

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D105/97

Profits tax – profits arising from sale of property – investment or trade – Inland Revenue Ordinance section 68(4).

Panel: Kenneth Kwok Hing Wai SC (chairman), John Mark Eddleston Leese and Paul Tong Hon To.

Dates of hearing: 1 and 2 October 1996.

Date of decision: 9 February 1998.

By a provisional agreement dated 15 November 1990, the taxpayer purchased the Subject Property, which was still under construction, at a consideration of \$1,171,300.

The Subject Property was assigned to the taxpayer on 23 June 1992. The acquisition was financed by a bank mortgage loan of \$850,000 and a loan of at least \$250,000 from the parents of the taxpayer.

By a provisional agreement dated 17 March 1993, the taxpayer sold the Subject Property for \$2,450,000 and it was completed on 10 May 1993. On deducting the necessary expenses, the net profit is \$964,871.

The taxpayer stated that the Subject Property was purchased for self residence purpose which was not accepted by the assessor. The taxpayer gave evidence before the Board that she purchased the Subject Property for self residence and she resided at the property for a period.

Held:

Whether it is a trade or an investment is a question of fact. (Simmons v CIR [1980] 1 WLR 1196, [1980] 53 TC 461, All Best Wishes Limited v CIR [1992] 3 HKTC 750 applied) The majority of the Board (Paul Tong Hon To dissenting) rejected the taxpayer's evidence after considering, inter alia, the electricity bills and the water bills during the period the taxpayer claimed to have resided at the Subject Property. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is incorrect is on the taxpayer. The taxpayer has not discharged its onus.

(Paul Tong Hon To dissenting) Trading requires an intention to trade and normally at the time of the acquisition of the asset. (All Best Wishes Limited v CIR [1992] 3 HKTC 750 applied) The taxpayer had intended to purchase

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the Subject Property for her residence but changed her mind for various reasons as given in evidence. Thus the taxpayer acquired the Subject Property as an investment.

Appeal dismissed.

Cases referred to:

Simmons v CIR [1980] 1 WLR 1196
Simmons v CIR [1980] 53 TC 461
All Best Wishes Limited v CIR [1992] 3 HKTC 750

Yim Kwok Cheong for the Commissioner of Inland Revenue.
C C Ho of Messrs C C Ho & Co for the taxpayer.

Decision:

1. This is an appeal against the determination dated 2 February 1996 by Commissioner of Inland Revenue, rejecting the Taxpayer's objection to the profits tax assessment for the year of assessment 1993/94 dated 4 August 1995 showing assessable profits of \$964,871 with tax payable thereon of \$144,730. The profits arose from the sale of a residential flat in District A ('the Subject Property').
2. The Taxpayer appealed on the ground that she acquired the Subject Property 'with a view of keeping as a private residence for herself and her parents, and had no intention of resale'.

Decision under section 65(4)

3. For reasons stated in 'Reasons for Dissent' attached hereto, Mr Paul Hon-To Tong disagreed and would have allowed the appeal had he not been in the minority. This is the decision of the majority and the decision of the Board under section 65(4) of the Inland Revenue Ordinance, Chapter 112 ('the IRO') which provides that all 'matters coming before the Board shall be decided by a majority of votes'.

The Primary Facts

4. On the statement of facts in the determination, the documents produced at the hearing of the appeal, and the oral evidence given by the Taxpayer, we make the following findings of primary facts.
 - 4.1 By a provisional agreement dated 15 November 1990, the Taxpayer agreed to purchase the Subject Property at a consideration of \$1,171,300. The Subject Property was still under construction at the time.

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4.2 The Subject Property was assigned to the Taxpayer on 23 June 1992. It had a floor area of 680 square feet.

4.3 The acquisition was financed by a bank mortgage loan of \$850,000, repayable by 180 monthly instalments of \$9,395.90 and a loan of at least \$250,000 from the parents of the Taxpayer.

4.4 By a provisional agreement dated 17 March 1993, the Taxpayer agreed to sell the Subject Property for \$2,450,000 and the sale transaction was completed on 10 May 1993.

4.5 In response to the assessor's enquiries in relation to the Subject Property, the Taxpayer stated that the Subject Property was purchased for self residence purpose and that the computation of the net profits was as follows:

	\$	\$
Sale price		2,450,000
<u>Less</u>	Purchase price	<u>1,171,300</u>
		1,278,700
<u>Less</u>	Legal fee – purchase	14,913
	Stamp duty	23,426
	Mortgage loan interest	181,240
	Decoration	70,000
	Legal fee- sale	12,000
	Sale Commission	12,250
Net profits		<u>313,829</u> <u>\$964,871</u>

4.6 The assessor did not accept the Taxpayer's claim that the Subject Property was acquired for self residence purpose and considered that the purchase and sale of the Subject Property by the Taxpayer amounted to an adventure in the nature of trade and raised on the Taxpayer profits tax assessment for the year of assessment 1993/94 with assessable profits of \$964,871 with tax payable thereon of \$144,730.

