

Case No. D4/12

Profits tax – sale of property – intention at time of acquisition – onus of proof – sections 14 and 68(4) of the Inland Revenue Ordinance.

Panel: Colin Cohen (chairman), Kumar Ramanathan and Carlye W L Tsui.

Date of hearing: 9 March 2012.

Date of decision: 8 May 2012.

The Taxpayer took assignment of two residential flats at 1/F and 2/F, Address B1 on 29 February 2008 at the consideration of \$600,000.

By a provisional agreement for sale and purchase dated 7 April 2008, the Taxpayer agreed to sell the 2/F Flat at the consideration of \$1,300,000.

By an assignment dated 9 May 2008, the sale was completed.

The Taxpayer claims that the 2/F Flat was originally purchased for long term investment purpose. The quick sale was due to her underestimation of the seriousness of water seepage problem and the cost of eradicating the problem.

Held:

1. The Taxpayer did not appear before the Board and did not give evidence.
2. The Board cannot attach any weight to the Affirmations of the Taxpayer and her brother, Mr C, which were uncorroborated and not tested by cross-examination.
3. The Taxpayer fails to put forward any credible or acceptable evidence to show that the 2/F Flat was a capital asset.
4. The Taxpayer fails to discharge her burden of proof to show that the assessment was excessive or incorrect.

Appeal dismissed.

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Cases referred to:

Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioner of Inland Revenue (1980) 53 TC 461
All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750
Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51
Real Estate Investments (NT) Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 433

Mr Wong Kwok Wah, Franky, for the Taxpayer.

Ng Lai Ying Vivian and Yip Chi Chuen for the Commissioner of Inland Revenue.

Decision:

Introduction

1. Ms A ('the Taxpayer') has objected to the Profits Tax assessment for the year of assessment 2008/09 raised upon her. The determination was upheld by the Deputy Commissioner of the Inland Revenue ('the Commissioner') by virtue of his Determination dated 2 November 2011 ('the Determination').
2. The issue for the Board to consider is whether the gain derived by the Taxpayer upon the sale of the property at 2/F, Address B1 ('the 2/F Flat') is assessable to profits tax.
3. Mr WONG Kwok-wah Franky ('Mr Wong') was authorized by the Taxpayer to appear on her behalf. Mr Wong is a solicitor. However, he is no longer in practice.
4. Mr Wong told us that the Taxpayer did not wish to appear before the Board and did not wish to give evidence. Mr Wong drew to our attention that the Taxpayer and her brother, Mr C, had each filed an affirmation dated 17 February 2012 ('the Affirmations') and in turn, would wish the Board to consider the Affirmations.
5. Ms NG Lai Ying, Vivian ('Ms Ng') on behalf of the Inland Revenue Department ('IRD') took the view that since she would not be able to cross-examine either the Taxpayer or her brother, then we should give little or no weight to the Affirmations.
6. The Board indicated to Mr Wong that without the Taxpayer being subject to cross-examination, then it is very likely that the Board would give little or no weight to the Affirmations and invited Mr Wong to consider whether or not he would wish to call the Taxpayer. A short adjournment was granted to allow him to take instructions.
7. Mr Wong informed the Board that the Taxpayer had made a considered and deliberate decision not to appear before us and elected not to give evidence.

The agreed facts

8. Helpfully, the parties agreed the following facts and we find them as facts:
- ' (1) [Ms A] (“the Taxpayer”) has objected to the Profits Tax assessment for the year of assessment 2008/09 raised on her. She claims that the profits on disposal of a property should not be chargeable to Profits Tax.
 - (2) (a) By an agreement for sale and purchase dated 4 February 2008 (“the Purchase Agreement”), the Taxpayer agreed to purchase two residential flats at 1/F and 2/F, [Address B1] (“the Flats” collectively and “the 1/F Flat” and “the 2/F Flat” respectively) at the consideration of \$600,000. Clause 6 of the Purchase Agreement reads as follows:

“[The Flats are] sold on an “as is” basis. The Purchaser has inspected and is aware of and satisfied with and accepts the existing state, condition and finishes of [the Flats] and shall take [the Flats] as it stands and shall not raise any objection thereto. The Vendor shall not be required to carry out any repair, renovation or maintenance of [the Flats] on or before completion.”
 - (b) The Taxpayer took assignment of the Flats on 29 February 2008.
 - (c) By a provisional agreement for sale and purchase dated 7 April 2008, the Taxpayer agreed to sell the 2/F Flat at the consideration of \$1,300,000. By an assignment dated 9 May 2008, the sale was completed.
- (3) In reply to a questionnaire issued by the Inland Revenue Department (“the IRD”) on the purchase and sale of the 2/F Flat, the Taxpayer claimed that she intended to use the 2/F Flat for letting. She also claimed that the purchase cost of the 2/F Flat was \$300,000 but did not provide any calculation of profits she derived from the sale of the flat. As regards the reason for selling the flat, the Taxpayer contended the following:
- (a) “[The 2/F Flat] was intended to be purchased for the purpose of letting out and for long term investment. However, after completing the purchase, I discovered that there was serious water leakage problems in [the 2/F Flat]. The water leakage problems were caused mainly by the flat immediately above [the 2/F Flat, i.e. the residential flat at 3/F, [Address B1] (“the 3/F Flat”)] and can only be remedied by carrying out repair works from [the 3/F Flat]. [The 3/F Flat] has been partitioned into a number of rooms each

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occupied by a tenant. I have tried to contact the occupiers and the owner of [the 3/F Flat] for the purpose of gaining access to the flat to view the condition but they were extremely in-cooperative (sic) and would not allow me to get into [the 3/F Flat] even for an inspection, let alone to carry out repair works. In the circumstances, I was not able to carry out necessary repair works from [the 3/F Flat] and could not remedy the water leakage problem.”

(b) “Without remedying the water leakage problem, I could not have let [the 2/F Flat] out nor could I move in to live there myself. Taking into account the above and considering the water leakage problem, I finally decided to sell [the 2/F Flat] in April 2008.”

(c) “[The 2/F Flat] was purchased with [the 1/F Flat]. [The 1/F Flat] is still kept by me and has not been sold and I am carrying out renovation thereto for the purpose of letting it out. Accordingly, [the 2/F Flat] was not purchased by me for speculation purpose and it was only because of the water leakage problem that I could not let it out or to live there that I finally decided to sell [the 2/F Flat]. In the circumstances, the gain from the disposal of [the 2/F Flat] should not be regarded as profit assessable to profit[s] tax.”

(4) The Assessor was of the view that the Taxpayer’s purchase and sale of the 2/F Flat amounted to an adventure in the nature of trade, and that the profits derived therefrom were chargeable to profits tax. The Assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 2008/09:

Estimated assessable profits	<u>\$972,000</u>
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Tax payable thereon	<u>\$145,800</u>
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(5) The Taxpayer objected to the above assessment on the following grounds:

(a) “[The 2/F Flat] was purchased by me in February 2008 and at the time of my purchase, [the 2/F Flat] had been left empty, unoccupied and unattended for more than 10 years. [The 2/F Flat] had become very old and desolate and in extremely dilapidated conditions, requiring immediate repair. Basically, it was in an absolutely uninhabitable condition with concrete crumbling and falling off from the ceiling and the walls.”

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- (b) “There were also serious problems of water leakage and drain blockage in [the 2/F Flat] with water seeping through the ceiling from [the 3/F Flat] and through the walls. There were even holes on the external walls.”
- (c) “Besides the dilapidated condition of [the 2/F Flat], there were unauthorized structures within [the 2/F Flat] and building orders have been issued by relevant authorities. Kindly also note that the Building Authority [(“BA”)] issued an order on 10 November 2009 to the owners of [the Building at Address B1 and Address B2 (‘the Building’)] declaring that the building is liable to become dangerous and substantial works have to be carried out in respect of the building. ... All in all, to put [the 2/F Flat] back in normal and habitable state and restoring the building to proper and safe conditions, I need to invest substantial money and time.”
- (d) “[The 2/F Flat] was purchased by me at the same time with [the 1/F Flat]. I originally intended to reside in one of the units while letting the other out so that I could live on the rental generated from the unit let out. The rental income will therefore provide me with a steady and regular income to meet my daily expenses. I am now over 60 and do not have any income and only live on my own limited savings. However, taking into account the substantial expenses that have to be incurred in restoring and redecorating [the 2/F Flat] before letting it out and considering the serious water seepage problem that may entail, I have finally decided not to let out [the 2/F Flat] but to sell it instead. It is true that [the 2/F Flat] was originally purchased for long term investment and for the purpose of letting out. Only after the purchase and after consulting the decorator did I realize that the condition of [the 2/F Flat] was much worse than I expected and the repair and renovation costs greatly exceeded my expectation. The unexpected and hefty repair and renovation costs forced me to scrap my plan. Finally, I decided just to keep [the 1/F Flat] as it was in a better condition and there was no water seepage problem. I am now staying in [the 1/F Flat] on my own.”
- (e) “Without prejudice to my appeal and the grounds of my objection abovementioned, [the assessment at Fact (4) above] has not taken into account the expenses which I incurred in the purchase and sale of [the 2/F Flat] such as the estate agent commission, the legal expenses and disbursements, the stamp duty and the additionally assessed stamp duty (HK\$20,000) and the ... overdue management fees (HK\$32,040).”

