

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D35/95

**Profits tax** – purchase and sale of residential property – whether profit assessable to profits tax.

Panel: Andrew Halkyard (chairman), Douglas C Oxley and Herbert Hak Kong Tsoi.

Date of hearing: 4 May 1995.

Date of decision: 4 July 1995.

The taxpayer purchased a residential flat under construction. It was sold at a profit after a period of ten months. There was no long term financial arrangement to own the flat. The flat was sold before the construction was completed.

Held:

The Board found as a matter of fact that the purchase and sale of the residential flat was an adventure in the nature of trade.

### **Appeal dismissed**

Cases referred to:

Simmons v IRC [1980] 53 TC 461  
All Best Wishes Ltd v CIR [1992] 3 HKTC 750  
D11/80, IRBRD, vol 1, 374

Chan Wai Mi for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

The Taxpayer has appealed against a determination of the Commissioner of Inland Revenue which confirmed the profits tax assessment for the year of assessment 1991/92 raised on him. The Taxpayer claims that the profit he derived from the purchase and sale of a property is not chargeable to tax.

### **The facts**

On the basis of various documents produced to us by both parties and oral evidence adduced by the Taxpayer, we find the following facts.

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1. At all relevant times, the Taxpayer was an officer of YY Department. He worked in a public library.
2. Employer's returns filed by the Hong Kong Government show that the emoluments derived by the Taxpayer for the years of assessment 1989/90 to 1992/93 were as follows:

<b>Year Ended</b>	<b>Basic Salary</b>	<b>Overtime Allowance</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
31-3-1990	96,360.00	2,647.54	99,007.54
31-3-1991	122,100.00	49,465.58	171,565.58
31-3-1992	132,060.00	45,682.93	177,742.93
31-3-1993	147,360.00	13,128.76	160,488.76

3. On 30 October 1990, the Taxpayer purchased from the developer a property known as Flat A ('the Property') for a consideration of \$981,300.
4. The purchase of the Property was financed by way of mortgage from Company X. The amount of the mortgage loan was \$770,000. The loan was repayable by 180 monthly instalments of \$8,511.60.
5. When the Property was purchased the Taxpayer's basic salary was \$9,490 per month; at that time he also received an overtime allowance of approximately \$4,000 per month.
6. On 3 September 1991, the Taxpayer entered into a provisional agreement to sell the Property for a consideration of \$1,765,000.
7. At all times when the Taxpayer owned the Property it was under construction. The occupation permit for the Property was issued on 20 December 1991.
8. The Taxpayer subsequently acted as confirmor to the assignment of the Property to the purchaser. The assignment of the Property to the purchaser was dated 19 June 1992.
9. On 24 June 1992, the Taxpayer entered into a provisional agreement to purchase a property located at Flat B, for a consideration of \$1,280,000.
10. Flat B was mortgaged to Bank Y for \$500,000. This loan was repayable by 180 monthly instalments of \$4,636.
11. In June 1992, the Taxpayer's basic monthly salary was \$11,005; at that time he did not receive any overtime allowance.

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12. Flat B has been occupied by the Taxpayer as his residence from the end of November 1992 until now.
13. The assessor considered the profit derived from the disposal of the Property a trading profit. A profits tax assessment for the year of assessment 1991/92 was raised on the Taxpayer showing assessable profits of \$766,000 with tax payable thereon of \$114,900.
14. The Taxpayer objected to the profits tax assessment for the year of assessment 1991/92 in the following terms:

‘Originally, I lived at Flat C in a public housing estate. The usable area of the flat was about 400 square feet with seven people residing there. A few years ago, I had the intention to purchase a property so as to improve the crowded living condition.

