

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D28/99

Profits Tax – profits realized from sale of property – whether for investment or trading purpose – intention of taxpayer at the time of acquisition – Inland Revenue Ordinance, Chapter 112, sections 2(1), 14(1) and 68(4).

Panel: Anna Chow Suk Han (chairman), Robin M Bridge and Michael Neale Somerville.

Date of hearing: 30 April 1999.

Date of decision: 23 June 1999.

The taxpayers by a formal agreement dated 20 March 1996 purchased the Subject Property at \$4,954,000. By an assignment dated 24 April 1996, the Subject Property was assigned to the taxpayer. The purchase was financed by a loan of \$3,300,000 from the bank, repayable by 120 equal monthly instalments of \$41,803 each. By a provisional agreement dated 10 December 1996 which was followed by a formal agreement dated 20 December 1996, the taxpayer agreed to sell the Subject Property at a consideration of \$5,900,000 and the sale was completed on 22 March 1997.

The assessor determined that the profits gained from the sale of the Subject Property was chargeable to profit tax. The taxpayers appealed against the determination on the grounds that (1) the Subject Property was purchased for self-occupation (2) the sale of the Subject Property was approached by property agents. Their repeated invitations and attractive offers reached a level that a reasonable man would not refuse (3) the property had been held for a year that is not normal period for a speculative transaction (4) the taxpayers never carry out business nor trade properties.

The issues are (1) whether the taxpayer have discharged the onus of proving that the assessment appealed against is incorrect in that the gain arising from the sale of the Subject Property which was acquired as a capital asset is not assessable to profit tax in accordance with section 14(1) of the IRO and (2) whether the taxpayers have discharged the onus of proving the assessment appealed against is excessive in that certain expenses in respect of the Subject Property should be deducted from the profit.

Held:

1. Trading requires an intention to trade. 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).

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2. An intention connotes a state of affairs which X decides, so far as in him lies, to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. X cannot be said to 'intend' a result which is wholly beyond the control of his will. He cannot 'intend' that it shall be a fine day tomorrow. At most he can hope or desire or pray that it will. Nor can X be said to 'intend' a particular result ... if X's volition is no more than a minor agency collaborating with, or not thwarted by, the factors which predominantly determine its occurrence (per Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253).
3. 'Intention' connotes an ability to carry it into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented (D11/80, IRBRD, vol 1, 374).
4. 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. 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 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 (per Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750 at 771).
5. Applying the above legal principles to the facts of this case, the Board found that the taxpayers purchased the Subject Property as a trading stock:
 - (1) The taxpayers did nothing to the Subject Property by way of decoration while they were in possession of it for eight months;
 - (2) Despite their assertion that the Subject Property was acquired as their residence, after the sale of the Subject Property over two years ago, the taxpayers are still living in their original flat;
 - (3) Whether an individual would select a payment method with the lowest gearing and would sell the property soonest possible, depends on the strength of his financial position and of the then property market. As from the evidence, the taxpayers were then earning about \$100,000 per month and were owners of yet another property which was free from mortgage and at their disposal. They had the financial means to meet their mortgage commitments and to hold the Subject Property for a lengthy period and would be willing to do so because they were then in a rising market;

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- (4) Mrs B's evidence on how and to what extent the Subject Property was used were vague and evasive, in particular, in view of the low electricity usage at the Subject Property.
6. As to the taxpayer's claim that the assessment is excessive in that building management fees, utility charges, rates and other expenses of approximately \$30,000 should be deducted from the profit, the taxpayers were unable to produce receipts or other documents in support of the same. In the absence of documentary evidence, the Board rejected this claim.

Appeal dismissed.

Cases referred to:

Simmons v CIR 53 TC 461
Cunliffe v Goodman [1950] 2 KB 237
D11/80, IRBRD, vol 1, 374
All Best Wishes Ltd v CIR 3 HKTC 750

Chow Cheong Po for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

The appeal

1. This is an appeal by the Taxpayers against the determination dated 18 November 1998 by the Commissioner of Inland Revenue, rejecting the objection raised by the Taxpayers against the profits tax assessment for the year of assessment 1996/97 dated 31 October 1997, showing assessable profits of \$430,380 with tax payable thereon of \$64,557. The gain arose from the sale of a residential flat in Private Housing Estate A ('the Subject Property').
2. The Taxpayers claim that the Subject Property was acquired by them as their residence and the gain they derived from the sale of the Subject Property should not be chargeable to profit tax.
3. The Taxpayers further claim that if profits tax is chargeable, building management fees, utility charges, rates and other expenses in respect of the Subject Property should be deducted from the profit.

