

**Case No. D9/11**

**Profits tax** – whether gain on disposal of property chargeable to profits tax – sections 14 and 68(4) of the Inland Revenue Ordinance (‘IRO’).

Panel: Colin Cohen (chairman), Mark Richard Charlton Sutherland and Patrick Wu Yung Wei.

Date of hearing: 23 February 2011.

Date of decision: 15 June 2011.

The Taxpayer contends that the profit it derived from the sale of its property at Address B (‘the Property’) which was purchased as long-term investment, should not be subject to profits tax.

**Held:**

1. The Taxpayer’s stated intention that the Property was purchased for long term investment (for the residence of its shareholders and/or directors and/or others) is not supported by the objective facts and the evidence before the Board.
  - The Property was left vacant throughout the entire period of ownership by the Taxpayer;
  - The short period of seven-month ownership does provide some indication of an intention to trade;
  - The appointment of an estate agent soliciting the sale of the Property before the completion and assignment of Property to the Taxpayer;
  - The Taxpayer did not carry out any decoration work to the Property;
  - The Taxpayer had no plan to purchase another property after the disposal of the Property.
2. The Board did not find the Taxpayer’s reason for the sale of the Property due to its sea view being blocked by the next door building a convincing reason.

**Appeal dismissed.**

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196  
All Best Wishes Ltd v CIR [1992] 3 HKTC 750  
Lee Yee Shing v CIR [2008] 3 HKLRD 51  
Real Estate Investments (NT) Limited v CIR [2008] 11 HCFAR 433

Taxpayer represented by its director.

Wong Ka Yee and Chan Wai Yee for the Commissioner of Inland Revenue.

**Decision:**

**Introduction**

1. Company A (in members' voluntary winding up) ('the Taxpayer' or 'the Company') appeals against the Determination of the Acting Deputy Commissioner of Inland Revenue dated 8 July 2010 in respect of the Profits Tax assessment raised on it for 2004/05 ('the Determination').

**The issue**

2. The issue for the Board to decide is whether the profit derived by the Taxpayer from the sale of its property at Address B ('the Property') should be subject to profits tax.

**The agreed facts**

3. The following facts were agreed by the parties and we find them as facts:

- ' (1) [Company A] (in members' voluntary winding up) ("the Company") has objected to the 2004/05 Profits Tax assessment raised on it. The Company claims that the gain it derived from the disposal of a property is capital in nature and should not be chargeable to Profits Tax.
- (2) (a) The Company is a private company incorporated in Hong Kong on 28 May 1996. At the relevant times, both of its authorized and issued share capital remained at \$10,000. The details of the shareholdings of the Company were as follows:

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

	No. of shares held	
	Before <u>10-12-2003</u>	On or after <u>10-12-2003</u>
[Mr C]	1	1
[Ms D]	1	9,969
[Mr E]	0	20
[Company F]	<u>9,998</u>	<u>10</u>
	<u>10,000</u>	<u>10,000</u>

- (b) At all material times, [Mr C], [Ms D] and [Company F] were the directors of the Company.
- (c) In its 2004/05 Profits Tax return, the Company described its principal business activity as “property investment”.
- (d) The Company closed its accounts on 31 December.
- (3) (a) [Mr E] and [Ms D] are husband and wife. Their only son (“the Son”) was born in 1994.
- (b) At all relevant times,
- (i) [Mr E] worked at [Address G].
- (ii) [Mr E] and [Ms D] resided at [Address H] (“Property H”). [Property H] was rented by a company, of which [Mr C] and [Ms D] were director or shareholders, for their residence up to October 2008. [Property H] had 3 bedrooms and a small maid’s bedroom with total floor area of around 1,500 square feet.
- (iii) The Son studied at [Primary School I].
- (4) (a) By a memorandum for sale and purchase dated 13 December 2003 (“the Purchase Agreement”), the Company agreed to purchase the Property at a consideration of \$6,180,000.
- (b) The purchase transaction was completed on 17 February 2004. The Property was assigned to the Company with vacant possession.
- (5) To finance the acquisition of the Property, the Company obtained a mortgage loan of \$4,326,000 from [Bank J], repayable by 180 monthly instalments of \$28,848 each.