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- (6) In reply to the Assessor's enquiries, the Taxpayer, through her representative Mr C ("the Representative"), contended the following:
- (a) "[The 2/F Flat] was purchased with the monies of [the Taxpayer] and was not financed by mortgage loan."
 - (b) "[The Taxpayer] has no history of property transaction whether solely or jointly with other persons."
 - (c) "[The Taxpayer] has through [the Representative] lodged oral complaints against the owner of [the 3/F Flat] in respect of the water leakage problem but [the Taxpayer] has not taken legal action against the owner. It was [the Taxpayer's] genuine suspicion at the material time that the leakage problem had been caused by [the 3/F Flat]. However, it should be noted there is no solid evidence that the leakage problem has been caused by [the 3/F Flat] although the leakage appeared at that part of the walls and ceiling adjacent to [the 3/F Flat]. Without solid evidence to prove that the leakage problem was caused by [the 3/F Flat], it was not appropriate for [the Taxpayer] to take legal action against [the 3/F Flat] owner. To spend the expenses, time and effort in finding the cause and eradicating the problem is the thing [the Taxpayer] would not want to get involved. Further, [the Taxpayer] is only an ordinary housewife with no legal or commercial knowledge and does not have any experience in handling property matters. It would not be realistic to expect her to take out a legal action against [the 3/F Flat] owner in the circumstances. Last but not the least, it is the reason that [the Taxpayer] did not want to get in the trouble of eradicating the leakage problem that she had to sell [the 2/F Flat]."
 - (d) "There is no documentary evidence as the complaints had been made orally. As [the 3/F Flat] has been let out, [the Representative] was only able to complain to the occupier and ask him to pass the message to the owner but to that complaint, [the Representative] ha[s] not received any response from the owner."
 - (e) "To the best of [the Representative's] recollection, the estimated costs for the repair and renovation work was close to HK\$200,000. ... [the Taxpayer] does not have the documentary evidence of such quotation."

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- (7) In relation to the above contentions, the Taxpayer and the Representative supplied copies of the following documents:
- (a) The order issued by the BA on 10 November 2009 referred to in Fact (5)(c) above.
 - (b) Certain photos alleged to be taken in the 2/F Flat on 21 April 2008.
 - (c) A demand note issued by the IRD showing the total stamp duty of \$20,100 charged on the Purchase Agreement in relation to the purchase of the Flats.
 - (d) A receipt issued by Messrs E & Co. (“the Solicitors”) showing the legal costs and disbursements of \$4,500 on the purchase of the Flats.
 - (e) A demand note issued by the Solicitors showing the legal cost and disbursement of \$4,000 on the sale of the 2/F Flat.
 - (f) A letter issued by the Solicitors showing the full and final settlement of the outstanding management fees of HK\$20,100 in respect of the 2/F Flat with the Taxpayer as vendor.
- (8) The Assessor has since ascertained that the 1/F Flat and the 2/F Flat each shares two equal undivided 27th parts or shares of and in all that piece or parcel of ground registered in the Land Registry as the Remaining Portion of New Kowloon Inland Lot [Lot number concealed] and of and in messuages erections and building thereon, i.e. the Building.
- (9) Having regard to all the above facts, the Assessor takes the view that:
- (a) the profits from the sale of the 2/F Flat should remain chargeable to profits tax; and
 - (b) the relevant net profits should be computed as follows:

	\$	\$
Sale proceeds [Fact (2)(c)]		1,300,000
<u>Less:</u> Purchase cost [Fact (3)]	300,000	
Legal fees on purchase [Note]	2,250	
Stamp duty [Note]	10,050	
Legal fees on sale [Fact (7)(e)]	4,000	
Outstanding management fees [Fact (7)(f)]	<u>20,100</u>	<u>336,400</u>
Net profits		<u>963,600</u>

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Note: The legal fees on purchase of \$4,500 [Fact (7)(d)] and stamp duty of \$20,100 [Fact (7)(c)] are apportioned equally between the 1/F Flat and the 2/F Flat [Fact (8)(a)].

Accordingly, the Profits Tax assessment for the year of assessment 2008/09 should be revised as follows:

Assessable profits	<u>\$963,600</u>
Tax payable thereon	<u>\$144,540</u> ”

Evidence

9. Mr Wong advised the Board that he would not be calling any evidence and would be relying on the documents and papers which he had submitted and in particular, the Affirmations.

10. As can be seen from the agreed facts, the Taxpayer had purchased the property at 1/F, Address B1 (‘the 1/F Flat’) and the 2/F Flat [(collectively ‘the Flats’)] for the sum of HK\$600,000 on 4 February 2008. The Flats were sold on an “as is” basis. Completion took place on 29 February 2008.

11. Our attention was drawn to an estate agency agreement between the Taxpayer and Property Agency D dated 2 March 2008. Hence, it can be seen within two days after completion, the Taxpayer had entered into an agreement to dispose of the 2/F Flat. Indeed, by 7 April 2008, the Taxpayer had agreed to sell the 2/F Flat for a consideration of HK\$1,380,000 and the sale was completed on 9 May 2008.

The relevant statutory provisions

12. Section 14 of the Inland Revenue Ordinance (‘IRO’) is the charging provision on profits tax. Section 14(1) provides as follows:

‘ Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.’

13. Section 2(1) of the IRO defines ‘trade’ and ‘business’ as follows:

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

“business”(業務) includes agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government’.

14. Section 68(4) of the IRO provides that:

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

The relevant legal principles

Capital or trading/business

15. Clearly, the intention at the time of acquisition is crucial. The well-established tax principle is clearly set out in Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioners of Inland Revenue (1980) 53 TC 461, where Lord Wilberforce said as follows:

‘One must ask, first, what the Commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss.’

16. Obviously, the subjective intention is to be tested against objective facts and circumstances and as such a mere declaration of intention is of limited value. The intention must be genuinely held, realistic and realizable. In All Best Wishes Ltd v Commissioner of Inland Revenue (1992) 3 HKTC 750 (‘the All Best Wishes case’), Mortimer J (as he then was) gave the following guidance:

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

‘The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the

whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. It is trite to say that intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done. Things said at the time, before and after, and things done at the time, before and after. Often it is rightly said that actions speak louder than words.'

17. Our attention was also drawn to the various badges of trade which would be of assistance to us in arriving at the conclusion as to whether or not the particular transaction was an adventure in the nature of trade or a long term investment. The badges of trade are as follows:

- (i) Whether the transaction was a one-off transaction?
- (ii) Whether the transaction was related to the trade which the Taxpayer otherwise carried on?
- (iii) Whether the transaction concerned a commodity which was normally the subject matter of trade?
- (iv) Whether the transaction was carried through in a way typical of the trade in that commodity?
- (v) Whether the source of finance for the transaction was borrowed money?
- (vi) Whether the item purchased was resold as it stood or whether work was done on it for the purpose of resale?
- (vii) Whether the purchaser intended to resell the item at the time of purchase?
- (viii) Whether the item was purchased to provide enjoyment or to produce income pending resale?

18. Of course, in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters and in turn look at the whole picture and ask the question whether this is an adventure in the nature of the trade.

19. Our attention was also drawn to Lee Yee Shing v Commissioner of Inland Revenue [2008] 3 HKLRD 51 whereby Bokhary PJ and Chan PJ emphasized at paragraph 38, page 66 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances.

