

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D102/97

Profits tax – whether profits realized from sale of property assessable to profit tax – whether the purchase and sale of the property amounted to an adventure in the nature of trade or for purposes of self-residence and preservation of the value of the money – appeal frivolous and vexatious and an abuse of the process – section 68(9) of the Inland Revenue Ordinance, Chapter 112.

Panel: Kenneth Kwok Hing Wai SC (chairman), Paul Ng Kam Yuen and David Wu Chung Shing.

Date of hearing: 30 December 1997.

Date of decision: 26 January 1998.

On 16 November 1990, two taxpayers (A1 and A2) entered into an agreement to purchase, as tenants in common, a property which was still under construction and with the estimated time of completion of construction being the end of 1991 in stages for a consideration of \$1,125,200. On 25 July 1991, they sold the property as confirmors for \$1,700,000 when the occupation permit for the property had not yet been issued.

The assessor was of the view that the purchase and sale of the property amounted to an adventure in the nature of trade. Accordingly, the assessor determined the estimated profit tax payable to be \$75,000 which was later revised to be \$60,071.

The taxpayers appealed against the determination on the ground that the purchase of the property was for self-residence and preservation of the value of money. A2 did not attend the hearing of the appeal.

Held:

- (1) Since the taxpayers each gave different reasons for the purchase and for the sale of the property, the Board has no hesitation in rejecting the taxpayer's claim that the intention at the time of the acquisition was to acquire the property for self-residence or preservation of the value of the money or as a long term investment.
- (2) In particular, the Board found A1 as an unreliable and evasive witness who had scant respect for the truth as he has given different versions of the reasons for his purchase and for his sale of the property to the Board.

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- (3) The taxpayers have also failed to prove on a balance of probabilities that they, whether jointly or severally, had the financial ability to acquire and hold the property as a capital asset.
- (4) The Board was of the view that the appeal was frivolous and vexatious and an abuse of the process. Pursuant to section 68(9) of the Inland Revenue Ordinance, Chapter 112, the Board ordered the taxpayers to pay the sum of \$1,000 as costs of the Board, which \$1,000 shall be added to the tax charged and recovered therewith.

Appeal dismissed and a cost of \$1,000 charged.

Tse Yuk Yip for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

1. This is an appeal against the determination dated 18 July 1997 by Commissioner of Inland Revenue, rejecting the Taxpayers' objection against the profits tax assessment for the year of assessment 1991/92 dated 29 August 1995 showing assessable profits of \$500,000 with tax payable thereon of \$75,000, but reducing the assessable profits to \$400,479, with tax payable thereon of \$60,071. The profits arose from the sale of a residential flat in District X ('the Subject Property').

The facts

2. On 16 November 1990, the two Taxpayers entered into an agreement to purchase, as tenants in common, from the developer the Subject Property at a consideration of \$1,125,200. At that time, the Subject Property was still under construction and the developer stated in its pamphlet that the estimated time of completion of construction was approximately end of 1991 in stages.

3. On 25 July 1991, the Taxpayers entered into an agreement to sell the Subject Property for \$1,700,000. By that time, the occupation permit for the Subject Property had not yet been issued. The Taxpayers sold the Subject Property as confirmors.

4. In a letter dated 12 March 1994 to the assessor, the second Taxpayer ('A2') stated that he forgot the date of purchase of the Subject Property; that the purchase price was approximately \$1,200,000; that the user was for self-residence and preservation of the value of money; that he forgot the date of sale; that the sale price was approximately \$1,600,000; that the reason for sale was that he was forced to sell because he owed debts; that he was a casual decoration worker; and that there was no employer's or salaries tax file reference as he often had insufficient or no work.

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5. In a letter dated 15 June 1995 to the assessor, the first Taxpayer ('A1') stated that the Subject Property was purchased purely for self-residence; that unexpectedly income dropped at a later stage because of economic recession and could not afford the mortgage payments and was forced to sell; that the purchase price was one million and ten plus thousand dollars; and that he could no longer remember the sale price.

6. The assessor was of the view that the purchase and sale of the Subject Property amounted to an adventure in the nature of trade and requested the Taxpayers to furnish a profits tax return for the year of assessment 1991/92.

7. Upon the Taxpayers' failure to furnish the return, the assessor raised on them estimated profits of \$500,000, with tax payable thereon of \$75,000.

8. By a letter dated 27 September 1995 signed by A1, the Taxpayers objected to the assessment on the ground that the profits from the sale of the Subject Property should not be assessable to profits tax.

9. On 28 November 1995, the Taxpayers submitted a profits tax return for the year of assessment 1991/92. In a letter attached to the return, the Taxpayers stated that the profit from the sale of the Property should be computed as follows:

Selling price		\$1,450,000
<u>Less:</u>	Purchase price	\$1,200,000
	Mortgage loan repayment	140,000
	Legal fees and stamp duty upon taking possession of the Subject Property	50,000
	Decoration	45,000

		<u>1,435,000</u>
Net profit		\$15,000 =====

10. On 13 September 1996, the Taxpayers submitted a letter from the mortgagee bank confirming that the total amount of mortgage loan interest paid by them for the Subject Property was \$155,921.