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (6) (a) By a provisional agreement for sale and purchase dated 3 August 2004 (“the Sale Agreement”), the Company agreed to sell the Property at a consideration of \$8,000,000.
- (b) The Company completed the assignment of the Property on 27 September 2004. The Property was sold with vacant possession.
- (7) (a) The Company filed its Profits Tax return for the year of assessment 2004/05 and declared an adjusted loss of \$445,467. In arriving at the loss figure, the Company, inter alia:
- (i) excluded the gain of \$1,508,047 [Fact (7)(b) infra] derived from the sale of the Property;
  - (ii) deducted mortgage loan interest of \$71,061 in respect of the Property; and
  - (iii) deducted depreciation allowance of \$327,667, out of which \$324,000 was attributable to a [vehicle] which was acquired during the year at a consideration of \$450,000.

- (b) The gain on disposal of the Property was computed as follows:

	\$	\$
Sales proceeds [Fact (6)(a)]		8,000,000
<u>Less:</u> Cost on purchase		
Cost consideration [Fact (4)(a)]	6,180,000	
Stamp duty	198,000	
Legal fee	<u>18,953</u>	6,396,953
<u>Less:</u> Cost of sales		
Agency commission	80,000	
Legal fee	<u>15,000</u>	<u>95,000</u>
Net gain		<u><u>1,508,047</u></u>

- (8) Pending a review of the property transactions, the Assessor issued a statement of loss for the year of assessment 2004/05 to the Company as follows:

	\$
Adjusted loss per return [Fact (7)(a)]	445,467
<u>Add:</u> Loss brought forward	<u>99,695</u>
Loss carried forward	<u><u>545,162</u></u>

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (9) In reply to the enquiries raised by the Assessor, the Company, through [the Taxpayer's Former Representative], stated the following in relation to its acquisition of the Property:
- (a) The original intention of the acquisition of the Property was for long-term investment.
  - (b) The Property was introduced to the Company through an estate agent who knew that it was looking for a flat with 3 bedrooms and some good sea view in Kowloon side or Hong Kong Island with a budget of between \$6 to 6.5 million.
  - (c) As the developer did not allow any potential buyer to have access to any offered flats for viewing or measurements at the time of acquisition, it could only rely on sales information provided by the developer, external assessment of the location and surrounding buildings, and recommendations from estate agents to determine whether the Property commanded good sea view.
  - (d) Understanding that there might be some other buildings to be put up in the vicinity later and that might block some or all of the sea view of the Property, it enquired of the estate agent whether the Property would command a good sea view. The estate agent told it that the Property might be affected by another building to be erected nearby but in any event the sitting room should have an oblique angle for looking on to the sea and the bedrooms should equally have, perhaps to a lesser extent, sea-views.
  - (e) It was informed by the estate agent that a good discount on the regular price of the Property was being offered by the developer and the discount would be withdrawn in a few days. As such, it did not have sufficient time to carry out any detailed feasibility study before the decision to acquire the Property was made.
  - (f) The discount was not a big one, about 0.5% to 0.75% of the listed/asking price. It was in fact not too worried whether or not a discount could be obtained at the end because firstly it believed that the estate agent would not lie to it about the discount and secondly the discount, which was not a big one, in fact was not its sole decisive consideration.
  - (g) It believed that the purchase price of \$6,180,000 was a discounted price as it was stated in the Purchase Agreement that "All promotional benefits have been included and reflected in the above purchase price".

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (h) The Property had not been occupied or leased out before it was sold on 3 August 2004.
- (10) The Company described the circumstances leading to the disposal of the Property as follows:
- (a) After taking possession of the Property in February 2004, it realized that the Property might be seriously blocked by another building nearby (“the Next-door Building”) which was being erected at the time quite close to the Property. It decided to wait for a few months to see whether after the building work of the Next-door Building progressed further the sea view and open view of the Property would be blocked.
- (b) There was one more problem which had not been previously anticipated at the time of purchase. It realized after taking delivery of the Property that the master bedroom of the Property was too close to the bedrooms/sitting rooms of the flats E in the same building. As such, it would not be able to enjoy any open view at all.
- (c) By the time of June/July 2004, the Next-door Building had been erected higher than the level of the Property and that building almost completely blocked the sea view and the other open view of the sitting room and the bedrooms of the Property. So, it decided that the Property would not be an ideal long-term investment and should be sold.
- (11) When being enquired about the future plan of the Company after the disposal of the Property, the Former Representative replied that the Company did not have any further plan to purchase another property.
- (12) The Assessor was of the view that the Property was the Company’s trading stock and thus the gain derived from its disposal was taxable. He raised on the Company the following 2004/05 Profits Tax assessment:

	\$	\$
Adjusted loss per return [Fact (8)]		(445,467)
<u>Add:</u> Gain on disposal of the Property	1,508,047	
[Fact (7)(a)(i)]		
Depreciation allowance disallowed	<u>324,000</u>	<u>1,832,047</u>
[Fact (7)(a)(iii)]		
Assessable profits		1,386,580
<u>Less:</u> Loss set-off		<u>99,695</u>
<u>Net assessable profits</u>		<u><u>1,286,885</u></u>
Tax payable thereon (@17.5%)		<u><u>225,204</u></u>

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

- (13) The Company objected to the 2004/05 Profits Tax assessment in Fact (12) on the ground that the disposal of the Property was not in the nature of trade.
- (14) In amplification of its ground of objection, the Company asserted that:
- (a) It should not be simply relied on the short holding period of the Property without looking into history of the Company which all along was a property investment company and also the underlying reasons behind the Company's decision to sell the Property to conclude that the disposal was in the nature of trade.
  - (b) In August 1996, it purchased a flat at Address K [Property K] which was occupied by [Mr E], [Ms D] and the Son since the acquisition. The [Property K] was sold in September 1998 at a loss of around \$1,147,041. It did not treat the loss as its trading or adjusted loss as the [Property K] was purchased for long-term investment and used as directors' residence. As was the case with the [Property K], the Property was purchased for long-term investment.
  - (c) Prior to the purchase of the Property, it was informed by the estate agent that the Next-door Building, which was under construction, might block some of the sea view from the master bedroom and the sitting room of the Property, but the sea view would only be partially blocked. Apart from studying the floor plan, [Mr E] went to the construction site of the Next-door Building together with the agent before making the decision to purchase the Property. At that time, the Next-door Building was erected to the podium level. [Mr E] reckoned that after the full construction of the Next-door Building, the sea view from the sitting room and master bedroom of the Property should not be too seriously blocked. When the Property was delivered to it, the Company decided not to carry out any decoration and renovation work until the time when the Next-door Building was erected to a level close enough of its better assessment of the substantial effect on the sea view of the Property. In June or July 2004 when the Next-door Building was approaching the level of the Property, it appreciated that the sea view from the sitting room and the master bedroom would be seriously blocked and decided to sell the Property.
  - (d) The Property was intended to be the family residence of [Mr E] and [Ms D]. The availability of sea view from the Property was the

most important consideration of the purchase as such had been and still was the personal preference and habit of [Mr E].

- (e) Although it did not commission any firm of surveyor or accountant to provide a report or study on the investment proposal of the Property, it did carry out all practical and available steps to find out whether or not the Property was an ideal investment.
- (15) In further correspondence with the Assessor, the Company made the following assertions to substantiate that the Property was intended to be used as directors' residence:
- (a) The Property had 2 bedrooms, a reading cum cloakroom and a small maid's bedroom with total floor area of around 1,400 square feet. On the whole, the layout and size of the Property was very satisfactory to [Mr E]'s family.
  - (b) The Property was situated in a very convenient location and was well connected by Mass Transit Railway and highways. It would only take less than 10 minutes for [Mr E] to go to work in [District L] and less than 15 minutes for the Son to go to school in [District M]. Besides, the Property was in close proximity to [Ms D]'s parents who resided in [District N].
  - (c) Regarding the purchase of the Property, the initial plan was that it would have the Property fully decorated and fitted out for [Mr E]'s family to move in around September/October 2004, or to have it let out for a term of two to three years, and thereafter had it repossessed as residence of [Mr E]'s family. The latter plan was the more ideal one as it was anticipated that a lot of decoration work would be carried out in the building of the Property during the initial two years which might cause high level of nuisance, annoyance and pollution to [Mr E]'s family if they lived in the Property at that time.
  - (d) The Property was a good investment property. The decision to sell it was only because of [Mr E]'s deep-rooted preference to flats with good sea view.'

