

**Case No. D2/10**

**Profits tax** – trading – whether a property was bought and sold as a capital asset or a trading stock – intention of the taxpayer – sections 2(1), 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Richard Leung Wai Keung and Edward Shen.

Date of hearing: 4 March 2010.

Date of decision: 19 April 2010.

In August 2004, the Taxpayer rented a property for 2 years with a break clause allowing him to early termination after 12 months. He claimed that his mother and grandmother would periodically visit Hong Kong and stay with him. He further claimed that he would like to buy a property for living with his mother and grandmother when they visited Hong Kong. In July 2005, he agreed to purchase a property ('the Property') with completion in August 2005 at \$2,250,000. He then rented out the Property in October 2005. In January 2006, he agreed to buy another property ('Property J') with completion in March 2006 at \$4,310,000. In February 2006, he agreed to sell the Property for \$3,700,000 with completion in April 2006.

The Assessor considered that the purchase and sale of the Property amounted to trading and raised on the Taxpayer profits tax on the profit he earned. The Taxpayer objected to the assessment claiming that it was not his intention to trade the Property for profit, but it was bought for the sole purpose of living with his mother and grandmother. He claimed that after purchasing the Property, his mother and grandmother found the location not convenient. Thus he bought Property J, and sold off the Property. He has been living in Property J since completion.

The Acting Deputy Commissioner confirmed the assessment. The Taxpayer appealed against that Determination.

**Held:**

1. In order to determine whether the Property was a trading stock or a capital asset, the intention of the Taxpayer towards the Property needs to be considered at the time of the acquisition (Lionel Simmons Properties Ltd v CIR (1980) 53 TC 461 applied). The whole of the surrounding circumstances, including things said and done had to be considered to see whether the intention was genuinely held, realistic and realisable. The mere

declaration of intention was of limited value (All Best Wishes Ltd v CIR 3 HKTC 750 applied).

2. The Taxpayer's explanation that the Property was purchased with the intention of living with his mother and grandmother was only an excuse attempting to justify the quick sale of the Property. The evidence showed that the Taxpayer must have been aware that the Property was not convenient for his mother and grandmother when he acquired it. Further, he could but he did not terminate his tenancy to move into the Property. The objective evidence did not support the Taxpayer's assertion about his intention. Given the short period of ownership, the Taxpayer failed to put forward a compelling reason to show the Property was not acquired for trading purpose.

**Appeal dismissed.**

Cases referred to:

Lionel Simmons Properties Ltd v CIR (1980) 53 TC 461  
All Best Wishes Ltd v CIR 3 HKTC 750

Taxpayer in person.

Leung To Shan and Fung Chi Keung for the Commissioner of Inland Revenue.

**Decision:**

**Introduction**

1. This is an appeal by Mr A ('the Taxpayer') in respect of a Determination dated 22 September 2009 ('the Determination') by the Acting Deputy Commissioner of Inland Revenue whereby a profits tax assessment for the year of assessment 2006/07 was confirmed.

**The issue**

2. The Board needs to decide whether the profit obtained by the Taxpayer from the buying and selling of a flat and a carport at Address B, Hong Kong ('the Subject Property') should be assessable to profits tax.

**Agreed facts**

3. The parties helpfully agreed the facts upon which the Determination was arrived at. We find these facts as agreed facts and now set them out as follows:

(2010-11) VOLUME 25 INLAND REVENUE BOARD OF REVIEW DECISIONS

- '(1) [Mr A] (“the Taxpayer”) has objected to the Profits Tax assessment for the year of assessment 2006/07 raised on him. The Taxpayer claims that the profit derived from the disposal of a property should not be chargeable to Profits Tax.
- (2) [Madam C] (“the Mother”) and [Madam D] (“the Grandmother”) were the Taxpayer’s mother and grandmother respectively. At all relevant times, the Mother and the Grandmother lived in Canada.
- (3) By a provisional tenancy agreement dated 3 August 2004, the Taxpayer rented the property at [Road E, District L, Hong Kong] (“the Rented Property”) for a term of two years from 20 August 2004 to 19 August 2006 at a monthly rent of \$6,500. This agreement provided, among other things, that the tenant, having resided at the property for 12 months, could terminate the tenancy by giving one month’s advance notice to the landlord.
- (4) By a provisional agreement for sale and purchase dated 9 July 2005, the Taxpayer purchased the property at [Address B, Hong Kong] (“the Flat” and “the Carport” individually and “the Subject Property” collectively) at a price of \$2,250,000. The purchase was completed on 31 August 2005 when the Subject Property was assigned to the Taxpayer.
- (5) To finance the purchase of the Subject Property, the Taxpayer obtained a loan of \$1,575,000 from [Company F]. The loan was to be repaid by 240 instalments of \$9,795 per month.
- (6) By a provisional tenancy agreement dated 19 October 2005, the Taxpayer let the Flat to a tenant for a term of two years from 5 November 2005 to 4 November 2007 at a monthly rent of \$9,500. The Flat was to be delivered to the tenant on 23 October 2005 when the formal tenancy agreement was signed.
- (7) By a provisional agreement for sale and purchase dated 16 January 2006, the Taxpayer and [Miss G] purchased the property at [Address H] (“Property J”) at a price of \$4,310,000. The purchase was completed on 15 March 2006 when Property J was assigned to the Taxpayer and [Miss G].
- (8) To finance the purchase of Property J, the Taxpayer and [Miss G] obtained a loan of \$2,500,000 from [Bank K]. The loan was to be repaid by 240 instalments of \$16,856 per month.
- (9) By a provisional agreement for sale and purchase dated 15 February 2006, the Taxpayer sold the Subject Property for \$3,700,000, together

(2010-11) VOLUME 25 INLAND REVENUE BOARD OF REVIEW DECISIONS

with the existing tenancy. The sale was completed on 27 April 2006 when the Taxpayer assigned the property to the purchaser.

- (10) The Assessor issued a questionnaire to the Taxpayer in respect of his purchase and sale of the Subject Property. The Taxpayer replied in the following terms:
- (a) Occupation as self residence: “No”.
  - (b) For letting: “No”.
  - (c) If the answers to (a) & (b) are “No”, state the intended/actual usage: “*Intended to move in w/parents but did not do so*”.
  - (d) Change of residence: “Yes”.
  - (e) Reason for changing to new residence: “*Did not like location, decided to move to [Address H]*”.
- (11) By a letter dated 27 June 2008, the Assessor requested the Taxpayer to supply further information in relation to the purchase and sale of the Subject Property. The Taxpayer did not respond to the Assessor’s request.
- (12) The Assessor considered that the purchase and sale of the Subject Property by the Taxpayer amounted to an adventure in the nature of trade and thus raised on him the following Profits Tax assessment for the year of assessment 2006/07:

Estimated Assessable Profits	<u>\$1,288,000</u>
Tax Payable thereon	<u>\$206,080</u>

- (13) The Taxpayer objected against the above Profits Tax assessment in the following terms:
- (a) “I am not a trader and am not in the profession of buying and selling properties actively in order to make a profit.”
  - (b) “The intention for the buying and subsequent selling of the [Subject Property] was in preparation for the sole purpose of using it as primary residence, residing with my parents and grandmother. The property was bought during a time when I was still renting another location in [District L]. The property was later sold due to the fact that my parents and grandmother found the location to be less than ideal and preferred to live in another part of Hong Kong. I have since moved into my current residential address for almost 3 years and have not made any ‘trading’ activities with regards to real estate properties”.

