

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D1/97

Profits tax – whether profit derived from the sale of property assessable to profits tax.

Panel: Robert Wei Wen Nam SC (chairman), Sydney Leong Siu Wing and William Zao Sing Tsun.

Dates of hearing: 4 and 13 December 1996.

Date of decision: 3 April 1997.

By an agreement of sale and purchase dated 21 December 1990, Mr A and his sister Madam B, the taxpayers, jointly purchased a property (the subject property) on a pre-sale for \$1.14 million. The purchase was financed by an equitable mortgage loan repayable by 180 monthly instalments. The occupation permit was issued on 22 November 1991. On 24 January 1992 they completed the purchase. On 30 January 1992 they sold the subject property for \$2.17 million. They contend that, at the time of acquisition, their intention was to hold the subject property as a long-term investment, namely, as a residence of Madam B's family (consisting of Madam B, her husband and their daughter) and her parents and therefore that the profit on its disposal is a capital gain and is not taxable. Their purported plan was that the parents should live together with Madam B's family in the subject property and sell their own flat to finance the purchase of the subject property. Their explanation of the quick sale was that the parents refused to sell their flat and move to the subject property. The Board was unable to accept the explanation.

Held:

Mr A and Madam B acquired the subject property as a trading asset with the intention of selling it at a profit.

Appeal dismissed.

Cases referred to:

Simmons v CIR 53 TC 461
Cunliffe v Goodman [1950] 2 KB 237
All Best Wishes Limited v CIR 3 HKTC 750

Wong Ki Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

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Nature and issues of appeal

1. This is an appeal by two individuals Mr A and Madam B, who are brother and sister, against the profits tax assessment raised on them for the year of assessment 1991/92 in respect of the profit on the sale of a property and confirmed by the Commissioner of Inland Revenue in his determination dated 15 February 1996. The Taxpayers contest both liability to be assessed to profits tax and quantum of the assessment.

Property transactions

2. (a) By an agreement of sale and purchase dated 21 December 1990, the Taxpayers purchased jointly a property (the Subject Property) for a consideration of \$1,142,100.

(b) The Taxpayers financed the purchase by an equitable mortgage loan of \$1,000,000 from Bank C. The loan was repayable by 180 monthly instalments starting from 28 January 1991. The amount of the first instalment was \$11,054.

3. By an agreement for sale and purchase dated 18 November 1991, Madam B and her husband acquired a flat (Property D) as joint tenants for a consideration of \$1,325,000.

4. The occupation permit for the Subject Property was issued on 22 November 1991.

5. On 13 December 1991, Property D was assigned to Madam B and her husband.

6. By a letter dated 30 December 1991, E Estate Agents Limited notified the Taxpayers that the Subject Property was ready for handing over to them from 20 January 1992.

7. The Taxpayers completed the purchase of the Subject Property on 24 January 1992.

8. By a provisional agreement for sale and purchase dated 30 January 1992, the Taxpayers sold the Subject Property for a consideration of \$2,178,000. The sale was completed on 2 March 1992.

Assessment

9. The assessor was of the view that the profit on disposal of the Subject Property was chargeable to profits tax and raised on the Taxpayers the following profits tax assessment for the year of assessment 1991/92:

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Estimated assessable profits	<u>\$843,000</u> (Note)
Tax payable thereon	<u>\$126,450</u>
<u>Note</u> 2,178,000 (sale proceeds) - \$192,900 (estimated expenses) - \$1,142,100 (purchase cost) = \$843,000	

Objection

10. The Taxpayers objected to the above assessment and Mr A wrote in the following terms:

‘The profit derived was not as much as \$843,000 stated in the demand note because various expenses were not deducted from the aforesaid sum. Please refer to the following calculation:

	\$
Gross Profit	843,000
Interest (from purchase to sale)	121,120
Legal fees and stamp duty	22,000
Decoration before sale	<u>105,000</u>
Net Profit	<u>594,880</u>

The Subject Property was purchased for the original intention of self-use by my sister’s family. After taking possession, she found that the transportation was inconvenient and it was difficult for her daughter to attend school. After discussion, the aforesaid property was sold. Part of the entire fund on sale (as her then financial position was very unstable, I lent my half share to her) was used to repay the loan borrowed from relatives on her purchase of Property D (in the joint names of the couple), part of it was used to repay the bank loan so as to reduce interest payable.

My sister and I only jointly purchased and sold this single property, how could it be property dealing.’