### **The evidence**

4. Mr E who was a director of the Taxpayer gave evidence before us. He confirmed that he was a director and a shareholder of the Taxpayer. Mr E signed a witness statement dated 13 February 2011 and confirmed to the Board that this statement was true and correct.



5. Mr E also told the Board that he was previously a solicitor in private practice.
6. He told the Board that he did not formally instruct Real Estate Agency O on 31 May 2004 or any time before 3 August 2004 to act for the Taxpayer as its agent in the sale or leasing of the Property. He asserted that neither himself nor the Taxpayer had met with Mr P or anyone from the same branch of Real Estate Agency O. Instead, he was approached by Mr P on or around 2 or 3 August 2004 in respect of the sale of the Property. However, he confirmed that he did sign an appointment letter with Real Estate Agency O on the same date when he signed the provisional sale agreement viz 3 August 2004.
7. However, he told the Board that the Taxpayer did not sign any appointment letters with Real Estate Agency Q or Real Estate Agency R. However, he informed the Board that he was contacted from time to time by a Mr S on behalf of Real Estate Agency Q and a Mr T on behalf of Real Estate Agency R at or around the time when the Taxpayer purchased the Property. He indicated that this was with a view to selling or letting out the Property. However, he did advise the Board that he had known the afore-mentioned Mr S of Real Estate Agency Q for some time. He informed the Board that it was the same Mr S who introduced him to the Property.
8. He told the Board that the Taxpayer's intention was to advertise the Property for rent and/or sale and that he took the view that it did not make sense for him and his family to move immediately into the Property. He drew to the Board's attention the fact that he was concerned with the highly likely possibility that the Property would have its sea view blocked. He also informed the Board that he had been in contact with the aforesaid Mr T. After the Taxpayer had signed the purchase agreement, he informed Mr T that he was concerned as to the lack of sea view and asked whether or not he was able to locate and introduce other units within the development which would have a sea view. He was shown some flats which faced a different direction. However, the asking price of those flats was between HK\$10,000,000 and HK\$12,000,000 and this was beyond his then budget.
9. Upon cross-examination by Ms Wong of the Inland Revenue Department ('IRD'), Mr E's attention was drawn to various facts that the Taxpayer's Former Representative, had sent to the IRD on 27 January 2011. The IRD confirmed they would rely on these facts before the Board. Mr E confirmed that Facts 5 to 10 as set out in the letter dated 27 January 2011 were indeed correct and we now set these out as follows:
  5. [Mr E] lived with his brother at [Flat 1] from around 1986 to 1992. After his marriage in 1992, [Mr E] moved away to live with his wife at [Flat 2] from November 1992 to October 1996.
  6. [Mr E] and his family moved to live in [Flat 3] between October 1996 to September 1998.
  7. From 1998 to Oct. 2000 [Mr E]'s family resided in [Flat 4] From Nov.

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

2000 to the present [Mr E]’s family live in [Flat 5].

8. Flat 1 was purchased by [Mr C] in his own name in around 1986 and had full sea view.
9. Flat 2 and Flat 3 were owned by [Mr E] indirectly through the family controlled separate companies, [Company U] and [Company A] Respectively. Both properties had full sea view.
10. Though Flats 4 and 5 were rented by [Mr E], each of them nevertheless had good sea view.’

10. On cross-examination, Mr E also accepted that his preference in respect of purchasing flats was to ensure they did have what he called a good sea view as indeed Mr E had confirmed in giving his own evidence in chief. He also confirmed that the Property was satisfactory in terms of its layout and size for his family. He also indicated that before he purchased the Property, he went there and conducted a physical inspection. He also confirmed that when he purchased the Property, he knew full well that the sea view of the Property may very well be affected by the building that was going to be constructed next door. He stated:

‘ Yes, to be honest, that was always a concern, even before the purchase. Actually, when the property was introduced to me I thought that it was going to have a good sea view, but then the agent sounded out there may be another building to be put up next to it. That is the reason why I had to take the trouble to go to the construction site of that next door building, which is just opposite to Block 2 of [the Property].’

11. His attention was also drawn to a letter dated 11 April 2008 from the Taxpayer’s Former Representative. In that letter, the following was stated:

‘ By the time of June/July 2004, the Next-door building had been erected past the level of the subject flat and it turned out that its size and situation was actually very close to [the Property] of which the flat formed part. That building almost completely blocked the sea view and the other open view of the sitting room and the bedrooms of the flat. So, it was decided that the flat would not be an ideal long term investment and should be sold.’