- (c) "... I have not had the intention and was not in the business of conducting a trade on the [Subject Property]."
- (14) The Taxpayer further asserted the following:
  - (a) "... I would like to reiterate the [Subject Property] was bought for the intention of living with my parents & grandmother. This property was later sold because it was not convenient for my 80+ years old grandmother to walk up & down a very steep cliff everyday."
  - (b) "... The rental income received [from the Subject Property] has not been reported. The reason for not reporting to the IRD HK was because i) I was not familiar with the taxation laws of Hong Kong as I have resided outside of Hong Kong for over 20 years ii) I was informed that income related to dividends, interest payment and rental income are not taxable."
  - (c) "I resolved to sell the subject property shortly after Chinese New Year in 2006 (This would be late January/early February 2006). The decision for such was this is the time I found out the property location is not suitable for my mother & my 80+ yrs old grandmother as it has a very steep hill ..."
  - (d) "All along, the subject property was purchased with the intention of residing with my mother and my grandmother. However, please note that the property was purchased in July 2005, delivered on August 22, 2005 but was not rented out until October 23<sup>rd</sup>, 2005 (was not immediately rented out). The reason is that after the purchase of the property, I was still residing at [the Rented Property] with still bounded by a rental agreement. In addition, my mother & grandmother was not residing in Hong Kong at that same time period. Therefore, I decided to rent out the subject property until the right time to move in."

### **Evidence**

4. The Taxpayer gave evidence before us. At a young age, he and his family left Hong Kong and went to live in Canada. He resided there for some 22 years where he obtained an MBA from University M. He returned to Hong Kong on 11 June 2004 with the intention to look for employment. One of his reasons for returning to Hong Kong was that his girlfriend who was to become his fiancée, Miss G, decided also to return to Hong Kong.

5. He entered into a tenancy agreement to rent a property at Road E, District L, Hong Kong ('the Rented Property'). This was a tenancy agreement for a 2-year term

(2010-11) VOLUME 25 INLAND REVENUE BOARD OF REVIEW DECISIONS

commencing on 20 August 2004 to 19 August 2006. After 12 months, there was a break clause that enabled him to determine the tenancy agreement, should he wish to do so.

6. The Rented Property consisted of a two-bedroom flat of approximately 500 odd square feet. Although his mother and grandmother remained resident in Canada, it was their practice to visit Hong Kong on various occasions. The purpose of renting a two-bedroom flat was to ensure that when his mother and grandmother visited Hong Kong, they had somewhere to stay.

7. He enjoyed living in District L. He obtained employment and became familiar with the local area and its amenities, etc. Since he enjoyed living in District L and was familiar with the area, he felt that he should consider purchasing a property. He spent time looking at various properties within the vicinity of the Rented Property. He was intending to get married and therefore, with his fiancée, they looked at various properties and in turn decided on purchasing the Subject Property. On 9 July 2005, he signed a provisional sale and purchase agreement to purchase the Subject Property for \$2,250,000. Completion took place on 31 August 2005. The Subject Property was located close by to the Rented Property. It was approximately 800 square feet and had 3 bedrooms.

8. His mother and his grandmother had spent time in Hong Kong at the Rented Property and were familiar with the area as well. It was their practice to come and visit Hong Kong during the cooler months of the year. The Taxpayer was very close to his mother and to his grandmother. He did not advise his mother of his intended purchase since he wanted to surprise her. He was keen to show that with his own resources, he had the ability to purchase a property. He was able to put down a deposit and arrange for the necessary financing. He was aware that the Subject Property was located above his Rented Property and it required a climb up a steep hill to enable access by foot. However, taxis were able to obtain access. He had observed elderly people walking up to Subject Property at Road E on numerous occasions.

9. Around mid-September 2005, he phoned his mother. He told his mother that he had purchased the Subject Property. During that telephone conversation, he described the location of the Subject Property to his mother. His mother indicated to him that there might be some difficulties with regard to the steep hill that needed to be climbed to obtain access by foot. During the course of that conversation, he felt that he might have made a mistake since he sensed that his mother and grandmother might have felt that access to the premises could be somewhat difficult.

10. In light of his conversation with his mother, he discussed matters with his fiancée and in turn, decided to let out the Subject Property for a 2-year term commencing on 5 November 2005 until 4 November 2007. There was a break clause after 12 months that allowed either party to determine the lease. He obtained the rent of \$9,500 per month in respect of letting the Subject Property. He was of the view that the current rent for his current premises at \$6,500 was modest rental payment. He felt the best way forward would be for him to stay where he was, to rent out the Subject Property and in turn, when his mother and grandmother visited Hong Kong, they might re-consider matters.