We note that the purchase of Property D was partly financed by a mortgage loan of \$900,000 from Bank F, repayable by 180 monthly instalments at \$9,398 per month. Early repayment within 12 months of drawdown of the loan carried a penalty.

Notice of appeal

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11. The Commissioner determined against the objection. By a notice of appeal dated 9 March 1996 and signed by them both, the Taxpayers lodged an appeal against the determination. The notice of appeal is set out below:

‘ First of all, we are now writing to lodge an appeal against the determination made by your Department that we have involved in property speculations. It is because, at that time, it was necessary for us to purchase the Subject Property for self-residence. Later, due to various reasons, we then decided to keep Property D purchased afterwards for self-residence.

Reasons for purchasing the Subject Property

1. In 1989, my mother suffered from strokes for the first time unfortunately. However, the condition was not so serious. Later, around 1990, she suffered from strokes again and had been admitted to the hospital. She then became hemiplegia. Since then, even her daily self care such as taking bath, going to the toilet, etc. had to be taken care of by my old father (who was nearly 80 years old). I was very sorry about that. Moreover, the environment of the present residence of my parents at an old building was relatively poor. Therefore, we considered to find another estate with a better living environment for them to live. It so happened that the properties at the Subject Property Estate were open for sale and the purchase price was within our budget. Therefore, although the property was still under construction, we purchased it.
2. I, [Madam B], had been living at a property purchased under Home Ownership Scheme in District G since marriage. My daughter was taken care of by a baby-sitter and it was time for her to go to school. (She was over 3 years old already). However, in view of the worsening social order in District G as well as the fact that the schools in the district were of a lower standard than those in the urban district, we had a plan to move back to the urban district long time ago so as to find a better school for my daughter.
3. As a result, my elder brother and I decided to purchase the Subject Property jointly. Originally, it was intended that I (Madam B) would live with my parents so as to take care of them. (It was because my sister-in-law, the wife of Mr A, could not go along well with my mother and was not willing to live with her.).

We chose the Subject Property at that time because after studying the sales brochure as well as visiting the sample flat, we found that the environment was nice and quiet and the air was fresh and it was suitable for the elderly and the children to live there. Moreover, the Subject Property was nearer to the urban district than that in District G. Therefore, although we had to wait for one odd year for occupation, we

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decided to purchase it. (At that time, when we visited the sample flat, the environment and the facilities were really very attractive. Moreover, the first day to school of my daughter and the expected date of occupation was very close.)

4. When we purchased the property under construction, we considered to dispose of the residence of my parents, a 30-year-old building, as well as the property purchased under Home Ownership Scheme in District G (as it was purchased for nearly 5 years and could be sold back to the Housing Department at market price), and then to rent a property in District H for my parents to live temporarily, waiting for the occupation of the Subject Property. The sale proceeds would be used to finance the purchase consideration of the Subject Property. Therefore, my elder brother and I had used our savings and he had also obtained some cash advance from his Visa Card as downpayment to purchase the Subject Property. (It was because my elder brother thought that he should also fulfil his filial obligation as his wife was not willing to live with and take care of them. Thus, he promised to finance the loan repayment temporarily.)

Reasons for disposing of the Subject Property

1. When planning to purchase the Subject Property, I had discussed with my father and he had no comments about it. However, when my mother realized that the property was purchased for our residence together, she was very unhappy about it and strongly objected against this plan. She also declared that she would never move away from District H for residence. Moreover, she was not willing to dispose of the property because there was a lot of friends and neighbourhood in the district. Besides, due to the differences of living habits, she was not willing to live with her children. Our plan was then completely ruined and we also had a serious argument with our parents. (Sometimes, the elderly was really very stubborn.)
2. Although my mother strongly objected against the plan, we still insisted on financing the repayment, hoping that it was possible to persuade our parents to accept our plan. However, shortly after that, we noticed from television and news reports that there was a serious traffic problem in the Subject Property district. We could see a long queue on the television. Moreover, some colleagues also said that they had to leave the vehicles and walk home, etc. After viewing such a situation, we were very regretful about our plan made.
3. As my parents were not willing to dispose of the old building and the property purchased under Home Ownership Scheme was not ready for disposal, it was very hard to finance the loan repayment, especially for my elder brother, Mr A. He was just a civil servant with a monthly salary

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of \$10,000 odd. Moreover, his wife was unemployed and he had two sons. It was really a heavy burden for him to finance the loan repayment. Originally, it was planned after the disposal of the old building, he would not be required to finance the repayment anymore. However, my mother's objection had ruined our plan and put us in a dilemma.