12. On cross-examination, Mr E conceded that there was no doubt in his mind that there was a real and significant risk of a building being constructed next to the Property which would have the effect of obliterating the sea view Mr E so strongly desired. We so find this as a fact.

13. Hence, we have no doubt it was quite clear that when the Taxpayer purchased the Property, Mr E must have known that there was a very strong likelihood that any sea

view would have been blocked. At the end of the day, Mr E confirmed that he knew the sea view was going to be blocked. However, Mr E appeared to hold out hope and optimistically he did not think the neighbouring building would wholly block the sea view but only part of it. In his evidence, he talked about there being a possibility of him having some angle of the sea view if he was able to sit in a certain area in the Property.

14. In answer to questions from the Board, in the light of the significance of the sea view in Mr E's decision making process, Mr E did not readily accept that he could have engaged a surveyor or other expert to advise him as to the likely impact of the neighbouring building on the sea view he craved. Mr E's answer was 'How could a surveyor help me?'

15. However, in our view, having regard to all the evidence before us, it was clear beyond doubt that Mr E was fully aware of the fact that, when he purchased the Property, the next door building was going to either obliterate or substantially reduce any sea view. Accordingly, we find that Mr E was on notice of this fact at the time of the Taxpayer's purchase of the Property.

16. It is also quite clear having regard to his evidence that the price he paid for the Property was considerably less than what would have been paid for those flats that would have a sea view. In short, his agent had introduced him to a very attractive deal. He accepted that he was paying approximately HK\$4,414 per square foot. He accepted that 'That's quite a good price'. It was put to him by the Board that if he was to sell the Property, he would realize a handsome profit very quickly. His response to this was 'You may say so, if you sold it.'

17. During the course of questioning by the Board, his attention was drawn to a letter dated 18 May 2009 from Real Estate Agency Q addressed to the IRD. Real Estate Agency Q was responding to a letter dated 11 May 2009 requesting various information. Real Estate Agency Q responded as follows:

'With reference to your letter of May 11, 2009 and would like to outline below our reply:

(1) [the Property].

1. According to our past computer record, the first appointment of [Company A] to sell the said property at the asking price HK\$7.80m on January 17, 2004 and the contact number was [XXXXXXXXXX]. It is not our practice to maintain any records for the appointment, so we are not able to provide any appointment document.
2. The change of asking prices of the said property provided by [Company A] are listed as follows:

(2011-12) VOLUME 26 INLAND REVENUE BOARD OF REVIEW DECISIONS

<u>Date</u>	<u>Asking Price (\$)</u>
January 17, 2004	7.80m
February 7, 2004	8.30m
March 4, 2004	8.60m
March 8, 2004	8.70m
May 16, 2004	7.80m
May 21, 2004	8.00m
May 28, 2004	7.88m
June 4, 2004	8.00m
June 16, 2004	7.95m
June 30, 2004	8.00m
July 12, 2004	7.95m

Finally, the said property was being entered into agreement at the consideration of HK\$8.00m by other agents.’

18. As can be seen from that letter, Real Estate Agency Q was appointed on 17 January 2004. Various computer print-outs were provided which showed quite clearly that there was considerable communications and correspondence between Mr E on behalf of the Taxpayer and Real Estate Agency Q with the latter requesting prices and information relating to the Property. Mr E confirmed that the various telephone discussions that were documented did indeed take place. However, Mr E on behalf of the Taxpayer tried to make it clear to us that it was his intention to initially lease the Property and after a few years, he would want to use it as a residence for himself and his family. Mr E also intimated that he was not really sure whether he wanted to sell the Property but at the same time he did not wish to turn away the estate agents which is why he kept up the dialogue.