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The background facts

4. The Taxpayers ('Mr B' and 'Mrs B') are husband and wife.
5. By an assignment dated 11 May 1991 and at a price of \$1,351,647, the Taxpayers acquired a property in Private Housing Estate A ('Property 1'), where they are now living and have been living since the acquisition together with their two daughters, now aged 14 and 9, the mother of Mrs B and a Philippine maid.
6. By a provisional agreement dated 16 March 1996 which was followed by a formal agreement dated 20 March 1996, the Taxpayers agreed to purchase the Subject Property at a price of \$4,954,000. By an assignment of 24 April 1996, the Subject Property was assigned to the Taxpayers. The purchase was financed by a loan of \$3,300,000 from the bank, repayable by 120 equal monthly instalments of \$41,803 each.
7. By a provisional agreement dated 10 December 1996 which was followed by a formal agreement dated 20 December 1996, the Taxpayers agreed to sell the Subject Property at a consideration of \$5,900,000 and the sale was completed on 22 March 1997.
8. In a questionnaire completed on 5 June 1997, the Taxpayers supplied the following information to the Inland Revenue Department in respect of the Subject Property:
- (a) The intended usage or actual usage of the property was 'self occupied (as residence)'.
 - (b) Reasons for selling the property were –
 - (i) 'Approached by property agent (had a firm buyer)'.
 - (ii) 'In view of the significant increase in market value within 1-2 months'.
 - (iii) 'Move to other flat'.
 - (c) Net profit –

	\$	\$
Selling price		5,900,000
Purchase cost		<u>4,954,000</u>
Gross profit		946,000
Total expenses involved		
Legal fees on purchase	59,234	
Stamp duty	136,235	
Bank interest	252,151	
Legal fees on sale	13,000	

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Commission to agent on sale	<u>55,000</u>	<u>515,620</u>
Net profit		<u>430,380</u>

9. The assessor was of the view that the profit derived by the Taxpayers from the sale of the Subject Property was chargeable to profit tax and on 31 October 1997 raised on the Taxpayers the following profit tax assessment:

Year of assessment 1996/97	
Assessable profits	<u>\$430,380</u>
Tax payable thereon	<u>\$64,557</u>

10. By a letter dated 3 November 1997, the Taxpayers raised objection against the profit tax assessment for the year of assessment 1996/97 in respect of the Subject Property in the following terms:

- '(1) The property was acquired for long-term investment. To improve our living condition, we brought a new flat as residence.
- (2) The sale of the flat was approached by property agents. Their repeated invitations and attractive offers reached a level that a reasonable man would not refuse.
- (3) The property had been held for a year that is not a normal period for a speculative transaction.
- (4) We never carry our business nor trade properties. The only occasion that we brought a new flat was to improve our living environments. Moreover, a single sale and purchase does not constitute an adventure of trade.'

11. In response to the assessor's enquiry, Mr B stated the following in a letter to the assessor of 12 December 1997:

- '(a) I intended to move in the flat [the Subject Property].
- (b) My family live in both Property 1 and the Subject Property but usually stayed in Property 1 at night. The Subject Property was usually used as study room and work office. Actually, we were considering to acquire the next room as a twin unit and either to sale or to rent Property 1 after moving in the Subject Property. However, the next flat had just rented for a lease of two years. So, we tried to find another flat and had contacted the developer asking it to sale to me the remaining twin unit at another block. Unfortunately, the market rose in mid 1996. The price of

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that block increased substantially to over \$8,500 per square feet. While we had not taken time to decide immediately and due to the prompt increase in property market, the developer refused to sell that unit and saying that it will be retained for its own use. Since mid 1996, the property agents frequently approached us and offered us an attractive price. We decided to sell it. Since then, we are still finding a larger flat to live but the property market rose to such a high level that we held on our idea until the price drop to a reasonable level.'

12. After further enquiry by the assessor and representations by the first named Taxpayer, by a determination of 18 November 1998, the Commissioner of Inland Revenue confirmed the profit tax assessment against the Taxpayers for the year of assessment 1996/97.

13. By a notice of appeal dated 16 December 1988, the Taxpayers gave notice of appeal against the said determination and also gave their grounds of appeal which are the same as the reasons for objection of the profit tax assessment as contained in their letter to the assessor of 3 November 1997.