4. After being persuaded for a few months, my mother still insisted on her view and was unwilling to move away. Moreover, we had made a visit to the building site in person and found that the traffic was really very inconvenient. The frequency of bus service was insufficient and the schedule was not punctual. In addition, the route was winding to and fro which was very time-consuming. Some close friends even disclosed that it was quite troublesome to go to work in the morning. Considering the fact that my mother had to go to the urban district to have a physiotherapist treatment, I wondered how she could bear such a long journey?
5. It so happened that my elder sister who lived in District I no longer went out to work and could take care of the living of my parents temporarily. Therefore, we considered to dispose of the Subject Property and planned to find another place which was close to my parents' home for residence. However, no one was interested in the Subject Property so far and no immediate action could be taken. However, my elder brother had already faced a serious financial problem.

Reasons for purchasing Property D and its procedures

1. During the period when the property was still under construction, I had taken my daughter to the Subject Property Estate for a visit. However, she could not bear the long journey and vomited in the vehicle. How poor she was! (It was because when living in District G, we usually went to Hong Kong by ferry.) It might be due to the fact that the roads were winding and the little kid could not get used to it. I wondered for a little kid of only 4 years old, how she could bear to take such a long journey to go to school everyday. I was afraid that it would affect her studies and I did not want her to suffer.
2. If I did not live with my parents, it was unreasonable to ask my elder brother to finance the purchase consideration with me.
3. As my daughter had to go to school in the Hong Kong Island in December 1991, we had lived with my parents for a period of time. (We had moved to live with them temporarily around October). As my husband had to work on shift, he had disturbed my mother's resting time. Since my mother was not able to move properly, her temper was worse than before. Therefore, we had to find another place for residence in a

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rush. At that time, the rent in District H was quite expensive. It so happened that we had received a letter from the Housing Department, informing that the disposal price of the property in District G which was purchased under Home Ownership Scheme was \$400,000 odd. Together with the cash of \$100,000 odd in hand, it was sufficient to finance the downpayment (10% of the consideration) for the purchase of Property D. Therefore, we decided not to rent a flat but to purchase Property D instead. Moreover, the reason for us to decide to purchase Property D was that it could be occupied for residence immediately, preventing any further conflicts with my parents from happening. Meanwhile, we planned to dispose of the Subject Property as soon as possible. (The information about the school of my daughter in the Hong Kong Island had been submitted.)

4. Although the purchase consideration of Property D was \$100,000 odd more expensive than the Subject Property, it was closer to the residence of my parents and we could take care of them more conveniently. Therefore, we determined to choose Property D.
5. In around June or July in 1991, the Home Ownership Scheme (HOS) flat in District G had been bought for five years and could be resold to the Housing Department. So (I) made an application to the Housing Department for the sale of the flat. However, government departments really need to improve their efficiency. Apart from filling in the application form, we had to wait for the officers to conduct the inspection as well as the valuation of the flat. Finally, in the end of the year (1991), we were informed of the market value of the flat. Because of the urgent need, (I) chose (to buy) Property D which is a smaller flat as I would not be living with my parents and the purchase price of which (\$1,325,000) was affordable. I bought this flat with my husband jointly because I was prepared to buy it for my family to live. This is different from the Subject Property which I had bought with my elder brother jointly because it was intended to be purchased for living with my parents.
6. However, I really felt that I was tricked. Just after I had paid the deposit for Property D in late November 1991, the government announced that the bank could only grant a mortgage of 70% on the flat, but the cash I had at that time was only enough to pay the 10% downpayment. I was thunderstruck. As my HOS flat was not sold yet, I had thought about forfeiting the deposit. However, I heard that a property company was considering to purchase the old flats in the district where my parents were living. If the majority of the residents accepted the offer, my parents, though unwillingly, would accept the offer, too, because their friends and neighbours were considering to accept the offer of the purchase. For this reason, my parents might need to find some place else

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to live, so I decided to keep Property D. In case the old flat was purchased, my parents would still have a place to live. I, therefore, lived temporarily at Property D. When I could move in the Subject Property and if the old flat was sold, my parents could move in to live at Property D while my family could move in to live at the Subject Property. I had also thought about transferring my daughter to a school near the Subject Property to save her from the trouble of traffic. (My daughter was going to kindergarten at that time).

I was in a turmoil, and could only act according to the circumstances. As the flat at the Subject Property was almost available for occupation, I decided to make a decision only after I had moved in the flat.