4.7 The Taxpayer's representative objected on behalf of the Taxpayer against the assessment on the ground that the profit on disposal of the Subject Property was capital in nature and should not be assessable to profits tax.

4.8 By his determination the Commissioner rejected the Taxpayer's objection and confirmed the profits tax assessment.

4.9 The Taxpayer appealed from the determination.

4.10 According to the 4 copy electricity bills in the name of the Taxpayer's father:

Reading		Units
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date	Metre reading		consumed
	Present	Previous	
14-4-1993	22792	22776	16
11-3-1993	22776	22774	2
11-2-1993	22774	22774	Nil
11-12-1992	22774	22773	1

4.11 According to the 4 copy water bills in the name of the Taxpayer's father:

Date of issue	Previous date/reading	Present date/reading	Consumption in cubic metres
24-6-1992	N/A	N/A	
24-8-1992	9-6-1992 15	23-7-1992 15	0
4-12-1992	23-7-1992 15	18-11-1992 15	0
29-3-1993	18-11-1992 15	13-3-1993 16	1

4.12 The developer equipped the Subject Property with window type air-conditioners for the bedrooms and living/dining room, an electric water heater in the kitchen and electric exhaust fans in the kitchen and the bathroom; one 'balanced flue' gas water heater; and telephone, and television/radio outlets.

Relevant provisions

5. Section 68(4) of the IRO, Chapter 112, provides that the onus of proving that the assessment appealed against is incorrect is on the Taxpayer. Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

The Issue

6. The issue is whether the Taxpayer has discharged her onus of proving that the assessment on the gain arising from the sale of the Subject Property is incorrect in that it is not assessable to profits tax in accordance with section 14(1) on the ground that the Subject Property was acquired as capital asset.

Authorities

7. We do not find it necessary to refer to the relevant authorities on whether there was an adventure in the nature of trade. Each case depends on its own facts. Simmons v CIR [1980] 1 WLR 1196 and [1980] 53 Tax Cases 461, and All Best Wishes Limited v CIR [1992] 3 HKTC 750 have been cited to us.

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Evidence

8. At the time of the appeal, the Taxpayer told us on oath that she had been working in a bank and that she bought the Subject Property because the public estate in Public Estate B that she was living in was too crowded for her and that she decided to buy a property which would have two rooms, one for her father and one for herself. She also said that she took possession of the Subject Property in June 1992, had some problems fixed and some decoration work done, and moved to the Subject Property around end of October 1992 and stayed there 'through the beginning of March ... October 1992 to March 1993'. She further said that her parents refused to move in to the Subject Property. She claimed that she had no washing machine or refrigerator at the Subject Property and that she had her clothes washed at the housing estate flat where she also took her baths. She told us that she had not installed any telephone at the Subject Property 'because there is no such need at the time' and that she had not completed the arrangements for connection to town gas, saying that 'I wash my face and hands in cold water'.

Our Decision

9. Having carefully considered all the materials before us, we categorically reject the Taxpayer's evidence that she purchased the Subject Property for the purpose of self residence and that she actually resided in the Subject Property.

10. If she had resided at the Subject Property from around end of October 1992 to the beginning of March 1993 as she claimed, then the electricity consumption for the period from 11 December 1992 to 11 February 1993 would not have been Nil and the water consumption in cubic metres for the period from 9 June 1992 to 18 November 1992 would not have been Zero. For a person who claimed to have spent \$70,000 on decorating her new residence, we find it incredible that she had not installed any telephone at her new residence; had not completed the connection of town gas; and had not fitted her new residence with any refrigerator or washing machine.

11. We disbelieve the Taxpayer's evidence that she actually resided in the Subject Property. The Taxpayer's representative has not advanced any reason why or how we can still allow the appeal in these circumstances. We have no doubt that the Taxpayer has not discharged the onus under section 68(4) of proving that the assessment appealed against is incorrect. We dismiss the appeal and confirm the assessment appealed against.