14. According to the records of China Light and Power Company Limited, the electricity consumption at the Subject Property during the period of ownership of the Taxpayers was as follows:

Period Covered	Units Consumed	Charges (\$)
2-4-1996 to 2-5-1996	2	17
3-5-1996 to 4-6-1996	4	16
5-6-1996 to 3-7-1996	0	13
4-7-1996 to 2-8-1996	0	17
3-8-1996 to 4-9-1996	1	16
5-9-1996 to 3-10-1996	0	17
4-10-1996 to 4-11-1996	0	16
5-11-1996 to 3-12-1996	1	17
4-12-1996 to 4-1-1997	0	16
5-1-1997 to 3-2-1997	0	17
4-2-1997 to 4-3-1997	0	16
5-3-1997 to 22-3-1997	0	17

15. The following information are ascertained from the sales brochures of the development for Private Housing Estate A:

- (a) The gross floor areas of Property 1 and the Subject Property are 857 square feet and 863 square feet respectively.

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- (b) The layouts of Property 1 and the Subject Property are more or less the same.

16. The Taxpayers are still the owners of Property 1 and they are still living there with their family.

17. The Taxpayers were the owners of another property at District C ('Property 2') which was purchased by them in 1981 and sold in November 1996.

18. Apart from the purchase and sale of Property 2 and the Subject Property, the Taxpayers have not purchased and sold another landed property.

The relevant statutory provisions

19. The relevant provisions of the Inland Revenue Ordinance ('the IRO') are as follows:

- (1) *Section 2(1) defines 'trade' as including every trade and manufacture, and every adventure and concern in the nature of trade.*
- (2) *Section 14(1) provides that profits tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits from such trade, profession or business (excluding profits arising from sale of capital assets).*
- (3) *Section 68(4) provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.*

The established legal principles

20. Trading requires an intention to trade. Was the asset 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).

21. An intention connotes a state of affairs which X decides, so far as in him lies, to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. X cannot be said to 'intend' a result which is wholly beyond the control of his will. He cannot 'intend' that it shall be a fine day tomorrow. At most he can hope or desire or pray that it will. Nor can X be said to 'intend' a particular result ... if X's volition is no more than a minor agency collaborating with, or not thwarted by, the factors which predominantly determine its occurrence (per Asquith LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253).

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22. 'Intention' connotes an ability to carry it into effect. It is idle to speak of 'intention' if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented (D11/80, IRBRD, vol 1, 374).

23. 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 (per Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750 at 771).

The issues

24. The issues are (1) whether the Taxpayers have discharged the onus of proving that the assessment appealed against is incorrect in that the gain arising from the sale of the Subject Property which was acquired as a capital asset is not assessable to profits tax in accordance with section 14(1) of the IRO and (2) whether the Taxpayers have discharged the onus of proving the assessment appealed against is excessive in that certain expenses in respect of the Subject Property should be deducted from the profit.

The evidence and our findings

25. The Taxpayers appeared in person. Mrs B adduced evidence on behalf of herself and Mr B. They did not call witnesses nor produce documents in support of their case.

26. The Respondent (the CIR) produced, inter alia, copies of the following documents:

- (1) Land Registry's records of the Subject Property.
- (2) Provisional agreement for sale and purchase dated 16 March 1996 of the Subject Property.
- (3) Provisional agreement for sale and purchase dated 10 December 1996, by which the Taxpayers sold the Subject Property, with a translation.
- (4) A plan extracted from the sales brochures of the development for Private Housing Estate A showing the size and layout of Property 1.

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- (5) A plan extracted from the sales brochures of the development for Private Housing Estate A showing the size and layout of the Subject Property.
- (6) Price list issued by the sales agent of the developer of the development for Private Housing Estate A in respect of the some of the flats of 5 blocks.
- (7) Electricity consumption record of the Subject Property for the period from 2 May 1996 to 22 March 1997.

27. It is the Taxpayers' case that they had never carried on business nor traded properties and that the Subject Property was acquired as their residence to improve their living condition and it was sold because they were approached by property agents whose repeated invitations and attractive offers reached a level that a reasonable man would not refuse and by these reasons the gain on disposal of the Subject Property was a capital gain and should not be subject to profit tax.

28. By virtue of section 68(4) of the IRO, the onus of proving that the Subject Property was acquired by the Taxpayers as their residence, rests on the Taxpayers.

29. As pointed out by Mortimer J, as he then was, in All Best Wishes Limited v CIR (1992), *'the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence'*. It is therefore our task to ascertain the actual intention of the Taxpayers at the time when the Subject Property was purchased. We have to be satisfied that their intention at the time was to purchase the Subject Property as their residence and such intention is on the evidence 'genuinely held, realistic and realisable'.