In 1990, my monthly salary was \$9,000 odd. Moreover, because of the shortage of staff at the library where I worked, I could earn an extra overtime allowance of \$3,000 to \$4,000 odd each month. So, I dared to purchase a property under construction (the Property) at the end of 1990. The monthly instalment for the Property was \$8,000 odd. This was the first time for me to purchase my own property. However, in the middle of 1991, I was given to understand from my senior that the library would employ temporary staff to fill the original vacancy, that was to say, my monthly income would be reduced by \$3,000 or more. This would create problems in my repayment of the mortgage loan. Therefore, after considering the possible change of my income, I decided to dispose the Property and changed to purchase another one which would not impose so much financial burden on me. Hence, I disposed the Property which was still under construction in August 1991. I received 20% of the consideration at once and the remaining amount was received in June 1992. After receiving the remaining amount for the Property under construction, I immediately purchased my present residence, (that is, Flat B). The purchase consideration was \$1,280,000. If I purchased this property at the end of 1990, the consideration would be about \$700,000 odd. Because of the difference in the consideration and other sundry expenses, I had to pay in 1992 an extra amount of over \$600,000 more than at the end of 1990. Moreover, for the repayment of mortgage loan for the Property for nine months, the bank interest paid was about \$50,000 odd.

The above explanation showed that it was actually due to my financial position for the repayment, I changed to purchase another property with less financial burden. I did not have any intention of disposing of the Property for profit-making.’

15. The Commissioner disallowed the Taxpayer’s objection to the profits tax assessment for the year of assessment 1991/92. He concluded that the

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Taxpayer's purchase and sale of the Property amounted to an adventure in the nature of trade.

16. On 7 December 1994, the Taxpayer appealed against the Commissioner's determination to the Board of Review. The Taxpayer contends that the Property was not purchased for the purpose of resale at a profit. In his grounds of appeal, amongst other things, the Taxpayer stated:

'The purchase of the Property under construction was the first time for me to purchase my own property. After completing the transaction in June 1991, I immediately purchased my present residence (Flat B), so as to improve the crowded living condition of my original residence at the public housing estate.'

### **Cross-examination of the Taxpayer**

Under cross-examination the Taxpayer stated that he lived in Flat C with his family before moving to Flat B (compare fact 16).

The Taxpayer stated that he usually gave to his parents a sum of \$2,000-\$3,000 per month but this was reduced by \$1,000 per month after he purchased the Property and had to pay mortgage interest.

The Taxpayer agreed that without the overtime allowance it would be very difficult for him to finance the purchase of the Property and that in the long term his mortgage commitments would affect his standard of living. However, he stated that if he continued to receive the overtime allowance he could afford to purchase the Property and that after three or four years financing the mortgage would not be difficult as he expected to receive a salary increase. The Taxpayer then stated that he approached an agent to sell the Property in the latter part of July 1991. At that time he had been informed by his supervisor that extra staff would be employed at his place of work and that his overtime opportunities would thus be reduced.

The following exchange then took place between the Taxpayer and the Commissioner's representative:

'Did you enter into any other property transactions? No. My only other transaction was to buy the flat in which I am presently living (that is, Flat B).

Is that all? After I sold the Property I purchased a flat at District K. I lived there for about half a year. I felt it was very humid and noisy and the transportation was not convenient and so I sold it.

But you said previously that you moved from Flat C to Flat D? When I answered the previous question about my place of residence I did not remember that I purchased the property in District K.

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Were there any other property transactions? None except for my present residence.

How about a flat in District L? Yes, but it is not totally mine. Although I am the registered owner, my family lives there. I am only a part owner.'

### **The issue before the Board**

The issue for the Board to decide is whether the gain derived by the Taxpayer from the purchase and sale of the Property is chargeable to profits tax as arising from an adventure in the nature of trade (section 14 and section 2(1) definition of 'trade').

### **The relevant law**

The law relevant to this appeal is clear and is not in dispute. The Board must decide whether the Taxpayer when purchasing the Property intended to sell at a profit or to hold the Property as a long term investment (see Simmons v IRC [1980] 53 TC 461 at page 491 and All Best Wishes Ltd v CIR [1992] 3 HKTC 750 at page 771).

In relation to establishing intention, we found the decision in D11/80, IRBRD, vol 1, 374 at page 379 of assistance:

*"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.'*

### **Analysis**

We were not impressed with the Taxpayer's evidence. His answers in cross-examination on his other property transactions were only extracted from him after repeated questioning. Those answers were inconsistent with his previous testimony that: (1) he moved from Flat C to reside in Flat B and (2) he had never entered into any other property transactions at all. At best, the Taxpayer was confused or forgetful during the course of the hearing. But given the Taxpayer's insistence that the purchase of property was a significant event for him, we find it difficult to explain the inconsistencies revealed during cross-examination other than to say that the Taxpayer, for whatever reason, did not want to disclose to the Board his other property transactions.