Reasons for Dissent (By Mr Paul Hon-To Tong)

1. The primary facts, relevant provisions, and the issue have been covered in the foregoing decision of the majority of the Board. I am not going to repeat those here.
2. The Taxpayer gave evidence before the Board. According to the Taxpayer:
 - (a) The reason for the purchase of the Subject Property was '... because the apartment I was living in the public estate is too crowded for me. So I

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decide to buy a property which has two rooms, one for my father and one for myself.’ Note at the time, the Taxpayer was being employed by Bank C and living with her parents at Public Estate B (Flat D).

- (b) To finance the purchase of the Subject Property for a total consideration of \$1,171,300, the Taxpayer obtained a mortgage loan from a bank in the amount of \$850,000 repayable over 15 years, when she could, if she chose to, borrow up to as much as 90 percent of the consideration for a maximum term of 20 years.
- (c) The Taxpayer had a loan of about \$250,000 from his father with no repayment terms. Her father also contributed \$5,000 per month towards the monthly instalment of \$9,395 in repayment of the said bank loan. Her monthly salary at the time was about \$10,000, but she expected to get pay rises in the future and a loan from her employer at certain preferential interest rate. She was not entitled to such loan from her employer until the assignment of the Subject Property, which would involve an additional cost of \$30,000 or \$40,000 for switching the loans. About the time she could do that, her job with the employer had become unstable because of staff changes occurring in her department, and she did not seek to request such benefit from the employer.
- (d) When the Subject Property was available for occupation, the Taxpayer and her father found the place very inconvenient. It was decided to sell the Subject Property.
- (e) The Taxpayer moved into the Subject Property in October 1992. She suffers from poliomyelitis and experienced difficulties, especially during rush hours, in commuting to work at District E by the MTR Line which required a long walk when changing trains at Station F. She said that at the time of purchase of the Subject Property, she had ‘no idea that changing trains at MTR stations can be such a troublesome affair’.
- (f) The said problem was not anticipated by the Taxpayer at the time, as it was not yet open to traffic.
- (g) The Taxpayer’s father also found it inconvenient commuting to his work at Company G in District H, and her parents never moved in.
- (h) Attempts were made by the Taxpayer to purchase another property as her residence upon disposal of the Subject Property. Following an unsuccessful attempt to purchase a property in District I, four applications were made consecutively to the Hong Kong Housing Authority, from about May or June 1993 till 1994, for the purchase of a flat under the Home Ownership Scheme. By an agreement made in December 1994 with the Hong Kong Housing Authority, the Taxpayer

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purchased Flat J in District K. The Taxpayer together with her parents took up residence at Flat J in late February 1996.

- (i) The purchase and sale of the Subject Property was a one-off transaction.

3. The Revenue contended the following:

- (a) The quick sale of the Subject Property suggests that the Taxpayer had no real need for a self-owned residence when it was acquired.
- (b) The Taxpayer could not rely on her father's financial assistance to hold the Subject Property on a long-term basis, as her father was at the retiring age of 63 when the Subject Property was purchased.
- (c) The Taxpayer did not stay in the Subject Property for any substantial period, and there is no evidence that the Taxpayer and her parents did take any active step in moving out of Flat D.
- (d) The reason for selling the Subject Property which was based on the alleged transportation problem should not be accepted. The Taxpayer should have seriously considered the transportation arrangement before committing to the purchase.
- (e) The Taxpayer only used a small portion of the sale proceeds of the Subject Property in acquiring Flat J, which was inconsistent with her claim that there was a replacement of investment.
- (f) The Taxpayer was eligible to apply for the purchase of a flat at below the market price under the Hong Kong Housing Authority Home Ownership Scheme, subject to the requirement to surrender Flat D upon acquisition of such flat. The Revenue expressed doubt as to her intention in acquiring the Subject Property as residence which would mean that the Taxpayer together with her parents would have to move out of Flat D and give up the said valuable right attached thereto. She continued to live at Flat D upon disposal of the Subject Property.
- (g) The Taxpayer should have obtained a mortgage loan from her employer at certain preferential interest rate to which she was entitled if she really intended to hold the Subject Property as her residence on a long-term basis.
- (h) During the relevant period, there was nearly no water and electricity consumption at the Subject Property, which does not lend support to the Taxpayer's claim that she had occupied it as her residence.

