

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D104/02

Profits tax – sale of residential properties – whether investment or trade.

Panel: Kenneth Kwok Hing Wai SC (chairman), Jiang Zhaodong and Daniel Wan Yim Keung.

Date of hearing: 29 November 2002.

Date of decision: 8 January 2003.

The appellant derived profits from the sale of two properties. The Commissioner assessed profits tax in respect of the profits.

The appellant appealed against the assessment because the two properties were capital assets.

Held:

1. Having heard all the evidence, the Board found that the appellant had claimed diminution in value of the two properties as closing stock and then claimed that he changed his intention of holding them for long term investment. Nevertheless, at the hearing before the Board, he appellant came up with his new story of capital investment right from the start.
2. The Board disbelieved that the two properties were capital assets.

Appeal dismissed and a cost of \$5,000 charged.

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

Fung Ka Leung for the Commissioner of Inland Revenue.

Taxpayer in person.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Decision:

1. By his determination dated 29 July 2002, the Commissioner of Inland Revenue:
 - (a) annulled profits tax assessment for the year of assessment 1993/94 under charge number 3-2758572-94-4, dated 11 May 1998, showing assessable profits of \$3,473,080 with tax payable thereon of \$520,962;
 - (b) reduced profits tax assessment for the year of assessment 1994/95 under charge number 3-2943548-95-7, dated 22 January 2001, showing assessable profits of \$2,670,242 with tax payable thereon of \$400,536 to net assessable profits of \$2,668,992 (after set-off of loss brought forward of \$1,250) with tax payable thereon of \$400,348;
 - (c) annulled profits tax assessment for the year of assessment 1996/97, dated 11 September 2000, showing assessable profits of \$900,000; and
 - (d) reduced profits tax assessment for the year of assessment 1997/98, dated 11 September 2000, showing assessable profits of \$7,500,000 to net assessable profits of \$6,627,264 (after set-off of loss brought forward of \$1,971,073).
2. By letter dated 29 August 2002, Accountants' Firm A gave notice of appeal on behalf of the Appellant in respect of the profits tax assessment for the year of assessment 1997/98. The ground of appeal was that the gain from the sale of a residential flat (and a car parking space) at Address B ('Property 1') and the gain from the sale of a residential flat (and two car parking spaces) at Address C ('Property 2') should not be chargeable to tax because they were sales of capital assets.
3. Accountants' Firm A did not represent the Appellant at the hearing of the appeal but they saw fit to allow their Mr D to attend the hearing as the Appellant's 'assistant'.
4. At the end of the Appellant's evidence and submission, we invited him to address us on costs. After his submission on costs, we did not call on the Respondent and told the parties that our decision would be given in writing.
5. The facts in the 'Facts upon which the determination was arrived at' in the determination were admitted by the Appellant and we find them as facts.

INLAND REVENUE BOARD OF REVIEW DECISIONS

6. Section 68(4) of the Inland Revenue Ordinance (Chapter 112) ('IRO') provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant. Section 2 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.

7. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 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 to 492; and the statement of the law by Orr LJ at pages 488 and 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).

8. 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 pages 770 and 771.

9. At the hearing of the appeal, the Appellant asserted **for the first time** that:

- (a) his intention in respect of Property 1 was long term holding for rental income; and
- (b) his intention in respect of Property 2 was long term holding for rental income.

10. In our decision, the Appellant was **not** a truthful witness and we **disbelieve** him. Clearly the alleged intention was neither genuinely nor in fact held. The alleged intention was neither realistic nor realisable. There was also no evidence of his financial ability to keep either property for an indefinite period. His case of capital assets fails and his appeal must be dismissed.

- (a) His assertion that both properties were acquired for long term holding for rental income was belied by the fact (which was admitted by the Appellant) that both properties had been placed through a property agency at various asking prices for sale. In respect of Property 1, the asking price was named on 8 December 1994 and changed on 25 July 1995, 25 October 1995, 8 November 1995, 26 February 1996, 21 May 1996, 13 July 1996, 29 August 1996 and 10 September 1996. In respect of Property 2, the asking price was named on 16 June 1994 and changed on 22 February 1995, 12 April 1995, 14 August 1996, 5 November 1996, 14 January 1997, 17 January 1997, 23 January 1997, 1 February 1997, 27 February 1997, 13 March 1997, 20 March 1997, 22 April 1997 and 9 May 1997. Copy advertisements which the Appellant produced showed that Property 2 was offered for sale in June 1994. We reject his assertion that he did all that to keep track of the property prices.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (b) In the Appellant's accounts for the year ended 31 August 1994, the costs of purchase of both properties were recorded as 'purchases' in the profit and loss account; both properties were classified as 'closing stock' in the profit and loss account and the balance sheet; and \$2,480,000 as a provision for diminution in value of the two properties was claimed by the Appellant as a deduction in arriving at the loss asserted by him.
- (c) In the accounts for the year ended 31 August 1995, both properties were again classified as 'stock' in the profit and loss account and the balance sheet.
- (d) By his former representatives' letter, the Appellant asserted that 'In order to seek short term profits from the property market, [the Appellant] acquired [both properties], together with [a third property] with a view to derive (*sic*) short term trading gain from property dealing. As a matter of fact, [Mr E] (presently an employee of [a property agency]) .. and [Ms F] (presently an employee of [a valuer]) were commissioned to market the properties for willing buyers. However, due to the unexpected downturn of the property market, [both properties] were left unsold and [the Appellant] therefore decided to hold these properties long term for leasing purposes'.
- (e) By another letter of his former representatives, the Appellant claimed that he 'changed his intention of holding [both properties] for long term investment instead of for sale'.
- (f) Further and in any event, there is no evidence of the Appellant's financial ability to hold either property for an indefinite period. There is no evidence on the personal net worth of the Appellant as at February 1994 when the Appellant contracted to acquire Property 1 and Property 2 within five days. There is also no evidence on the cash flow of the Appellant.
- (g) There is neither commercial nor common sense in the Appellant's case that of acquiring both properties for long term holding for rental income.
- (h) On Property 1, the monthly rental income during such period when it was tenanted was \$63,000. Assuming full occupancy (an assumption which is **not** justified on the facts of this case) this represented a 6.64% return on the acquisition price of \$11,380,000. The costs of funds of the \$6,600,000 bank loan (58% of the acquisition price) ranged from 8.75% to 11.75%. It is plainly nonsensical to invest for a 6.64% return when the costs of the 58% borrowed funds ranged from 8.75% to 11.75%.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (i) On Property 2, the monthly rental income during such period when it was tenanted was \$68,000. Assuming full occupancy (an assumption which is **not** justified on the facts of this case) this represented a 4.32% return on the acquisition price of \$18,900,000. The costs of funds of the \$12,000,000 bank loan (63.49% of the acquisition price) ranged from 9% to 11.75%. It is plainly nonsensical to invest for a 4.32% return when the costs of the 63.49% borrowed funds ranged from 9% to 11.75%.

Disposition

11. We dismiss the appeal and confirm the assessment appealed against.

Costs order

12. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process. Messing around with the Inland Revenue Department was bad enough. Having claimed a provision for diminution in value of closing stock, the Appellant then went on to claim a change in intention. At the hearing before us, the Appellant came up with his new story of capital investment right from the start. Not having the wisdom to stop wasting public resources and funds by pursuing this hopeless appeal earns himself a costs order. Pursuant to section 68(9) of the IRO, we order the Appellant to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.