### **The relevant legislation**

19. Section 14(1) of the Inland Revenue Ordinance (‘IRO’) provides as follows:

*‘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.’*

20. Section 2 of the IRO provides as follows:

*“trade”(行業、生意) includes every trade and manufacture, and every adventure and concern in the nature of trade’*

*“business”(業務) includes 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;'*

21. Section 68(4) of the IRO provides as follows:

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

### **The law**

22. Ms Wong in her written submissions sets out the relevant legal principles. These are as follows:

#### **Intention at the time of acquisition is crucial**

23. This is a well-settled tax principle in determining whether a property is a capital asset or trading asset. It is always necessary to ascertain the intention of the taxpayer at the time of acquisition of the property. Therefore, if the property was purchased with the intention of disposing of it at a profit, it was a trading asset. If the property was acquired as a permanent investment, it was a capital asset. In Simmons v IRC [1980] 1 WLR 1196, Lord Wilberforce at page 1199 stated as follows:

*'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.'*

#### **Subjective intention is to be tested against objective facts and circumstances**

24. Again, this is an accepted principle. A mere declaration of intention is of little value. Subjective intention has to be tested against the objective facts and all the relevant circumstances. Such intention must be genuinely held and must be realistic and realizable. In All Best Wishes Ltd v CIR [1992] 3 HKTC 750, Mortimer J (as Mortimer NPJ then was) stated at pages 770 and 771 as follows:

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

*'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.'*

### **Badges of trade**

25. Lee Yee Shing v CIR [2008] 3 HKLRD 51 was a case on share dealing activities McHugh NPJ stated at paragraphs 60 and 61 as follows:

60. *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 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?*
61. *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.'*

26. As can be seen, there are various badges of trade that can be of assistance in deciding whether there is an intention to trade or more correctly carrying on a trade. In Real Estate Investments (NT) Limited v CIR [2008] 11 HCFAR 433, Bokhary PJ and Chan PJ stated at paragraphs 40 and 55 as follows:

‘ 40. .... It is clear question (ii)(b) uses the expression “badge of trade” to mean the circumstances that shed light on the issue of intention. Those circumstances simply do not fall to be considered separately from the issue of intention or any assertion made by Taxpayer or on its behalf as to intention. .... ’

‘ 55. The question of whether property is trading stock or a capital asset is always to be answered upon a holistic consideration of the circumstances of each particular case. .... ’

### **Discussion**

27. The Taxpayer considers that the gain on disposal of the Property was capital in nature and asserts that therefore this should not be chargeable to profits tax. Mr E on behalf of the Taxpayer all along has maintained his stance that the Property was purchased for a long term investment.

28. However, as we have no hesitation in accepting the submission by Ms Wong that upon careful and close scrutiny, the Taxpayer’s stated intention in this regard is in our view not supported by the objective facts and the evidence before the Board. As pointed out above, the Taxpayer’s stated intention alone can never be conclusive. It must be tested against objective facts and circumstances and, of course, that intention in our view must be realistic.

29. We make the following observations:

- (a) It was quite clear that the Property was left vacant throughout the entire period of ownership by the Taxpayer. Neither Mr E nor any of the members of his family resided in the Property nor did Mr E take any steps to render it suitable for occupation as such (for example, by decorating the same).
- (b) The Taxpayer completed the purchase on 17 February 2004, however, it was sold on 27 September 2004, that is some seven months thereafter. In our view, this is a short period of ownership. We accept Ms Wong’s submission that such a short period does provide some indication of an intention to trade. However, the short period of ownership is not the sole factor and should not be considered in isolation.
- (c) The Taxpayer claimed that the Property was a satisfactory choice for Mr

E and his family in respect of size, layout, etc. It appears that the Taxpayer tried to show to us that it was their intention to purchase the Property for Mr E and his family's residence. However, it is quite clear to us that this flies in the face of the reality of the situation as a whole. The Taxpayer's claim is entirely inconsistent with the appointment of an estate agent (on behalf of the Taxpayer) soliciting the sale of the Property on 17 January 2004. Indeed, at that time, the Property had not been assigned to the Taxpayer. We accept that the readiness of the Taxpayer to put the Property into the market for resale, as shown unequivocally by the communications and correspondence from Real Estate Agency Q, clearly does not match with its asserted intention to hold the Property as a long term investment.