In any event, even if we were to accept the Taxpayer as a confused or forgetful witness, we cannot accept his contention that his intention was to acquire the Property as a residence. In this regard, we agree with the Commissioner that the following factors indicate that the Taxpayer entered into an adventure in the nature of trade:

1. **There was never any long term financial arrangement to hold the Property as a long term investment.** When purchasing the Property the Taxpayer's basic salary was \$9,490 per month. The mortgage payment was \$8,511 per month. At all relevant times, the Taxpayer paid a **minimum** of

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\$1,000 per month to his parents. Although the Taxpayer received overtime allowances of some \$4,000 per month when he purchased the Property, this level of remuneration commenced after 1 April 1990, just six months prior to purchasing the Property. Given the usual understanding that overtime is a temporary solution to staff shortages, we doubt that the Taxpayer formed the belief that the overtime allowances could be his regular income and a secure source of long term finance for purchasing the Property. In the event, the Taxpayer received notice from his superior in July 1991 that overtime work would be curtailed. This notice came only eight months after purchasing the Property. During cross-examination the Taxpayer agreed that without the overtime allowance it would be very difficult for him to finance the purchase of the Property and that in the long term his mortgage commitments would affect his standard of living. With no secure source of finance to hold the Property it comes as no surprise that the Property was sold prior to taking possession. The Taxpayer simply has not proved to the Board's satisfaction that he had the ability to hold the Property for residential purposes.

2. **The short period of ownership.** The Property was owned for a period of ten months. Although not determinative of itself, a short period of ownership is indicative of trade, rather than purchase for residential purposes.
3. **Sale before completion of construction.** A sale before the issue of the occupation permit although again not determinative does cast some doubt on the Taxpayer's claim that the Property was purchased for residential purposes.

Having considered the facts and the Taxpayer's evidence, we ask what objective facts are available to support the Taxpayer's claims that the Property was purchased for residential purposes. The answer is very little. The bare facts are that the Property was bought and sold within a short period of time and was never occupied or capable of being occupied by the Taxpayer. Moreover, we have formed the conclusion from the Taxpayer's cross-examination that his evidence must be looked at sceptically. We also remind ourselves of the decision in *All Best Wishes Ltd v CIR* [1992] 3 HKTC 750 where Mortimer J stated at page 771: '*Often it is rightly said that actions speak louder than words*' and in *D11/80* where the Board of Review stated an intention connotes an ability to carry it into effect. In this case, those actions, when viewed in light of the evidence before us, show that the Taxpayer did not have any realistic intention to purchase the Property for residential purposes.

On the facts found by us and having heard and considered the Taxpayer's evidence, the Board is unable to conclude that the Taxpayer's contentions as to his reasons for purchasing the Property have been substantiated. We conclude that in purchasing and selling the Property the Taxpayer had engaged in an adventure in the nature of trade and that the Taxpayer has not discharged the onus of proving that the basis of the assessment was incorrect.

**Expenses incurred by the Taxpayer in deriving the assessable profits**

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The Taxpayer claims that the additional cost in purchasing Flat B should be taken into account in determining the level of any chargeable profits. This expense was not incurred by the Taxpayer in the production of assessable profits. Clearly it does not qualify for deduction under section 16 or any other provision of the IRO.

However, during the course of the hearing, it became clear that the Taxpayer had incurred certain expenses in buying and selling the Property which indicated that the level of assessable profits assessed was excessive. In fairness to the Taxpayer, who did not appear to appreciate that the amount of the relevant expenses must be proved, we consider that he should be given the opportunity to produce evidence to the Commissioner of the quantum of those expenses. On this basis the assessment is remitted to the Commissioner for revision. In the absence of agreement as to the quantum of expenses which should be available for deduction, either party is at liberty to remit this case to this Board.