stands in the original):

> ' ... that the gain derived from the sale of the property in question was emanated from a change in intention over the property. The property was originally purchased for the purpose of providing a place of residence for the directors. The Commissioner has not given due regard to the relevant evidence behind the change of intention over the property and has erroneously determined that the gain was a trading profit.'

The appeal hearing

23. At the hearing of the appeal, the appellant was represented by Mr A, ably assisted by Mrs A. The respondent was represented by Mr Yeung Siu-fai.

24. The appellant called Mr A, Mrs A and Mr V to give evidence. No witness was called by Mr Yeung Siu-fai.

Capital assets

25. Section 2 of the Inland Revenue Ordinance, Chapter 112, defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets. Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.

26. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 - 1349 and [1986] STC 463 at pages 470 - 471;

what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 - 492; and the statement of the law by Orr LJ at pages 488 & 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

27. We also remind ourselves of what Mortimer J (as he then was) said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771.

> '*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)*

Onus of proof

28. As the onus of disturbing the assessment lies on the appellant, failure to discharge the onus may be decisive against the appellant.

29. In Mok Tsze Fung v Commissioner of Inland Revenue 1 HKTC 166 {also reported in [1962] HKLR 258}, Mills Owens J said (at page 183 of the HKTC report and page 281 of the HKLR report) that:

> *'It was for the appellant to adduce evidence before the Board of Review in order to discharge the onus resting upon him, and on his failure to do so the Board was entitled, indeed bound, to reject his appeal (vide **Pyrah v Amis**).'*

30. In Commissioner of Inland Revenue v The Board of Review, ex parte Herald International Ltd [1964] HKLR 224 Blair Kerr J said that:

> *'According to section 68(3) the assessor attends the hearing before the Board "in support of the assessment", but the onus of proving that "the assessment as determined by the Commissioner .... is excessive" is placed fairly and squarely on the appellant by section 68(4).' (at page 229)*
>
> *'The question for the Board of Review is not whether the Commissioner erred in some way, but whether the assessment is excessive. As Mr Sneath so aptly put it:*
>
> *'The question is: "Did the Commissioner get the correct answer"; not "did the Commissioner get the correct answer by the wrong method".'*
>
> *And the onus of proving that the assessment is excessive lies on the taxpayer-appellant.' (at page 237)*

31. In All Best Wishes Limited v Commissioner of Inland Revenue (1992) 3 HKTC 750 at page 772, Mortimer J (as he then was) said that:

> *'It must be remembered that the burden of disturbing the assessment, rests upon the taxpayer.'*

32. In Li Tin Sang v Poon Bun Chak & others, unreported, CACV 153 of 2002, 18 November 2002, the Court of Appeal held that a judge is not bound always to make a finding one way or the other and may decide the case on the burden of proof.

> *' I agree with Cheung JA and Stone J that the answer lies in Rhesa Shipping Co. S.A. v Herbert David Edmunds (The "Popi M") [1985] 1 WLR 948, 955H-956A, [1985] 2 Lloyd's Rep. 1 at 6, where Lord Brandon observed that the judge is not bound always to make a finding one way or the other with regard to the facts averred by the parties and may decide the case on the*

burden of proof. This was what happened below: the judge found that the plaintiff had failed to prove his case', per Le Pichon JA, at paragraph 3.

'A judge is not bound always to make a finding one way or the other with regard to facts averred by the parties. While the court does not generally favour deciding a case on the basis of burden of proof, a judge has open to him this third alternative of saying that the party on whom the burden of proof lies in relation to any averment made by him has failed to discharge that burden: Rhesa Shipping Co. S.A. v. Herbert David Edmunds, ("The Popi M.") [1985] 2 Lloyd's Law Report 1', per Cheung JA at paragraph 63.

'A trial judge is not bound to find one way or the other, and it is open to the court to decide the case on the burden of proof: see here the observations of Lord Brandon in The "Popi M" [1985] 2 Lloyd's LR 1, at p.6', per Stone J at paragraph 77.

