

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D116/97

Profits tax – sale of property – whether profits derived from the sale of the property assessable of profit tax – whether loss can be set-off – intention at the time of purchase – inference from long list of property transactions – whether short period of ownership indicative of an intention to trade.

Panel: Christopher Chan Cheuk (chairman), Aarif Tyebjee Barma and Robin M Bridge.

Date of hearing: 9 January 1998.

Date of decision: 3 March 1998.

The taxpayers purchased Property A on 13 July 1988 for investment purpose and on 28 July 1988 the taxpayers purchased Property B as their own residence. As they did not want to live in Property B, they sold it on 3 January 1989 and purchased Property C on the next day as a replacement because Property C was more convenient. The taxpayers further argue that even if the gain from the sale of Property B was found to be trading profits, the taxpayers should have the right to set off the profits by the loss they suffered in the sale of Property A on July 1989.

Considering all evidence before the Board, the Board find that the taxpayers have failed to discharge the burden and the Board was not convinced by balance of probabilities that the Property B was acquired for the purpose of self-use.

Held:

- (1) According to section 19C of Inland Revenue Ordinance, the loss can only be carried forward and set off against the amount of assessable profits for subsequent years of assessment. It cannot be brought backward to set off the profits made in the previous year of assessment.
- (2) No inference can be drawn from the taxpayers' previous long list of property transactions that the particular property purchased by the taxpayers was for trading purpose. The length of time that the taxpayers held the property and whether they paid the stamp duty and executed the assignment do not indicated whether or not the taxpayers traded in the property. It is wrong to consider the different pieces of evidence in isolation (All Best Wishes Limited v CIR 3 HKTC 750 applied).

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Appeal dismissed.

Case referred to:

All Best Wishes Limited v CIR 3 HKTC 750

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

Decision:

1. This is an appeal by Mr X and Madam Y ('the Taxpayers') against the determination dated 27 June 1997 by Commissioner on the profits tax assessment for the year of assessment 1988/89 relating to profits arising from sale of the property known as 'Property B' together with a carpark space.

Proceedings

2. The Taxpayers appeared before us in person and the appeal was conducted by Madam Y while Mr X did occasionally offered assistance during the course of hearing. Following the usual practice Ms Chan Wai-mi for the Revenue prepared a bundle of documents for hearing and the Taxpayers readily agreed to their production. The following exhibits were produced by consent:

- 'R1' A bundle of documents consisting of 38 pages including the grounds of appeal and the Commissioner's determination together with the relevant annexures;
- 'R2' A list of property transactions carried out by the Taxpayers; and
- 'R3' A letter dated 19 January 1993 from the Revenue to Madam Y together with her reply dated 15 February 1993.

3. Madam Y chose to give evidence but not Mr X.

Grounds of Appeal

4. The Taxpayers advanced two grounds of appeal: (a) that Property B was purchased for their own use as residence and it was not for trading and (b) even if the gain from the sale of Property B was found to be trading profits, the Taxpayers should have the right to set off the profits by the loss they suffered in the sale of another property in the same estate known as 'Property A' together with two carparks spaces.

5. We intend to deal with ground (b) of the appeal first. Property A was sold under a sale and purchase agreement dated 22 July 1989 and the transaction was completed

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on 27 July 1989. The loss, if any, occurred in the year of assessment 1989/90. According to section 19C of Inland Revenue Ordinance the loss can only be carried forward and set off against the amount of assessable profits for subsequent years of assessment. It cannot be brought backward to set off the profits made in the previous year of assessment and in the present case, 1988/89. For this reason we have to dismiss this ground of appeal.