For this reason, I took loans from different sources to pay for the downpayment which made up 30% of the purchase price, thinking that the loans could be repaid when the flat in District G was sold. In the mean time, I still had to pay the interest. (I dared to take the risk to borrow the downpayment from my relatives because the agreement (of the sale and purchase) of my HOS flat would be signed later).

7. In around mid December 1991, I was informed that the Subject Property would be occupied in around January. (A date earlier than the expected date of occupation stated on the sales brochure). For this reasons, I could not but use the money which I had planned to spend on the decoration of Property D to pay for the decoration of the Subject Property, so that I might move in there to live. The flat at Property D would be reserved for my parents, (when the old flat was purchased). However, later on, I found out that the purchase plan of the property company was still under discussion, and the plan would not be executed in the near future. I did not know what to do at that time. How could I possibly be able to pay for the instalments of two flats simultaneously? I had considered selling Property D because the Subject Property was under decoration but Property D was not. Moreover, my daughter had already found a school near the Subject Property Estate and the wife of my husband's colleague (the couple were also living at the Subject Property Estate) had agreed to babysit my daughter. My mother was recuperating after receiving physiotherapy for a period of time.

I often visited the Subject Property Estate when my flat was under construction. But I found that the traffic there was really annoying. The sales brochure of the Subject Property Estate had mentioned about the construction of another bridge to ease the tariff. But this plan was called off and was replaced by the extension of the existing bridge. The traffic there really made me think twice about whether to move in there to live.

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8. In late January 1992, (the decoration work was almost finished) I was excited to find that someone wanted to buy the Subject Property. (If the flat was sold), all the economic problems would be resolved. More importantly, I would have made a decision by then. However, the purchaser wanted us to deliver up vacant possession only in March.

Having lived at the Subject Property before

Property D was not decorated because I moved in there in a hurry. As the Subject Property was decorated and did not need to deliver up vacant possession yet, I moved in there to live for two weeks to facilitate decorating Property D. Having lived at the Subject Property, I discovered that the traffic there was rather chaotic during rush hour. The transport was not enough to cater for the increased population and I was one of the victims. I was sometimes early and sometimes late for work. The timing was not easy to control. Moreover, I had to send my daughter to live in my elder sister's home in District I. So selling the Subject Property seemed the correct decision to make at that time.

Objection to the accusation of property speculation

We bought the Subject Property originally for our own residential purpose. A lot of troubles had arisen during the time. As my company was restructured, my income was not steady. So after selling the Subject Property, my elder brother took back the principal and paid back the bank. He let me use the rest of the money to repay my relatives and pay back the bank. (The receipts had been submitted).

The abovesaid was the real reason why and how the Subject Property was sold. I bought the flat solely for my own residential purpose use and had no heart for property speculation. The flat was bought with my elder brother as a joint-owner out of filial piety. Out of my expectations, my parents did not understand me. We had quarrelled many times and that made us all very unhappy. More surprisingly, in late 1994, the Inland Revenue Department sent us a profits tax assessment for property speculation. We were innocent. We were really not involved in property speculation. Only that there was a time lag between the purchase of Property D and the selling of the Subject Property. The time lag was resulted from a series of unexpected events, such as the fact that my parents insisted on not selling the flat, the clashes we had when living together; the chaotic traffic at the Subject Property Estate and my urgent need to move in to live at Property D. We bought the flat solely for our own use. We were not able to pay the instalments for two flats simultaneously. My elder brother was making strenuous effort already. As a living place, Property D was more suitable than the Subject Property (from my point of view). The objection sent last time had not stated clearly the details of this whole incident. As a result, our case was unfairly determined.

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I hope that you would reconsider our explanation given above and accept our appeal with such reasonable grounds.

	\$	\$
Sale price of the flat		2,178,000
Purchase price of the flat		<u>1,142,100</u>
		1,035,900
Expenses:		
The fee for obtaining a bank mortgage for the flat under construction (including legal fee and stamp duty)	50,000	
Interest expenses (for the instalments of the flat)	121,120	
Decoration fee	105,000	
Legal fee for the sale of the flat and the settlement of the loan in advance	<u>22,000</u>	<u>298,120</u>
Surplus		<u>737,780*</u>

* The surplus was used in the repayment of relatives (from whom the downpayment for Property D was borrowed)(\$540,000) and the repayment of the bank loan (\$200,000).