(2010-11) VOLUME 25 INLAND REVENUE BOARD OF REVIEW DECISIONS

11. His mother came back in November 2005 and stayed with him. However, it was clear from her reaction to the location of the Subject Property. She was not happy nor content to stay with him at the Subject Property. His mother also indicated to him that she did not really want to waste money on taxis and felt that they should look for premises which were close by to an MTR station either in Hong Kong or Kowloon.

12. He then decided with his fiancée to look for alternative premises. Shortly thereafter on 16 January 2006, the Taxpayer and his fiancée signed a provisional sale and purchase agreement to jointly purchase a property at Address H ('Property J') for \$4,310,000. Completion took place on 15 March 2006. He drew to our attention the fact that Property J comprised of 3 rooms and was approximately 800 square feet.

13. It was their intention that he and his fiancée would live together and in turn, they had plenty of space for his mother and grandmother to live with them when they visited Hong Kong. However, matters did not work out with his fiancée and in turn, they split up. He also drew to our attention the fact that his fiancée's share in Property J was subsequently transferred to himself after each of them decided to go their own way.

14. Since he had purchased Property J, he needed to take steps to dispose of the Subject Property. He was fortunate and was able to do so quickly and on 15 February 2006, he entered into a provisional sale and purchase agreement to sell the Subject Property for \$3,700,000. This sale was completed on 27 April 2006.

15. As can be seen, with the rise in the property market, he made a profit of \$1,288,000. In respect of Property J, he was able to obtain a bridging finance through the assistance from his father-in-law.

16. He told us that he was of the view that he was fortunate and lucky that the timing was on his side with regard to the profit he obtained.

17. He emphasized to us that his intention all along was to purchase the Subject Property as a long term investment. He still resides at Property J. He emphasized to us that he was not a speculator and that the profit he obtained on the Subject Property was fortunate having regard to the timing and the relevant events that had arisen. On cross-examination, he accepted that his mother and grandmother had spent time with him at the Rented Property and both he and his mother and grandmother were fully aware as to the surrounding area and in particular, Road E. He accepted that he had never lived in the Subject Property.

18. On 6 May 2009, the IRD wrote to the Taxpayer. His attention was also drawn to his response dated 5 June 2009. He stated as follows:

'(b) I resolved to sell the subject property shortly after Chinese New Year in 2006 (This would be late January/early February 2006). The decision for such was this is the time I found out the property location is not

suitable for my mother & my 80+ yrs old grandmother as it has a very steep hill.

I have appointed [Agency N] as agent to sell the subject property.

.....

- (d) All along, the subject property was purchased with the intention of residing with my mother and my grandmother. However, please note that the property was purchased in July 2005, delivered on August 22, 2005 but was not rented out until October 23<sup>rd</sup>, 2005 (was not immediately rented out). The reason is that after the purchase of the property, I was still residing at the [Rented Property] with still bounded by a rental agreement. In addition, my mother & grandmother was not residing in Hong Kong at that same time period. Therefore, I decided to rent out the subject property until the right time to move in.'

19. However, it can be seen that his explanation to the IRD is different from the evidence which he gave to the Board. During the course of evidence, he also drew to our attention the fact that his mother had difficulties in walking due to an injury which she had previously suffered. However, the only evidence we have is a copy of a doctor's report dated 23 May 2008 which showed that she had a left knee injury (a cruciate ligament tear). However, it can be seen that this report was dated 2008 and there was no evidence put to us in respect of the state of her knee in 2004 and 2005. The Taxpayer accepted that this indeed was the case.

### **The law**

20. Section 14(1) of the Inland Revenue Ordinance ('IRO') is the relevant charging provisions for profits tax. The Section states 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.'*

21. Section 2(1) of the IRO defines 'trade' to include every trade and manufacture, and every adventure and concern in the nature of trade.

22. Section 68(4) of the IRO clearly provides that the burden of proof on showing that the assessment is excessive or incorrect is on the Taxpayer.