20. In Real Estate Investments (NT) Limited v Commissioner of Inland Revenue (2008) 11 HKCFAR 433 ('the Real Estate Case'), Bokhary PJ and Chan PJ stated at pages 448 and 452 as follows:

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

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

Onus of proof

21. Again, the Taxpayer must discharge the burden of proof. In the All Best Wishes case, Mortimer J stated at page 772 as follows:

‘ It must be remembered that the burden of disturbing the assessment, rests upon the taxpayer’.

22. In the Real Estate Case, Bokhary PJ and Chan PJ stated as follows:

‘ It is natural and appropriate to strive to decide on something more satisfying than the onus of proof. And it should generally be possible to do so. But tax appeals do begin on the basis that, as s.68(4) of the Inland Revenue Ordinance provides, ‘(t)he onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant’. And it is possible although rare for such an appeal to end – and be disposed of – on that basis.’

‘ As for the notion of a shifting onus, such a notion is seldom if ever helpful. Certainly it cannot shift the onus of proof from where s.68(4) of the Inland Revenue Ordinance places it, namely on a taxpayer who appeals against an assessment to show that it is excessive or incorrect.’

‘ Suppose a tax assessment is made on the footing that the position is X and the taxpayer appeals against the assessment by contending that the position is Y. The taxpayer will have to prove his contention. So his appeal to the Board of Review would fail if the Board positively determines that, contrary to his contention, the position is X. And it would likewise fail if the Board merely determines that he has not proved his contention that the position is Y. Either way, no appeal by the taxpayer against the Board’s decision should succeed on the “true and only reasonable conclusion” basis unless the court is of the view that the true and only reasonable conclusion is that the position is Y.’

Discussion

23. The Taxpayer in her grounds of appeal takes the view that the Commissioner had erred in concluding that the purchase and sale of the 2/F Flat is a trading venture by putting reliance on the mere of a quick sale and short period of ownership. The Taxpayer contended that the quick sale was due to her underestimation of the seriousness of a water seepage problem and the cost of eradicating the problem.

24. The Taxpayer also asserted that the Commissioner erred in claiming that the Taxpayer had not taken any serious action to investigate the water seepage problem and restored the 2/F Flat into habitable condition for letting.

25. The Taxpayer also asserted that the Commissioner had not given sufficient weight and consideration to the fact that the 2/F Flat was purchased at the same time and as one transaction with the 1/F Flat and that the 1/F Flat is still owned by the Taxpayer in determining and ascertaining her intention towards the purchase of the 2/F Flat.

26. We accept Ms Ng's submissions that in order for this appeal to succeed, the Taxpayer must prove to our satisfaction by way of credible and acceptable evidence that the 2/F Flat was a capital asset.

27. However, since Mr Wong took the position that he was not calling evidence, he also accepted that the only evidence he put before the Board were the Affirmations.

28. Having considered matters very carefully, we are of the view that we should attach no weight to the Affirmations. In our view, the Affirmations were uncorroborated. It is also clear that Ms Ng did not have the benefit of cross-examining either the Taxpayer or her brother. The evidence was not tested by cross-examination.

29. As such, we conclude that the Affirmations are nothing but their assertions and as such, we also conclude that we cannot attach any weight to them.

30. Hence, that being the case, it is very clear in our view that the Taxpayer has not been able to put forward any credible or acceptable evidence to show to us that the 2/F Flat was a capital asset.

31. In short, no evidence was adduced before us to enable us to consider whether or not the Determination was excessive.

32. The Taxpayer had failed to discharge the burden of proof in her case.

33. Mr Wong put forward to us a property tax return in respect of the 1/F Flat. However, this was not in the relevant year of assessment hence we could not attach any weight to this.

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34. Since no evidence was put before us, it is quite clear that the Taxpayer could not show that the assessment was wrong, excessive or that it was her intention to ensure that the 2/F Flat was a long term investment. Indeed, from the agreed facts and from all other matters that have been put before us, it is obvious that the Taxpayer had embarked upon an adventure in the nature of trade in buying and selling the 2/F Flat and as such, the gain on disposal should be subject to profits tax in accordance with section 14 of the IRO.

35. Mr Wong emphasized to us that we should give regard to the fact that the 1/F Flat has not yet been disposed of and the Taxpayer has remained in possession. However, little regard can be put to such a submission.

36. We therefore dismiss the appeal.