The photocopies of the receipts were sent to the Inland Revenue Department.'

Parties

12. At the hearing of this appeal, the Taxpayers appeared in person. Miss Wong the assessor represented the Commissioner. Madam B stated that she had written the notice of appeal and confirmed that it bore the signatures of them both. Mr A also confirmed the same. Madam B gave evidence first and was followed by Mr A. No other witness was called.

Evidence of Madam B

13. Madam B's evidence is summarised as follows.

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In chief

- 13.1 She lives in quarters in District I, having lived there for 4 years.
- 13.2 She purchased the Subject Property for self-use.
- 13.3 She used to live in District G.
- 13.4 In 1990 she planned to move back to urban area, because her daughter was going to a kindergarten.
- 13.5 Her daughter was born in August 1987.
- 13.6 At the time she realised District G might not be the right district for educating her daughter.
- 13.7 End of 1990, the Subject Property Estate was open for sale.
- 13.8 Her elder brother, Mr A, discussed with her.
- 13.9 At the time, her mother had suffered a stroke and had become hemiplegic. Since her mother was sick and father was old, she and Mr A decided to buy an apartment big enough for the parents, herself, her husband and her daughter, that is, all 5 of them, to live in.
- 13.10 They, that is, her elder brother and herself, jointly purchased the Subject Property and waited for the day when they could take possession.
- 13.11 For the downpayment she paid more.
- 13.12 In September or October 1990, her daughter's nanny resigned. She failed to find a replacement in District G, so, together with her husband and her daughter, she moved to her parents' place in District H. At that stage, she had already purchased the Subject Property.
- 13.13 They were not living happily with her parents. So they decided to rent a place nearby but rent in the area was high. They then found Property D suitable. The downpayment was only 10%. She had the money to pay that. So, while keeping the Subject Property, she bought Property D, just to see which was more suitable for her.
- 13.14 The day after signing the principal agreement for sale and purchase, the government announced the downpayment should be 30%. The former owner of Property D allowed her to move in, which she did, upon payment of the 10% deposit. It was close to where her mother lived, so she could look after her without having to quarrel with her.

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13.15 All along her parents, she herself and her husband and her elder brother had been talking about whether they should move into the Subject Property to live with her parents. They had received the occupation permit for the Subject Property.

13.16 The parent factor and the traffic factor affected their decision whether to move into the Subject Property. So she moved into the Subject Property and lived there for a few days to see if the traffic was really that bad.

13.17 She realised that during morning peak hours it was difficult to get to work or to school. She discussed the traffic situation with her elder brother because her mother had to go out of the district very often to see doctors and to receive physiotherapy. So she did not want to live in the Subject Property.

13.18 Her sister-in-law, Mr A's wife, said that, since the parents were not going to move into the Subject Property, the whole apartment would benefit her (Madam B), because Mr A contributed money towards the purchase. In principle they should share the payments equally, but sometimes she paid more, because he could not manage. Her sister-in-law wanted her to buy Mr A's half interest in the premises at market price. She could not afford that because (1) the bank did not grant further mortgages to her and (2) she did not have the money to buy the half interest. Also she would have to pay stamp duty. So they decided to sell the Subject Property. That was end of January or February 1992.

13.19 She wanted the things mentioned in the notice of appeal to be taken as part of her evidence.

13.20 She and her elder brother financed the purchase of the Subject Property this way: she paid more of the downpayment, that is, over \$100,000 and he paid \$40,000. She was working in a securities firm, earning over \$10,000 per month. Instalments were over \$11,000; she and her elder brother each paid half.

13.21 When she bought Property D in 1991, it was financed from her savings. The property belonged to her and her husband. They shared the burden. He let her use his income to pay the instalments. He was earning over \$10,000. She paid 10% downpayment. As for the other 20%, she borrowed the money from her eldest brother, her mother-in-law and her mother. Mortgage payments were \$9,000 per month.

13.22 She sold the flat in District G at the end of 1991. She had given notice to the Housing Department to sell. She now lived in quarters in District I, having lived there for 4 years. Beginning of 1992, she was living at Property D. End of 1992, she moved into quarters in District I and rented out Property D. They planned to move into quarters in District I around April/May 1992.

13.23 Her father's reaction to the purchase of the Subject Property was that he would let them decide but her mother was opposed to the idea. At that stage, they had already purchased it. My elder brother had said he was sure he could convince the parents to move

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into the Subject Property. She herself had not talked about it with either parent; that was the duty of her elder brother.