30. The Taxpayers asserted that they had never carried on business nor traded properties and that the purchase and sale of the Subject Property was an one-off transaction. From the evidence, we understand that Mr B is a teacher and Mrs B is a manager in the audit department of an accounting firm. We accept that the Taxpayers' occupations are not related to property trading which is a factor in their favour. But this factor is not conclusive. Many people in Hong Kong having full time occupations also trade or speculate in landed properties. We also accept that the purchase and sale of the Subject Property by the Taxpayers was an one-off transaction. This too is a pointer in favour of the Taxpayers, which indicate that there might not be trade here but something else. However, the lack of repetition by itself is not conclusive and an one-off transaction in law is capable of being an adventure in the nature of trade.

31. The Taxpayers claimed that they acquired the Subject Property for self occupation to improve their living condition. Although Mrs B claimed that the Subject Property was in a better condition and had a better view, its size and layout are similar to those of Property 1. We have doubt as to whether the Subject Property could serve the Taxpayer's purpose. Our doubt seems to be supported by the Taxpayer's assertion that they

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wished to purchase a twin unit both before and after the selection of the Subject Property. Mrs B explained that they wanted a twin unit because 'it was a larger flat and because there were many people in their flat and there was not sufficient space for them to work'. Thus, we are not convinced that the Subject Property could have recommended itself to the Taxpayers as an improvement in their living condition.

32. The Taxpayers argued that if they were trading, they would select the payment method with the lowest gearing and would sell the property as soon as possible, preferable before the completion of the purchase. They did not think a reasonable man would pay over \$40,000 monthly mortgage instalment for a year in order to make a profit especially not in the market boom period. We are not persuaded by this argument. Whether an individual would select a payment method with the lowest gearing and would sell the property soonest possible, depends on the strength of his financial position and of the then property market condition. As from the evidence, the Taxpayers were then earning about \$100,000 per month and were owners of Property 2 which was free from mortgage and at their disposal. They had the financial means to meet their mortgage commitments and to hold the Subject Property for a lengthy period and would be willing to do so because they were then in a rising market.

33. The Taxpayers further argued that if they were to trade, they would purchase a unit of about 600 odd square feet and not one of 800 odd square feet. However, there is no evidence before us that units of 600 odd square feet were available when Mr B made the selection of the Subject Property.

34. Although it is the Taxpayers' assertion that the Subject Property was acquired as their residence, the Taxpayers did nothing to the Subject Property by way of decoration while they were in possession of it for eight months. This is a strong indicator that the Taxpayers had never intended the Subject Property as their residence.

35. The Taxpayers argued that the Subject Property had been held for a year and such period of ownership was not a normal period for speculative transaction. We do not accept this argument. Again, the length of ownership depends on the strength of the speculator's financial position and the then property market condition. As we said before, the Taxpayers had the financial means to hold the Subject Property for a lengthy period. But then, the Taxpayers entered into an agreement to sell the Subject Property eight months after they acquired it and their exposure was thereupon limited.

36. The Taxpayers claimed that they used the Subject Property as study room and work office during day time. When cross-examined on the low electricity usage at the Subject Property, Mrs B then said they seldom went to the Subject Property during weekdays but usually went there on Saturdays and holidays and when cross-examined on the use of computer installed at the Subject Property, she then said it was a notebook computer which could be taken here and there and did not need to be plugged in. We find Mrs B's evidence on how and to what extent the Subject Property was used, vague and evasive. We are not persuaded that they used the Subject Property regularly as claimed.

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37. Despite their assertion that the Subject Property was acquired as their residence, after the sale of the Subject Property over two years ago, the Taxpayers are still living at Property 1. This factor indeed casts doubt on their assertion that the Subject Property was acquired for self residence purpose.

38. After having carefully considered the Taxpayer's grounds of appeal, the evidence before us, and the Taxpayers' submission, we find that they have not been able to discharge their duty of proving that the Subject Property was acquired by them for self use.

39. Since we have rejected the Taxpayers' claim that they acquired the Subject Property as a capital asset, the question whether they changed their mind and decided to sell the Subject Property, does not arise. Nonetheless, we find that the Taxpayers' reason for the sale of the Subject Property is compatible with the intention that the Subject Property was acquired as a trading stock.

40. As to the Taxpayers' claim that the assessment is excessive in that building management fees, utility charges, rates and other expenses of approximately \$30,000 should be deducted from the profit, the Taxpayers were unable to produce receipts or other documents in support of the same. In the absence of documentary evidence, we do not admit this claim.

41. For the above reasons, we dismiss the appeal and confirm the assessment in the determination.