The Board's Decision

33. The stated intention was to provide a place of residence for Mr & Mrs A. In summary, the appellant's case was that:

(a) Mr & Mrs A planned to have their first baby and chose Private Residential Estate C because of its proximity to the MTR Station of District W thereby reducing the travelling time of Mrs A to and from her place of work at Address I in New Territories; and

(b) Mr & Mrs A changed their minds on 11 July 1997 (A1 page 5), the day they obtained possession of the Property, and decided to sell the Property because of 'fung shui' reasons (the discovery that 'a fire station came into obvious sight from the living room and two bedrooms inside the Property') and because of the 'unpleasant environment of the [District W]'.

34. Whether the stated intention was in fact the intention of the appellant at the time of acquisition of the Property is a question of fact.

35. The formal agreement to acquire the Property contained a prohibition (clause 11, a standard prohibition under the Consent Scheme) against disposal or alienation of the Property prior to completion of the acquisition assignment. While it is true that the clause 11 does not prohibit sale of the shares of the appellant, sale of shares of land holding companies was less popular or common than sale of landed properties. The acquisition assignment is dated 11 July 1997 and two days later, the appellant entered into the provisional agreement dated 13 July 1997 to dispose of the Property.

36. On the appellant' s case, it relied heavily on borrowed funds to finance the acquisition of the Property. The acquisition price of the Property was $3,903,700, $1,171,110 of which was payable before completion and $2,732,590 was payable on completion. The appellant' s case was that the mortgage loan of the 1st Property was increased by $1,400,000 to finance the acquisition of the Property and that the mortgage loan of $2,732,000 from Bank O was drawn on to complete the acquisition. In addition to these two loans, there was a further loan of $390,000, said to be a decoration loan.

37. Two reasons were given for the decision to sell – 'fung shui' and 'unpleasant environment of the [District W]'.

38. The presence of the fire station and the environment of the District W are both objective facts which, if material, should have been known to the appellant before acquisition.

39. The appellant claimed that Mr & Mrs A did not know about the presence of the fire station until the day they took possession of the Property. They claimed that they believed in 'fung shui'; bought a book on 'fung shui'; and produced an extract in an attempt to substantiate their contention that a fire station was bad for 'fung shui' reasons. We are not satisfied on a balance of probabilities that the couple or either of them believed in 'fung shui'. Nor are we satisfied on a balance of probabilities that the fire station was a reason for their decision to sell the Property. A genuine believer in 'fung shui' would have satisfied himself/herself on 'fung shui' matters before deciding to buy. The fire station was on the other side of xxxx Road. Nearer Block 2 of Private Residential Estate C was the District W Police Station. Neither Mr nor Mrs A seemed to know or care about the proximity of the police station or its significance, apparently oblivious to the fact that according to the extract which they produced, a fire station was said to be bad in 'fung shui' by analogy with a temple or a police station.

40. Mr & Mrs A were young professional accountants. District W was not known as a district which appealed to young professional men and women. The District W neighbourhood or environment was an objective fact. Neither Mr nor Mrs A claimed that they had never been to District W in his or her life prior to 20 September 1996. If they had never been there in their lives, this would have made their assertion of intention to reside in the Property difficult to believe. We are not satisfied on a balance of probabilities that the District W neighbourhood or environment was unknown to Mr & Mrs A prior to 20 September 1996. We are also not satisfied on a balance of proababilities that District W neighbourhood or environment was a reason for the decision to sell the Property.

41. The appellant' s case is discredited by the claim by Agent X that the appellant put up the Property for sale through Agent X on 20 September 1996, the date of the provisional agreement to acquire the Property.

42. In answer to the assessor's enquiries, Agent X replied by letter dated 10 March 2003 stating that (written exactly as it stands in the original):

> 'With reference to your letter dated 23 December 2002, the required information are shown as follows:
>
> (a) The Vendor put up the captioned property for sale through our company on 20 September 1996.
>
> (b) The contact numbers of the vendor, Mr A of [the appellant] are [Mrs A's direct line at [Company G]], [home telephone number] and [pager number].
>
> (c) The initial asking price was HK$4,090,000. Movement of the asking price of the captioned property are shown as below:
>
> | Date | Asking price |
> |---|---|
> | 20 Sept 1996 | HK$4,090,000 (Initial) |
> | 12 Dec 1996 | HK$4,500,000 |
>
> (d) We regret to inform you that we are unable to locate any information to provide each occasion of flat visits made by each potential buyer introduced by our company during the agency period shown.
>
> It is our company's policy to require our frontline staff, whereby they are instructed, but without constant reminder, to enter into our computer maintenance system spontaneously conclusive and complete records of each and every contact with our clients and of all instruction from them. Unless and until concrete evidence suggests any element of fraud or leads us to think otherwise, we honestly believe that the said computer records represent true record of our respective clients' instruction. Having said that, no warranty is given or implied by us as to the completeness or accuracy of the said records therein contained. We expressly disclaim any liability whatsoever for any loss or damage that occurs to any person or corporation arising from any use of or in reliance upon the whole or any part of the said records.'

