

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D12/02

Profits tax – real property – whether the gains arising from the disposal of property were liable for profits tax – whether the commission paid deductible – section 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Dennis Law Shiu Ming and Gidget Lun Kit Chi.

Date of hearing: 28 January 2002.

Date of decision: 13 May 2002.

The appellant was a conveyancing clerk. In July 1992, the appellant purchased with his mother Property 1 which was sold in November 1998.

In February 1994, the appellant purchased Property 2 and sold it in July 1994. In the first questionnaire, the appellant informed the Revenue that Property 2 was purchased for self use. In October 1994, the appellant purchased Property 3. He asserted in the first questionnaire that Property 3 was purchased for use by family members.

In February 1995, the appellant purchased Property 4 and sold it in March 1996. He explained in the first questionnaire that Property 4 was purchased for self use and he sold the same as he wanted to switch premises.

By a memorandum for sale dated 11 May 1996, the appellant purchased Property 5 in the New Territories for \$6,067,700. In the second questionnaire dated 6 February 1998, the appellant informed the Revenue that he purchased Property 5 for 'self use'.

By a provisional agreement dated 3 November 1996, the appellant sold Property 3. He explained in the first questionnaire that the sale was attributable to the need of his family members to move out of the city and to financial problems.

By a provisional agreement for sale and purchase dated 29 April 1997, the appellant sold Property 5 for \$9,900,000. Clause 8 of the agreement provides that '[the realty agent] shall be entitled to receive HK\$ / from the Vendor ...'. The taxpayer informed the Revenue in the second questionnaire that the sale was attributable to his children's admission into kindergarten in Kowloon in September 1997; traffic inconvenience in the New Territories and the premises being located in an industrial area.

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Held:

1. The intention of the appellant at the time of the acquisition of Property 5 is crucial in determining whether that flat was acquired as capital asset or trading asset. An intention to hold property as a capital investment must be definite. The stated intention of the appellant was not decisive.
2. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the appellant. In order to discharge this onus, it is incumbent upon him to place before the Board supporting materials in support of his assertions by furnishing the Board with primary evidence that is within his easy access. There was no documentary evidence to support the appellant's assertion. The Board was of the view that the appellant was correctly assessed in respect of the profit arising from his dealings of Property 5.
3. The appellant did not respond to the request of the Revenue to provide particulars in respect of his alleged payment of commission of \$200,000. His evidence before the Board did not advance this issue in any way. The Board disallowed this extravagant claim.

Appeal dismissed.

Cases referred to:

Simmons v IRC (1980) 53 TC 461
All Best Wishes Ltd v CIR (1992) 3 HKTC 750

Fung Chi Keung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. At all material times, the Appellant ('Mr A') was a conveyancing clerk in the employment of Company B. On 1 March 1995, his wife ('Mrs A') commenced operating a real estate consultation business in the name of Company C. They have two sons, born respectively on 19 April 1994 and 12 February 1996.

