

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D127/01

Profits Tax – whether the sale of a property was trading in nature – the circumstances and facts of the case go against the contention of the taxpayer – absence of explanation as to the nature of money deposited into the bank accounts of the taxpayer – the failure of the taxpayer to give evidence on appeal – burden of proof on the taxpayer – appeal was unmeritorious and frivolous – penalized in costs – sections 2(1), 14 and 68(4) of the Inland Revenue Ordinance (‘IRO’).

Panel: Patrick Fung Pak Tung SC (chairman), Cheung Wai Hing and Herman Fung Man Hei.

Date of hearing: 22 November 2001.

Date of decision: 21 December 2001.

The taxpayer appealed against a profits tax assessment for the year of assessment 1997/98 arising out of his acquisition of a piece of land in the New Territories (‘the Lot’) for the purpose of redevelopment. There was a dispute between the taxpayer and the Commissioner on the purpose of redevelopment. On the one hand, the taxpayer contended that originally he intended to redevelop the Lot as a residence for him and his family but eventually, by reason of the *fung shui* problem, he decided to sell the three-storey house, which was divided into three separate properties (‘the Properties’), subsequently erected on the Lot. On the other hand, the Commissioner argued that the taxpayer’s intention was to redevelop it for the purpose of sale and making a profit. The issue in the appeal was whether the taxpayer was liable to profits tax from the sale of the Properties by having entered into an adventure in the nature of trade (sections 14 and 2(1) of the IRO).

Held:

1. The fact that the taxpayer and his family never resided at and never took any action which manifested an intention to reside at the Lot after the completion of the redevelopment (other than the bare assertion of the taxpayer) would naturally whittle at such alleged intention.
2. On the *fung shui* question, the Board did not accept the taxpayer’s allegation that he thought it was possible to get a *fung shui* master to inspect the site only after it had been leveled. If he did intend on getting the service of a *fung shui* master, *fung shui* being of primary importance to him, he would have asked such a master to visit the Lot first before even a stone was turned. The disposition of the house to be built

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would have been important. Furthermore, the leveling work itself might have destroyed whatever good *fung shui* there existed. It might have been another matter if a *fung shui* master had visited the Lot and advised that he could not do anything at that stage but would have to come back after the leveling. This, however, was not the allegation. There was also no evidence that the *fung shui* master was asked how the bad *fung shui* could be remedied. Moreover, the Board found it difficult to accept that the taxpayer did not even have the address or telephone number of the *fung shui* master in question so as to enable him to be called as a witness in order to add credence to the taxpayer's story.

3. Although it appeared that the money for the construction of the Properties had come out of the bank account or accounts of the taxpayer, such money appeared to have been derived from other sums of money deposited into such account or accounts and there was no explanation by the taxpayer as to the source of such other sums of money. It had to be borne in mind that the taxpayer was not a businessman but a civil servant. It was difficult to conceive that he had sources of income other than his salary. Furthermore, under the agreements for sale and purchase of the Properties, the purchasers were expressly liable to pay part of the premium payable to the Government. It was certainly open to the Commissioner and the Board to draw the inference that the sums injected into the account or accounts of the taxpayer which were used to pay for the construction had originated from the purchasers and not the savings of the taxpayer.
4. Fourthly, since the original intention of the taxpayer was to have a larger accommodation for him and his family, one would expect that the original design of the house was a single house of three storeys with internal staircases. As it turned out, the house completed was divided into three self-contained flats (two of which were agreed to be sold well before completion). There was no evidence before the Board that there was a change of design at any stage. Such evidence would have supported the taxpayer's case at least to some extent.
5. The onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer (section 68(4)).
6. This was particularly significant in the context of ascertaining the 'intention' on the part of the taxpayer at a particular time. Only he himself can speak about his own 'intention' subject to being tested in cross-examination. The absence of the taxpayer in the appeal hearing had deprived the Board of the chance to consider the most relevant and direct evidence of his own intention.
7. In all the circumstances, the Board found that the taxpayer had failed to discharge his burden of proof in this appeal.