13.24 The flat in District H was in the names of her parents. They never moved out of that flat.

13.25 She purchased the Subject Property not for speculative purposes. Otherwise: (1) she would not have moved out of Hong Kong by the end of 1991; (2) she would not have started paying instalments at the time of purchasing the uncompleted flat; (3) ever since the purchase, she did not ask any estate agent to sell it; (4) she would not have gone to the solicitors firm to complete the mortgage procedures; (5) she would not have needed to move out of her Home Ownership Scheme flat in District G. At the beginning of 1992, she did ask an estate agent to sell the Subject Property.

In cross-examination

13.26 She had 3 elder brothers (including Mr A) and 2 elder sisters.

13.27 At first her daughter enrolled in a kindergarten in District G in February 1990. She enrolled in another school on the Hong Kong Island around October 1991.

13.28 As for the claim for decoration fee of \$105,000, no receipt or job list from the decoration company was in her possession any more.

13.29 (Answering a question from the Board) She lived in District G from 1986 to 1991. Then she moved to her parents place in October 1991. She sold the District G flat beginning of 1992. She bought Property D end of 1991. She sold the Subject Property in 1992. She moved to District I in 1992 and rented out Property D, which she sold end of 1994. She sold 3 flats in a period of 2 to 3 years.

Evidence of Mr A

14. Mr A's evidence is summarised as follows.

In chief

14.1 He signed that notice of appeal.

14.2 In 1986 his wife was not happy about living with his parents in District H, so they moved to his mother-in-law's place and lived there for 6 months before they got a flat in District J.

14.3 In 1989/90, his mother's health deteriorated. Often his father had to take care of her alone. So he suggested to his father whether it would be better if one of his children (except Mr A) should help him to look after mother. His response was positive.

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14.4 In 1990, Madam B said she would like to move from District G to Hong Kong. So he had the idea that it would be good for her to live with the parents. He thought that relationship between mother-in-law and son-in-law would be better than that between mother-in-law and daughter-in-law. Further, of all the daughters, his mother preferred Madam B. So without asking his parents' consent, he suggested to Madam B to buy a flat so that she and her husband and Madam B's parents could live together. That was why they chose a medium-sized flat.

14.5 He thought he could persuade his parents to sell their flat in District H to move into the Subject Property, so he took the risk. Later on, he found he did not have sufficient money to pay the downpayment and in the subsequent months might not have enough money to pay the monthly instalments.

14.6 He tried to do filial duty. He thought he could persuade them into selling their flat. He failed to consider that they had friends and neighbours in the vicinity. He thought they would be happy if there was someone to take care of them.

14.7 In 1989/90 he found a part-time job with the Hong Kong Government. He did not know living together made them so unhappy and could not persuade them to sell their flat.

14.8 At the time when he tested their response, he had not purchased the flat. He chatted with his father and asked him if he would like one of his children (except Mr A) to live with him and mother. His father's response was – it would be good.

14.9 Later, maybe 1990 or end of 1991, Madam B moved into her parents' place. At that stage, the parents had not yet objected to moving out of the District H flat.

14.10 When he went to give his father some money, they talked – it would be end of 1990. He told his father they had bought the Subject Property. They were having tea in a restaurant, while his mother was by herself at home. It was not OK to leave her alone by herself, but sometimes it could not be helped. When having tea, they touched upon the subject. He told his father that Madam B and he had jointly purchased a flat and would like him and mother to move into that flat to live with Madam B so that his father would not be the only one to take care of his mother. He also mentioned that the air in District H was not good. His father said that he would like to talk about it with mother first. Two days later, his father phoned him saying that they would not like to move out. At that stage they were paying the 2nd instalment of the uncompleted flat. He was not in any great difficulty because he just contributed what he could afford.

14.11 He asked his father why. Father said, 'Since all of you are working, it would be better for neighbours in District H to take care of us.' At any time, if he made a telephone call, people from his home town and his neighbours would come to his help. That attitude never changed since his father talked it over with his mother. They were still living in their District H flat today.

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14.12 End of 1990 or end of 1991, Madam B moved into the District H flat to live there. The two families were not happy. So he talked it over with Madam B and asked her what she was going to do about it – either to sell his half interest in the Subject Property to her or for them to sell the whole flat to an outsider.

In cross-examination

14.13 He paid \$40,000 towards downpayment – some \$20,000 from his savings and a few thousand on credit card. He would only borrow from his brothers and sisters as a last resort. His wife did not get along with his parents, so as compensation he would like to bear the burden.