6. **Taxpayers' case**

The Taxpayers' case is relatively simple. At the material time they lived at Property H for about a year but before that time they had resided on Hong Kong side for a relatively long time, according to Madam Y's evidence, for at least seven years. They found that they liked to live on Hong Kong side and looked for new alternative accommodation. They found the subject premises which at that time was still under construction. They entered into agreement for purchase of Property A on 13 July 1988. About half a month later on 28 July 1988 purchased Property B. They claimed that they purchased Property A for investment purpose and Property B as their own residence. It was their practice that any rental property for investment would be purchased in only one name, either in the name of Mr X or that of Madam Y whilst properties for self-use would be in the Taxpayers' joint names. It was their intention to use Property B as their home because it was cheaper and Property A would be used for rental purpose. For that reason Property B was put in their joint names and Property A was acquired in the sole name of Madam Y.

7. About half a year later, certain estate agent recommended to them flats at District I. They then realised that Property B was not as convenient as properties at District I with the Mass Transit Railway Station. After visiting the site the Taxpayer decided to purchase a flat for self-use that is, 'Property C'. After purchase they visited the site again and Mr X took the trouble of climbing up to view the flat as at that time the building was not yet completed and was not served by any passenger lift. After seeing the flat he did not like its 'diamond-shape' layout and on 17 January 1989 the Taxpayers decided to purchase another one ('Property D') in the same estate. Because both properties were intended for the purpose of self-use they were registered in their joint names.

8. As they did not want to live in Property B, they sold it on 3 January 1989 and purchased Property C on the next day. The Taxpayers' main argument was that they purchased Property B originally with an intent to use it as their own home and later found the location of Property C was much better so they decided to purchase it as a replacement for Property B.

Evidence

9. The Revenue wanted to create an impression that the Taxpayers were trading in real estate properties by producing a list of over 20 transactions put through by the Taxpayers, either severally or jointly as set out in Exhibit 'R2'. We accept that the Taxpayers have had many property dealings but from this we cannot draw the inference that the particular property purchased by the Taxpayers was for trading purpose.

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10. The Revenue also submitted that the Taxpayers sold the Subject Property within six months of their acquisition before taking up the assignment and that it was a strong indication that they traded in the property. We do not accept this submission: if what the Taxpayers told us was true the length of time that they held the property and whether they paid the stamp duty and executed the assignment do not affect our decision.

11. We think that it is wrong to consider the different pieces of evidence in isolation. We should approach the evidence in the way what Mortimer J described as trite in the then High Court case, *All Best Wishes Limited v CIR* 3 HKTC 750 at 771 '*intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done*'.

12. The Taxpayers claimed that they purchased the Subject Property and intended to use the property as their home. They did not like to live on Kowloon side and they had experience of living on the Hong Kong island. This was the main reason for their move. At that time their two children were relatively young, eight and ten respectively. They did not worry too much about changing their schools. Later, about half a year after acquisition of Property B, they found that it was more convenient to live in Property C at District I which was served by the Mass Transit Railway as both Mr X and her wife Madam Y worked at District J. Property B had no other convenient means of access except by mini-bus or private car. They sold Property B and almost immediately purchased Property C.

13. The Taxpayers had lived on the Hong Kong side for at least seven years; it was reasonable for us to assume that they were familiar with the different places in Hong Kong. The location of Property B was at the same level as the property in which they formerly resided at District O. In fact, the two places were not too far away from each other. They should be aware of the transportation problem. They should have visited the site before purchase though they did not inspect the flat itself but they should have known the different means of transport. We are prepared to accept that Property C was more convenient but this does not help to prove that he purchased Property B for self-use. Mr X was a very meticulous person in choosing a flat as their home: he even took the trouble of going up to inspect the flat before completion and it would be quite difficult for us to believe that the Taxpayers had not considered the means of transportation to work.

14. Madam Y told us that they intended to live in Property B and not Property A. the reason was that Property B was less expensive. She did not elaborate on this point but went on to say that Property A had good seaview and Property B had very little of it. We think what she meant was that the purchase price of Property B was cheaper and Property A with good seaview could produce more rent. This would have been very reasonable had the Taxpayers purchased Property B first. She told us that she wanted to move back to Hong Kong and it is natural for us to expect that they would have purchased the property for their own use, that is, Property B, first instead of buying one for rental at the beginning.