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2. On 8 July 1992, Mr A purchased with his mother a flat at Housing Estate D ('Property 1') for \$827,000. Property 1 was sold on 30 November 1998 for \$1,503,800.
3. By a provisional agreement for sale and purchase dated 23 February 1994, Mr A purchased a flat at Housing Estate E ('Property 2') for \$2,100,000. He sold Property 2 on 23 July 1994 at \$2,300,000. In a questionnaire dated 28 October 1997 ('the First Questionnaire'), Mr A informed the Revenue that Property 2 was purchased for self use and he sold the same in the process of switching premises.
4. By a provisional agreement for sale and purchase dated 12 October 1994, Mr A purchased a flat at Housing Estate F ('Property 3') for \$2,227,000. This purchase was financed in part by a mortgage loan extended by Bank G. Mr A asserted in the First Questionnaire that Property 3 was purchased for use by family members.
5. By a provisional agreement for sale and purchase dated 21 February 1995, Mr A purchased a flat at Housing Estate H ('Property 4') for \$2,987,600. He sold Property 4 on 3 March 1996 for \$3,120,000. He explained in the First Questionnaire that Property 4 was purchased for self use and he sold the same as he wanted to switch premises. He further explained in that Questionnaire that the sale was attributable to traffic inconvenience and difficulties in meeting mortgage instalments.
6. By a memorandum for sale dated 11 May 1996, Mr A purchased a flat at Phase Two of Housing Estate I in the New Territories ('Property 5') for \$6,067,700. Under this memorandum for sale, \$650,000 was payable by way of initial deposit; \$563,540 was payable on or before 29 May 1996 and the balance of \$4,854,160 was payable on or before 14 June 1996. This purchase was financed in part by an instalment loan of \$4,247,390 extended on 4 June 1996 by Bank J in favour of Mr A which loan was repayable by 360 monthly instalments of \$34,175.46 each. Property 5 has a saleable area of 1,043 square feet with a bay window of 29 square feet. In a questionnaire dated 6 February 1998 ('the Second Questionnaire'), Mr A informed the Revenue that he purchased Property 5 for 'self use'.
7. By a provisional agreement dated 3 November 1996, Mr A sold Property 3 for \$2,820,000. He explained in the First Questionnaire that the sale was attributable to the need of his family members to move out of the city and to financial problems.
8. The occupation permit and the certificate of compliance in respect of Property 5 were granted on 23 December 1996 and 23 March 1997. By a receipt dated 29 April 1997, Mr A acknowledged receipt of the keys from the developer.
9. By a provisional agreement for sale and purchase also dated 29 April 1997, Mr A sold Property 5 for \$9,900,000. Clause 8 of this agreement provides that 'In consideration of the

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services rendered by the Agent [Realty Agency K], the Agent shall be entitled to receive HK\$ / from the Vendor and HK\$200,000 from the Purchaser as commission ...'. The sale was completed by assignment dated 13 June 1997. Mr A informed the Revenue in the Second Questionnaire that the sale was attributable to his children's admission into kindergarten in Kowloon in September 1997; traffic inconvenience in the New Territories and the premises being located in an industrial area.

10. By a provisional agreement dated 15 May 1997, Company L purchased a flat at Housing Estate M ('Property 6') for \$7,120,000. At all material times, Company L is a company controlled by Mr and Mrs A. The purchase was completed on 8 August 1997. The family has since been residing in Property 6.

11. On 8 November 1997, the eldest son of Mr and Mrs A ('the Son') was interviewed for admission into Kindergarten N in Kowloon. The Son started in Kindergarten N on 9 February 1998.

12. According to the tax returns of Mr A, his earnings for the relevant years were as follows:

Year of assessment	Source of income	Total \$
1995/96	Clerk with Company B	82,000
1996/97	Ditto	130,000
1997/98	Conveyancing clerk with Company B	220,000

13. Mr A produced before us various bank statements for the years 1996 and 1997. He enjoyed the following credit balances:

	Bank G in sole name of Mr A	Bank G in joint names of Mr and Mrs A	Bank O in sole name of Mr A	Bank P in sole name of Mr A	Total \$
	\$	\$	\$	\$	\$
1-1996			621,708.01		
2-1996			713,258.92	539,060.97	1,252,319.89
3-1996	516,495.23		116,173.97	452,562.57	1,085,231.77
4-1996	518,325.25		276,509.98	435,044.08	1,229,879.31
5-1996	520,251.14			323,582.70	843,833.84
6-1996			1,957,036.82		1,957,036.82
6-1997		766,356.59			
8-1997		772,119.22			

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14. The issues for our determination is whether Mr A is liable for profits tax in respect of the gains that he made from his dealings with Property 5 and if so, whether he is entitled to deduct from the profits made \$200,000 he allegedly paid by way of commission for the sale.

Sworn testimony of Mr A before us

15. Mr A told us that by virtue of the strained relationship between Mrs A and his mother, he and his wife moved out of Property 1 in 1994. They resided in Property 3 with his sister for about a year whilst the Son remained in Property 1 with his mother. He returned to Property 1 for dinner two to three nights a week. The acquisition of Property 5 was to change their family residence.

16. He inspected the show flat for Phase One of Housing Estate I quite some time before his own purchase. He accepted that he was aware at the time of the purchase that the development was within an industrial area.