14.14 He paid \$40,000 downpayment and 13 instalments. His contribution towards the instalments was only \$4,000 per month.

14.15 When the Subject Property was sold, he shared the profit with her sister half and half.

The relevant law

15. The relevant legal principles may be summarised as follows.

15.1 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? It is not possible 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 (per Lord Wilberforce in Simmons v CIR 53 TC 461 at 491).

15.2 Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253 had this to say about the word ‘intention’:

‘... If there is a sufficiently formidable succession of fences to be surmounted before the result at which X aims can be achieved, it may well be unmeaning to say that X “intended” that result.’

15.3 On the question of intention, Mortimer J stated in All Best Wishes Ltd v CIR 3 HKTC 750 at 771:

‘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

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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 louder than words...'

15.4 If the intention was to dispose of the asset at a profit, it was a trading asset, and the profit is a trading profit and is taxable. If the intention was to hold it as a permanent or long-term investment, the profit is a capital gain and is not taxable.

Taxability

16. (a) In this appeal, the Taxpayer's case is that, at the time of its acquisition, their intention was to hold the Subject Property as a long-term investment, namely, as a residence of Madam B's family (consisting of Madam B, her husband and their daughter) and her parents, that the profit on its disposal is a capital gain and not taxable and that the assessment under appeal is therefore incorrect. The onus is on the Taxpayer to prove that case.

(b) Essential to the Taxpayers' case was their purported plan (hereinafter called the parent factor) that their parents should live together with Madam B's family in the Subject Property and sell their own flat in District H to finance the purchase of the Subject Property.

A. The parent factor

16.1 Briefly this is the story of the parent factor. The Taxpayers' mother was hemiplegic and the father was 80 years old. So the Taxpayers agreed between themselves that their parents should live together with Madam B and her family so that they could be looked after. As a result, Mr A and Madam B jointly purchased the Subject Property (which was under construction) as a residence of Madam B's family and her parents. The underlying financing plan was that the parents' 30-year-old flat in District B and the flat in District G which was jointly owned by Madam B and her husband should both be sold and that the proceeds of sale should be applied to finance the purchase of the Subject Property. In the meantime, Mr A and Madam B paid the downpayment with their own funds, with Mr A promising to finance the loan repayment temporarily. The parents were not consulted or informed about the purchase until the Taxpayers were paying the 2nd instalment, when, over a cup of tea in a restaurant, Mr A informed his father about the purchase and about the plan that the parents should come to live with Madam B in the Subject Property. His father wished to consult his mother. Two days later, his father telephoned Mr A to say that they would not like to move out of the District H flat and that, since all of them were working, it would be better for the neighbours in District H to look after them. That attitude never changed (see paragraphs 14.10 and 14.11 above). His mother strongly objected to the plan; she declared that she would never leave District H; she was not willing to dispose of the District H flat because there were a lot of friends and neighbours in the district. The plan

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was completely ruined. It was very hard, especially for Mr A, to finance the loan repayment. He was a civil servant with a monthly salary of over \$10,000 and had a wife and two children. At first it had been planned that after the disposal of the District H flat, Mr A would not be required to finance the repayment any further. But that was not to be. Further, around the end of 1990 or 1991, Madam B had lived with her parents in the District H flat for a period, and that was an unhappy experience. In the end, Mr A put two alternatives to Madam B: either he should sell his half interest in the Subject Property to Madam B; or they should sell the whole flat to an outsider (see paragraph 14.12 above). Madam B could not afford to buy Mr A's interest. So it was decided that the whole Subject Property should be sold (see paragraph 13.18 above). And it was sold.

16.2 At the objection stage, the Taxpayers' case was couched in terms set out in paragraph 10 above. There was no mention in the objection letter, as Miss Wong pointed out, of the parent factor, while in the notice of appeal (see paragraph 11 above) much space was devoted to it. If the parent factor was true, it would, we think, have been the first thing to mention in the objection letter. In our view, the parent factor is an afterthought. We find it very difficult to accord any weight to it.