15. The Taxpayers wanted to convince us that as the Subject Property was acquired in joint names it was intended for self-use; otherwise, they would have put it in the name of one of them. They did not explain to us the reason why they had such arrangement. The

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Revenue gave us counter examples by referring us to two properties which the Taxpayers also claimed that their acquisitions were for self-use. They were 'Property E' and 'Property F'. Madam Y explained that she did not move into Property E because of '*fung shui*' and not into Property F because of the inconvenience in transportation. For whatever reason it might have been, the fact remains that not all the properties they acquired with an intent for self-use were registered in the joint names. These two examples definitely weakened the Taxpayers' argument on the theory that the properties they purchased for self-use were invariably put in joint names.

16. Ordinary people hate moving house; the Taxpayers' family was rather unusual in that they kept on looking for new homes and moving. In 1988 when they had stayed in Property H for about a year they decided to move back to Hong Kong and acquired Property B. Within half a year of their new purchase they made another decision and chose Property C and Property D respectively. They took up the assignment of Property D in July 1989 and moved in to live there. But, after staying there for about one and half year they planned to move to Property E and entered into agreement for purchase on 29 December 1990. A month later, on 26 January 1991 because of bad '*fung shui*' of Property E they made another decision to purchase Property F which was in District L. Their determination to move to Property F did not last long; three months later they entered into agreement to purchase another property that is, 'Property G'. Before they moved into this flat they lived temporarily at District K for a few months because they had sold Property D on 27 March 1991 before Property G was due for occupation. Within the relevant period of three years the Taxpayers kept looking for house and planned to move. We were not told the reasons; the only explanation we can give was that the Taxpayers were impulsive buyers. They seized upon whatever they liked. This may seem reasonable for investment purpose but it is not a good explanation to purchase properties for self-use, particularly in the present case where the Taxpayers had two previous experiences of making the wrong decision: first, purchasing Property B which was found not to be convenient and second, acquiring Property C which had a diamond-shape layout. They gave other reasons for not living in Property E and Property F. All these happened too often and within too short a time for us to be convinced that they are true.

17. They said that they wanted to live on Hong Kong side when they acquired Property B and later chose Property C because it was directly served by MTR. Within three years they forgot all these preferences: they acquired Property F which was situate in District L, nowhere near to Hong Kong island and purchased flats at District M, the location of which was at the same level as Property B and which was not served by MTR. Now they even live further away in a house at District N which they purchased in June 1992.

18. Madam Y told us that they never considered of living in Property A but Mr X in his letter dated 20 March 1995 stated to the effect that '*at first I decided to abandon Property B originally intended for self-use and continued to retain Property A for self use*'. Madam Y explained that this was only Mr X's idea and not hers.

19. Madam Y was asked about their family income; she told us that their monthly income was about ten odd thousand dollars at the time they acquired Properties A and B.

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The amount of the monthly instalments for the two loans together well exceeds \$50,000. Notwithstanding the claim by Mr X that they were overseas Chinese who always had large cash reserves we still have great reservation how they could service the monthly payments. By letter dated 18 March 1997 (pages 24-25 of Exhibit R1) Mr X himself admitted that they had financial difficulty after 4 June 1989. This to a certain extent contradicts what Mr X told us in his submission. In any event if the properties were for self-use they would have made better planning than this.

20. Section 68(4) of the Inland Revenue Ordinance puts the burden of proof on the Taxpayers to show that the Commissioner was wrong in his determination. Considering all evidences before us we find that the Taxpayers have failed to discharge the burden and we are not convinced by balance of probabilities that the Subject Property was acquired for the purpose of self-use.

Decision

21. For reasons set out above we dismiss the appeal. As the Taxpayers did not dispute the quantum and there is no evidence before us requiring us to interfere with the determination of Commissioner we accordingly confirm that the profits tax assessment for the year of assessment 1988/89 dated 10 March 1995, showing assessable profits of \$450,000 with tax payable thereon of \$69,750 be reduced to assessable profits of \$324,364 with tax payable thereon of \$50,276.