4. The following four factors weighed heavily in this decision:

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- (a) It sounded credible that the Taxpayer living in the understandably congested conditions at the public housing estate, made efforts to improve her living conditions by acquiring the Subject Property. This factor would have been given much less weight or no weight at all if the Taxpayer was already living in conditions equivalent or near to those of the Subject Property. Although the Revenue would argue here, as in its contention under (f) above, that the Taxpayer did not intend to purchase the Subject Property as her residence, at market price from a private developer when she was entitled to purchase a flat under the Home Ownership Scheme at below the market price. I find it difficult to adopt such a view, because that would have the implication of restricting the choice of the public housing occupants and imposing on them a more onerous burden of proof, in the sense that they should look primarily to the Home Ownership Scheme for improved housing and that any purchase of property from private developers for residence purpose could mean a harder task on their part to explain a subsequent sale as a capital transaction even if the original intention was genuinely held.
- (b) The Taxpayer did have walking problem and I saw the way she walked to the witness chair at the hearing. I agreed that she could be quite a way behind others and did experience difficulties when changing trains at the MTR station, which is supposed to be the most convenient way of commuting to District E for a normal person without walking problem. I am inclined to give the Taxpayer the benefit of doubt here, as there was no way for her to actually understand the extent of difficulty when that station was not yet open at the time.
- (c) The Taxpayer, with the financial assistance from her father, borrowed only about 70 percent of the cost of purchase of the Subject Property, although financing upto 90 percent was possible at the time. This was more consistent with the intention to hold it for the long term than that of a trader or speculator who, more often than not, would try and obtain as much leverage as possible in financing his or her purchase.
- (d) This is a one-off transaction, and other than this one, the Taxpayer never engaged in any dealing in real property.

5. I have also considered the well-known 'badges of trade'. The transaction was a one-off transaction. The length of ownership would appear to be against the Taxpayer, but the frequency factor and her walking problem which was special in this case, would be in her favour. There was no relationship between the transaction in question and any trade which the Taxpayer otherwise carried on. The subject matter of the realisation would appear to be neutral. There was no evidence of any effort of dealing or marketing a sale on the part of the Taxpayer. No facts were found to point to a clearly discernible profit-making motive at the time of purchase.

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6. The Revenue did raise the issue of the Taxpayer's financial capability to hold the Subject Property on a long-term basis, since she relied quite heavily on the support of her father who was then already aged 63. With the benefit of hindsight, however, the Taxpayer would appear to be proved to be right in so relying on her father because he has since continued working.

7. As to the alleged replacement of investment, this factor would either be neutral or work slightly in favour of the Taxpayer's case if it was relevant at all. She did subsequently purchase her own flat, Flat J, as residence for herself and her parents, albeit under the Home Ownership Scheme. The purchase price of the Subject Property was \$1,171,300, financed by a bank mortgage loan to the extent of \$850,000, whereas the purchase price of Flat J was \$1,291,400, financed by a mortgage loan of \$1,000,000. In both instances, the Taxpayer put up a sum of about \$300,000, which would appear to be quite consistent. I am not sure, as the Revenue argued, that in a subsequent acquisition, any holding back of the gain on a previous disposal would be incoherent with a claim of investment replacement.

8. Although the Taxpayer's father was not called as a witness, yet from the copy of his Hong Kong Identity Card as submitted, his age at the time when the Subject Property was available for occupation, was about 66. It is reasonably probable that he could find it very inconvenient to commute from the Subject Property to his place of work.

9. On balance of probabilities, I am unable to conclude that the Taxpayer set out to acquire the Subject Property for trading.

10. Substantial doubts, however, were raised on the Taxpayer's alleged residence at the Subject Property upon its being available for occupation. Evidence was given to show minimal consumption of electricity and water. But since she was a single lady with the walking problem and used to be living with her parents, it would appear to be understandable if she did not really stay there regularly for any meaningful period or failed to stick to her alleged original intention of using it as her residence, when her parents for whatever reasons, subsequently chose not to move in to the Subject Property.

11. In their submissions, both the representative for the Commissioner and the representative for the Taxpayer referred the Board to Lionel Simmons Properties Ltd v CIR 53 TC 461 at 491, Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750 (in page 770):

'Reliance is placed upon a passage of Lord Wilberforce in Lionel Simmons Properties Limited v The Commissioner of Inland Revenue 53 TC 461 at 491. It is well known, ... The nub of it reads:

'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.'

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... 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. ... 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...'

12. I agree that subsequent actual residence, if proven, would be one of those actions that speak louder than words. Nevertheless, on balance of probabilities, considering the whole of the surrounding circumstances, if I am unable to conclude that the Taxpayer, at the time of the acquisition of the Subject Property, set out to acquire it for trading, and if a more reasonable finding is that the Taxpayer intended to purchase the Subject Property as her residence but changed her mind for various reasons as given in the evidence, then I cannot see why the credibility in respect of her alleged subsequent residence at the Subject Property, should have the effect of converting what otherwise a 'capital' label into a 'trading' label.

13. It follows that this appeal should be allowed whilst I recognise the force of some of the points urged upon me by the Revenue.