16.3 Further, the parent factor story itself has some disquieting features. To start with, there was the lack of prior consultation with the parents about the planned purchase of the Subject Property. Mr A's explanation was that he thought he could persuade his parents to sell their District H flat and move into the Subject Property. In 1989/90 he had asked his father whether he would like one of his children (except Mr A, because his wife did not get along with his parents in 1986 when they lived together in the District H flat) to live with him and mother. His father's response was that it would be good (see paragraph 14.8 above). Further, he thought that the relationship between mother-in-law and son-in-law would be better than that between mother-in-law and daughter-in-law. Moreover, of all the daughters, his mother preferred Madam B (see paragraph 14.4 above). So much for Mr A's explanation. As for Madam B's failure to consult her parents before the purchase, her explanation was that that was the duty of Mr A (see paragraph 13.23 above). In our view, none of those explanations satisfactorily answers the question why neither of them sought their parents' prior consent.

16.4 The Taxpayers' purported plan would involve – to paraphrase Miss Wong's submission – (a) leaving the parents with no flat of their own; (b) applying the sale proceeds of the District H flat which were rightfully theirs to finance the Subject Property which was not in the name of either parent; (c) moving the parents away from their friends and neighbours in District H, and (d) moving the parents to the Subject Property to live together with Madam B's family. Needless to say, the parents would have been greatly affected by the carrying out of the plan. It is unrealistic to presume that the parents could be persuaded. Without any prior consultation and without any positive commitment from the parents, the purported intention of acquiring the Subject Property as the residence of their parents and Madam B's family could hardly have been 'genuinely held, realistic and realisable'.

16.5 At about the time when they were paying the 2nd instalment, Mr A visited his parents in their District H flat, and, without saying a word about the purchase of the Subject

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Property, took his father to a restaurant to have tea, leaving his mother all by herself at home. Then, in the restaurant, as the story goes, Mr A informed and consulted his father for the first time about the purchase of the Subject Property (see paragraph 14.10 above). There is such an air of unreality about the lack of prior consultation with the parents, about the way the mother was not informed or consulted about the purchase and about the way the father was informed and consulted about the purchase in the absence of the mother that the whole story about the parent factor loses its credibility.

B. The quick sale

16.6 The undisputed facts reveal a quick sale of the Subject Property. It was purchased for \$1,142,000 on 21 December 1990 on a pre-sale. The occupation permit was issued on 22 November 1991 and the Taxpayers completed the purchase on 24 January 1992. It was sold for \$2,178,000 on 30 January 1992, that is, within 6 days of completion (see paragraphs 2, 7 and 8 above). Unless it is satisfactorily explained away, a quick sale of an asset is normally regarded as being inconsistent with an intention of holding the asset as a long-term investment, for example, as a residence, and being consistent with an intention of holding it for sale at a profit. The Taxpayers' explanation of the quick sale was that the parents refused to sell their flat in District H and move to the Subject Property to live with Madam B's family. Since we are unable to accept the evidence relating to the parent factor, the quick sale has not been explained away.

Quantum

17. Regarding the issue of quantum, a statement of the expenses allowed in the computation of assessable profits as against the expenses claimed by the Taxpayer is set out below:

	\$	The Revenue	\$	The Taxpayers	\$
Sales proceeds		2,178,000		2,178,000	
<u>Less Purchase cost</u>		<u>1,142,100</u>		<u>1,142,100</u>	
Gross profit		1,035,900		1,035,900	
<u>Less: Mortgage interest</u>	121,656		121,120		
Other expenses	71,244		72,000		
Decoration	<u>-</u>	<u>192,900</u>	<u>105,000</u>	<u>298,120</u>	
Assessable Profits		<u>843,000</u>			
Gain on disposal				<u>737,780</u>	

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The difference between the two computations is the amount of \$105,220, consisting of decoration fees in the amount of \$105,000 and other outgoings amounting to \$220. The centre of argument is whether the Taxpayers have incurred the decoration fees. No job lists detailing the work undertaken nor documentary evidence of payment was submitted. The Taxpayers have failed to prove that decoration fees in the amount of \$105,000 or any other amount were in fact incurred in the production of profits derived from the sale of the Subject Property. They have also failed to prove the incurring of the amount of \$220.

Conclusion

18. For all the above reasons we conclude as follows.

18.1 The Taxpayer have failed to prove that, at the time of its acquisition, their intention was to hold the Subject Property as a residence of their parents and Madam B's family.

18.2 The Taxpayers acquired the Subject Property as a trading asset. Their intention was to sell it at a profit.

18.3 The profit on the disposal of the Subject Property is a trading profit and is assessable to profits tax.

18.4 The Taxpayer have failed to discharge their onus to prove that the profits tax assessment under appeal is incorrect or excessive.

Decision

19. It follows that this appeal is dismissed and that the assessment under appeal is hereby confirmed.