23. The authorities are clear and illustrate that in determining whether a property is a trading stock or a capital asset, the intention of the purchaser towards the property needs to



be considered at the time of the acquisition. The leading authority is Lionel Simmons Properties Ltd v CIR (1980) 53 TC 461, Lord Wilberforce stated at page 491 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?’*

24. However, it is also clear from the authorities that a mere declaration of one’s intention is of limited value. It is accepted that the subjective intention has to be tested against the objective facts and circumstances. That intention must obviously be genuinely held, realistic and realizable. In All Best Wishes Ltd v CIR, 3 HKTC 750, Mortimer J said at page 771 as follows:

*‘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.’*

## **Discussion**

25. The Taxpayer in his evidence and in his submissions to us has contended that it was his intention from the very beginning to use the Subject Property as his residence. He contends that he purchased a property as a long term investment. Once the Subject Property had been purchased, the Taxpayer did not move in, he signed a tenancy agreement to let the Subject Property in October 2005.

26. We do have regard to his response dated 5 June 2009 to the Inland Revenue Department (‘IRD’) which we have previously referred to (paragraph 18 above). It is clear that the reason in his letter that he did not move in was because he was bound by a tenancy agreement. However, he had the opportunity to give notice to determine that tenancy agreement. It is clear that the Taxpayer decided to rent out the Subject Property. We accept the submissions of Ms Leung on behalf of the IRD that this illustrates that he clearly did not have an intention to use the Subject Property as his residence.

27. The Taxpayer also explained to us that one of the reasons why he decided to

rent out the Subject Property was due to the fact that his mother and grandmother were not residing in Hong Kong at that time. However, the Taxpayer's mother and grandmother had all along been living in Canada. In his notice of appeal, the Taxpayer asserts that the grandmother came back 3 months out of the 18 months whilst his mother spent 6 months out of every year between Canada and Hong Kong. He asserted to us that he wanted to have a place for his mother and grandmother to stay when they came to Hong Kong. However, it is clear that by leasing out the Subject Property, it could not have been used for that purpose. We also have regard to the fact that the Subject Property was sold within less than 7 months from the date of its purchase.

28. In our view, there must be a compelling reason for selling the Subject Property after such a short period of ownership. Failure to give such a compelling reason would be a strong indication of trading. The Taxpayer's explanation is straightforward. He takes the view that after his mother and grandmother had come back to Hong Kong, they found that the Subject Property was located up a steep hill and as such, it would cause them difficulties in obtaining access. However, looking at all the circumstances, we have to say that this is not a compelling reason. It is quite clear that both his mother and grandmother had already lived in the area at the Rented Property. The Taxpayer himself was fully aware as to the fact that he was intending to purchase a property that would be suitable both for his fiancée and his mother and grandmother. Clearly he would have had this in mind when he was purchasing the Subject Property.

29. In his evidence, the Taxpayer indicated to us that he was fully aware as to the surrounding environment as well as the hill. He felt that the hill was not a problem because his mother and grandmother could take taxis to obtain access.

30. In our view, when he came to purchase the Subject Property, he must obviously have taken into account whether or not that property was suitable for his mother and grandmother. If he was aware as to his mother's knee problems and having regard to his grandmother's age, this was surely a fact that he would have taken into account at the time when he entered into the purchase of the Subject Property. This would not have escaped his attention.

31. Having considered the Taxpayer's evidence and having regard to the various documents and representations he made previously to the IRD, we have come to the conclusion that the location as to the Subject Property was an excuse to explain away the quick sale of the Subject Property.

32. We have come to the conclusion that at the relevant time, the Taxpayer did not have the genuine intention to hold the Subject Property as his residence.

33. The Taxpayer also drew to our attention the fact that he resided at Property J since April 2006 up to the present time. That may very well be the case but whether or not Property J itself is a capital asset is not the subject matter of this appeal and as such, this is a matter which does not assist the Taxpayer.

(2010-11) VOLUME 25 INLAND REVENUE BOARD OF REVIEW DECISIONS

34. We are of the view that if the Taxpayer was genuine in his intention to purchase the property for his residence as well as for the residence of his mother and grandmother whenever they came to Hong Kong, then he would have taken into account the location of the Subject Property.

**Conclusions**

35. Therefore, having considered carefully the evidence of the Taxpayer and having regard to his submissions and the materials before us, we have no hesitation in coming to the conclusion that this appeal must be dismissed.