- (d) The computer records referred to by Real Estate Agency Q and Mr E's dealings with Real Estate Agency R who in turn were appointed on 10 February 2004 again in our view, reinforces the argument that the Taxpayer all along decided to sell the Property before the completion on 17 February 2004. The volume, extent and frequency of Mr E's dealings with Real Estate Agency Q point to a real and keen intention to sell the Property as opposed to a vendor merely 'testing the water'.
- (e) The Taxpayer, as Ms Wong pointed out to us, did not carry out any decoration work to enable Mr E and his family to move in to the Property. Again, this shows that the Property was not acquired for their occupation. It was purchased as an undecorated Property (akin to a bare shell) and it remained as such. The Taxpayer, through Mr E, put the Property on the open market on the same basis: nothing more, nothing less.
- (f) The Taxpayer confirmed that it had no plan to purchase another property after the disposal of the Property.
- (g) As can be seen from the evidence, Mr E's family resided in Property H during the period from November 2000 to the present date. Property H had once been a rent-free place of residence provided by Company V of which Mr E was a shareholder and/or director.

30. We have no hesitation in accepting that the Taxpayer did not produce before us any evidence to show that it had an intention to purchase and/or lease the Property for the residence of its shareholders and/or directors and/or others.

31. We have also had the opportunity to consider carefully the reasons given by the Taxpayer that the compelling reason for the sale was due to the fact that the Property's sea view was blocked by the next door building and Mr E's 'deep-rooted preference' of having a property with good sea view as his residence. However, we did not find this to be a convincing reason. It is quite clear that in his evidence before us, Mr E accepted that when



he visited the next door site, it was clear that there was a very strong likelihood that the sea view was either going to be completely obstructed or he would only have a very small or slight view of the sea. Mr E was on notice of the impact on the sea view.

32. Hence, his intention to purchase the Property with a full and good sea view clearly was not going to happen. Indeed, we have no hesitation in coming to the conclusion that when the Taxpayer purchased the Property, Mr E must have had full knowledge that the Property was unlikely to have a sea view and, if it did, it would be negligible and one that would be of no appeal as a principal residence for Mr E and his family. Again, this is reinforced by the fact that the reason why he appointed Real Estate Agency Q to solicit a sale was that he must have known that this was indeed the case. In our view, this came as no surprise and therefore his reasoning in our view was unconvincing, inconsistent with, and contradictory to, the evidence he gave before us.

33. His assertion that a sea view was a crucial factor for his family living there was never going to be made out. When the Taxpayer purchased the Property and when Mr E visited it, clearly, this could never have been the case. Indeed, in our view, it was also quite clear that had he looked closely at the plans of the actual units he bought, there was no way in which he could enjoy an open sea view from any of the rooms.

34. If one looks at all the circumstances of the facts before us, there could never have been a fixed or genuine intention by the Taxpayer to purchase and hold the Property as a residence for Mr E's family or for it to be held as a long term investment. In our view, having regard to the rising property market at the time, the circumstances of the case and it was clearly his intention to sell it for a profit within a short period of time which is exactly what he did.

35. We have reviewed very carefully Mr E's written submissions and his assertion that it is the Taxpayer's case that at the time of purchase, he intended to have it leased out and then for it to be turned into his family residence could never be made out and indeed, there was no evidence at all to support such an intention.

36. It is also quite clear that he has not been able to explain his dealings with Real Estate Agency Q nor did he call evidence himself to show that Real Estate Agency Q's representations to the IRD were incorrect. He accepted that he was in continuous communications with them. Although Mr E on behalf of the Taxpayer asserted that it was the Taxpayer's intention to hold the Property for the long term, we have to look at the objective evidence to support such a contention. There was no such evidence before the Board.

37. If, indeed that was his intention, why was the Property not leased immediately to generate some income to offset his mortgage payments? Why was the Property not decorated in such a way so as to suit such an intention? Mr E's assertion to us that he required a place with a sea view being of paramount importance clearly could not have been met by purchasing such a property.

38. As we have also stated above, before he purchased the Property, he must have known from (a) his physical inspection as well as (b) his review of the plans that there was little or any likelihood of the Property having a sea view. This is further supported by the fact that Mr E could have engaged a surveyor or other professional to give him the requisite degree of comfort he needed regarding his desire for a sea view. This, Mr E did not do. Regard should be had to the actual price that he paid at the relevant time when one looked at the prices of other blocks that did indeed have a sea view and these prices were much higher.

**Conclusion**

39. Therefore, having looked at the evidence carefully and having regard to all the written submissions from Mr E and from the IRD, we have no hesitation in dismissing the appeal.