17. When he first acquired Property 5, his primary consideration was improvement in his living environment. He did not give any thought to the education of his children. After selecting Property 5, he discovered that the flat is more than five minutes' walk from the railway station. The developer had made various representations to the contrary.

18. He would have no difficulty in financing the acquisition of Property 5. He drew our attention to the bank statements referred to above. He explained that apart from his employment with Company B, he had interests in various catering and fashion businesses in China till 1999. He laid emphasis on the fact he had been paying mortgage instalments in respect of Property 6 for well over five years and he still held Property 1 when he acquired Property 5.

19. He began looking for kindergarten in about September 1996. He sought help from his friends and they were introduced to Kindergarten N. He made the decision to send his son to Kindergarten N in October 1996.

20. He tried to dispose of Property 5 in 1996 without success. At no time did he reside in that flat.

21. He accepts that the commission of \$200,000 which he allegedly paid was on the high side. He was prepared to be generous as the agent was a friend of his and the purchaser had a genuine interest.

The applicable principles

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22. The intention of Mr A at the time of the acquisition of Property 5 is crucial in determining whether that flat was acquired as capital asset or trading asset. As stated by Lord Wilberforce in Simmons v IRC (1980) 53 TC 461

‘ 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?’.

23. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750 Mortimer J gave the following guidance:

‘ 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 ... 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’.

24. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on Mr A. In order to discharge this onus, it is incumbent upon him to place before this Board supporting materials in support of his assertions. Although the standard of proof is one of balance of probabilities, Mr A must ensure that the balance be tilted in his favour by furnishing the Board with primary evidence that is within his easy access.

Our decision

25. In the course of his evidence, Mr A sought to impress on us his vast experience in handling conveyancing transactions in Company B. We are surprised in the light of such experience that there is hardly any documentary evidence to support Mr A’s case in several important aspects.

26. Mr A had a long history of property dealings prior to his acquisition of Property 5. He told the Revenue in the First Questionnaire that his acquisitions were for self use. He maintained before us that he resided in Property 3 with his sister. There is no documentary evidence to support these assertions. Property 1 was the only address used in his tax returns, the returns of Company B, his bank statements and the memorandum for the acquisition of Property 5. We are not satisfied

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that any of his previous acquisitions was used as his matrimonial home. We are inclined to the view that Mr A is an experienced trader of properties.

27. Mr A attributed the acquisition of Property 5 to a desire to change his living environment. Given his experience in property dealings, we reject his evidence that he was misled by the developer. He accepted in cross-examination that he was aware throughout that Property 5 is located in an industrial area. Two of the three reasons that he gave in the Second Questionnaire do not stand up to scrutiny.

28. Mr A placed considerable emphasis on his acquisition of Property 6 which is near Kindergarten N. We are however not convinced that the education of the Son played any role leading to Mr A's decision to sell Property 5. According to records maintained by Kindergarten N, the Son was interviewed on 8 November 1997. He was formally admitted into that institution on 9 February 1998. These events took place well after Mr A's sale of Property 5 on 29 April 1997. Mr A sought to meet this by his testimony that the Son was in fact interviewed in October 1996. There is no evidence to support such interview apart from Mr A's bare assertion. He did not mention this fact in the Second Questionnaire or in any of his correspondence with the Revenue. We reject this piece of evidence. Furthermore, had he taken steps in anticipation of the Son's education in October 1996, that factor should have been present in his mind when selecting Property 5 in May 1996. This casts doubt on Mr A's claim that Property 5 was purchased as his matrimonial home.

29. Whilst we are satisfied that Mr A did have the ability to finance the purchase of Property 5 on a long term basis, we are not persuaded that he made a decision to move from his Property 1 until his purchase of Property 6. We are of the view that he is correctly assessed in respect of the profit arising from his dealings of Property 5.

30. By letter dated 13 August 2001, the Revenue asked Mr A to provide particulars in respect of his alleged payment of commission of \$200,000. Mr A did not respond to that request. His evidence before us did not advance this issue in any way. We disallow this extravagant claim.