43. More than 16 months later, the assessor wrote to Agent X by letter dated 2 August 2004 as follows (written exactly as it stands in the original):

> 'Thank you for your letter of 10 March 2003 (copy enclosed).
>
> Under the authority of sections 51(4)(a) and 51(4A) of the Inland Revenue Ordinance, I shall be grateful if you would furnish me with the following information and documents:

> A copy of the computer printout of the record kept for recording the property transactions acted on behalf of [the appellant] in respect of the captioned property, including the details of the appointment, asking price/rent and details of negotiation for selling/letting the captioned property.'

44. Agent X replied by letter dated 5 August 2004 stating that (written exactly as it stands in the original):

> 'With reference to your letter dated 2 August 2004, the required information are shown as follows:
>
> We are regret to inform you that we are unable to provide any copy of our company's computer printouts showing details of the appointment, asking price and details of negotiation for selling the captioned property.
>
> It is our company's policy to require our frontline staff, whereby they are instructed, but without constant reminder, to enter into our computer maintenance system spontaneously conclusive and complete records of each and every contact with our clients and of all instruction from them. Unless and until concrete evidence suggests any element of fraud or leads us to think otherwise, we honestly believe that the said computer records represent true record of our respective clients' instruction. Having said that, no warranty is given or implied by us as to the completeness or accuracy of the said records therein contained. We expressly disclaim any liability whatsoever for any loss or damage that occurs to any person or corporation arising from any use of or in reliance upon the whole or any part of the said records.'

45. If the stated intention was in fact the intention, would the appellant have put up the Property for sale through Agent X as early as September 1996? We think not. Mr & Mrs A denied having put up the Property for sale through Agent X and claimed that Mrs A gave the estate agents the pager number to avoid pestering. We reject the denial. Giving a pestering estate agent a pager number would only encourage further pestering. In our Decision, Mr & Mrs A were quite capable of telling the estate agents that the Property was neither for sale nor for lease if such was in fact the case. Furthermore, Agent X would not have been able to give the assessor Mrs A's direct line at Company G as one of the three contact numbers unless it was given by her to Agent X and we so find. We also note that neither Mr nor Mrs A took up the matter with Agent X until 30 January 2005, that is to say, after the first hearing before us. This is in sharp contrast with the way they handled Agent N.

46. The appellant contended that the paragraph numbered (c) in Agent X's letter dated 10 March 2003 was contradicted by Agent X's letter dated 2 August 2004. In our Decision, there is no inconsistency. The Property was still under construction at the time and there was no real

opportunity for any flat visit or appointment. What Agent X wrote in the second paragraph of its letter dated 2 August 2004 was quite consistent with the paragraph numbered (d) in its letter dated 10 March 2003. Furthermore, Agent X did not say in the letter dated 2 August 2004 that it had no information or printout – what Agent X said was that it was unable to provide any copy of its computer printouts showing **details**.

47. The appellant contended (A1 page 10) that the fact that they appointed a number of property agents in March 1997 to sell the 1st Property showed that they intended to reside in the Property once decorated. In our Decision, no such inference of intention can be drawn. The appellant put up the 1st Property for sale through Agent Y as early as December 1996. At that time, the Property was still under construction and the appellant did not and would not know when the developer would obtain the certificate of compliance or the consent of the Director of Lands to assign and when the developer would be in a position validly to assign the Property.

48. For reasons which we have given, the appellant has not shown on a balance of probabilities that the stated intention was in fact the intention. We are not satisfied that the stated intention was genuinely held.

Disposition

49. The appellant has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment as confirmed by the Deputy Commissioner.