11. By a letter dated 17 September 1996, the assessor proposed to the Taxpayers to revise the profits tax assessment for the year of assessment 1991/92 as follows:

Selling price		\$1,700,000
<u>Less:</u>	Purchase price	\$1,125,200

Estimated amount of legal

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	18,400	
fees on scale charge		
Mortgage loan interest	155,921	
	-----	<u>1,299,521</u>
Revised assessable profits		\$400,479
		=====
Tax payable thereon		\$60,071
		=====

12. The Taxpayers did not accept the assessor's proposal.

13. In a letter dated 1 October 1996 to the assessor, A1 stated that he was a good friend and co-worker of A2; that during 1990, they discussed the possibility of purchasing a property which could be used as self-residence or as long term investment; that at that time A1 resided in an outlying island; that the transport to and from that outlying island was very inconvenient; that at times when he worked late or when typhoon signal was hoisted and if he could not catch a ferry, he would have to wait for the next one or to spend the night at a friend's home and that he felt very disturbing; that at that time only 10% deposit was required and based on a purchase price of about one million and ten plus thousand dollars for the Subject Property, for a mortgage loan of about \$1,000,000, the estimated amount of monthly mortgage payments would be about \$10,000 and each would share about \$5,000; that with a daily wage of \$350 and 26 working days per month, the monthly income would be \$8,100 (sic, $\$350 \times 26 = \$9,100$); that 3 or 4 months after the purchase of the Subject Property, the wife of A2 knew about the purchase and she was very angry because A2 had not discussed the purchase with her before hand; that A2 had funds of about \$400,000 and \$500,000 and could have purchased the Subject Property himself; and that she threatened to divorce A2; and that the Subject Property was subsequently sold.

14. A2 was married on 1 December 1988 and had a son born on 9 July 1989. A2 and his wife are the owners of a residential flat in District Y, acquired by them on 15 March 1990 at a price of \$285,400.

15. In 1987 and 1988 A2 had purchased and sold as confirmor a residential flat in District Z and a residential flat in District B. In A2's profits tax return for the above transactions, A2 offered the profit from the sale of the first property for assessment to profits tax and claimed that the loss from the sale of the second property should be deducted against the profit.

16. Neither Taxpayer had reported to the Inland Revenue Department any salaries income during the years of assessment 1990/91 or 1991/92.

17. The Commissioner rejected the Taxpayers' objection but reduced the assessment to assessable profits of \$400,479, with tax payable thereon of \$60,071.

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18. By a letter dated 28 July 1997 signed by A1, the Taxpayers appealed against the determination on the ground that the purchase of the Subject Property was for self-residence and preservation of the value of money. There is no appeal against the correctness of the figures of assessable profits of \$400,479 with tax payable thereon of \$60,071.

The appeal

19. At the hearing of the appeal, A1 appeared before us in person representing himself and A2 who did not attend the hearing of the appeal.

20. A1 gave evidence before us on oath, and he told us that by November 1990, he had resided at the outlying island for some 20 years; that at the time of purchase, he intended to reside there with those in the same outlying island who could not go back to the outlying island when typhoon signal No 8 was hoisted; that in November 1990, he worked 28 days per month; that for the year ended 31 March 1991, he earned about \$100,000; and that although he admitted that the letter dated 15 June 1995 was written by him, the first paragraph thereof (summarised in paragraph 5 above) had nothing to do with this appeal.

Our Decision

21. Having carefully considered all the materials before us, we have no hesitation in rejecting the Taxpayers' claim that the intention at the time of acquisition was to acquire the Subject Property for self-residence or preservation of the value of money or as a long term investment.

22. A1 impressed us as an unreliable and evasive witness who had scant respect for the truth.

23. Neither Taxpayer was able to state or recall, accurately or at all, the date when or the price at which the Subject Property was purchased or sold. This is odd if the Taxpayers, said to be earning \$350 a day, were acquiring a capital asset at \$1,125,200.

24. The Taxpayers submitted a profits tax return claiming deduction of \$45,000 as decoration expenses when they in fact had sold the Subject Property as confirmors before the issue of the occupation permit and could not have incurred any decoration expenses.

25. The Taxpayers each gave different reasons for the purchase and for the sale of the Subject Property. In the letter of 12 March 1994, A2 stated that the purchase was for self-residence and preservation of the value of money and that the sale was forced because he owed debts. In the letter of 15 June 1995, A1 stated that the purchase was purely for self-residence and that the sale was forced because of an unexpected drop in income due to economic recession. In the letter of 1 October 1996, A1 stated that the purchase was for self-residence or as long term residence and that the Subject Property was sold because of the objection by the wife of A2. In his evidence before us, A1 stated that the intention was for residence of not only himself, but also persons in the same outlying island who could not

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go back there when typhoon signal No 8 had been hoisted. A1 was evasive about who those persons allegedly were and about the alleged arrangements, if any, for payment of rent to A2 for the occupation of the Subject Property.

26. It has never been alleged that the Subject Property was purchased for the residence of A2.

27. We reject the assertion that the intention at the time of purchase was for the residence of A1. A1 had made no attempt to answer the question why he agreed to purchase the Subject Property which was still under construction and would not be available for occupation for about 1 year instead of a property which was available for immediate occupation in November 1990. November is outside the typhoon season.

28. Moreover, the Taxpayers have also failed to prove on a balance of probabilities that they, whether jointly or severally, had the financial ability to acquire and hold the Subject Property as a capital asset.

29. For the reasons given above, we dismiss the appeal and confirm the assessment appealed against.

Order under section 68(9)

30. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process. Pursuant to section 68(9) of the Inland Revenue Ordinance, Chapter 112, we order the Taxpayers to pay the sum of \$1,000 as costs of the Board, which \$1,000 shall be added to the tax charged and recovered therewith.