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8. Bearing in mind all the circumstances, in particular, the failure of the taxpayer to be present, to give evidence and to call any other evidence when he must have been advised by his legal advisers of the onus he has to discharge on appeal, the Board found that this appeal was unmeritorious and frivolous. The Board ordered that the taxpayer to pay costs of \$5,000.

Appeal dismissed and a cost of \$5,000 charged.

Cases referred to:

Lionel Simmons Properties Limited (in liquidation) v Commissioners of Inland Revenue
[1980] 1 WLR 1196

All Best Wishes Limited v Commissioner of Inland Revenue [1992] 3 HKTC 750

Ngan Man Kuen for the Commissioner of Inland Revenue.

Christopher S H Lam instructed by Messrs Kitty So & Tong, Solicitors, for the taxpayer.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against an assessment for profits tax for the year of assessment 1997/98 ('the Assessment') issued by the Respondent ('the Commissioner'). An objection was lodged by the Taxpayer against the Assessment. By his letter dated 31 July 2001, the Commissioner made a determination rejecting the Taxpayer's objection and revised the assessable profits from \$2,460,700 to \$2,835,500 with the consequence of the profits tax payable on the assessable profits being increased from \$332,194 to \$384,792. The Taxpayer has brought this appeal against such determination.

2. At the hearing, the Taxpayer was absent but represented by Mr Christopher Lam of Counsel instructed by Messrs Kitty So & Tong, Solicitors. No evidence was called by Mr Lam who simply made his submission.

3. The appeal was originally scheduled to be heard in Chinese but Mr Lam had prepared his written submission in English whereas Miss Ngan for the Commissioner had prepared her written submission in Chinese. In the end, the appeal was conducted in both English and Chinese without any objection from anybody. At the end of the hearing, it was also agreed by the parties that the Board should deliver its decision in English. Hence, this decision.

The facts

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4. The relevant facts of the case are well summarised in the letter of the Commissioner containing the determination. It is convenient for us to adopt substantially the recital of the facts therein for the purpose of this decision below.

5. The Taxpayer is an indigenous villager of Village A in District B in the New Territories. He was married with four children, who were born on 25 January 1975, 17 April 1978, 13 July 1982 and 29 September 1983 respectively.

6. (a) By an assignment dated 13 April 1989, *Tso C* agreed to assign a piece of dry cultivated land described as lot number XXX in demarcation district number XXX ('the Land') in favour of the Taxpayer and Mr D at a consideration of \$1.
- (b) By a deed poll dated 28 November 1992, the Taxpayer and Mr D agreed to partition the Land into seven sections, namely, lot numbers XXXA, XXXB, XXXC, XXXD, XXXE, XXXF and XXXRP.
- (c) By an assignment dated 28 November 1992, Mr D agreed to assign his beneficial interest in lot number XXXA in demarcation district number XXX ('the Lot') to the Taxpayer at a consideration of \$100,000.

7. On 14 November 1992, the district lands officer, District B received an application from the Taxpayer for the grant of a licence to build a small house on the Lot. In the application form, the Taxpayer declared that he resided at 1 Village A, District B.

8. (a) On 10 July 1996, the Government, under its small house policy for indigenous villagers in the New Territories, granted to the Taxpayer a building licence ('the Licence') to erect on the Lot a building of not more than three storeys.
- (b) The Licence contained a restriction clause which prohibited the Taxpayer from assigning the building to be erected on the Lot unless:
- (i) a period of five years had elapsed from the date of issue of a certificate of compliance by the district lands officer; or
 - (ii) the Taxpayer had paid to the Government a premium to be determined by the district lands officer.

9. On 18 July 1996, two certificates of exemption in respect of site formation works and building works for the building to be erected on the Lot were issued to the Taxpayer.

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10. On 18 February 1997, Messrs Kitty So & Tong ('the Representatives'), on behalf of the Taxpayer, notified the district lands officer, District B that the construction of a small house on the Lot had been completed and asked for the issue of a certificate of compliance. The small house was a three-storey building consisting of G/F and garden, 1/F, 2/F and roof ('the Properties'). Its address was described as 2 Village A, section A of lot number XXX in DDXXX, District B, New Territories.

11. On 15 August 1997, the district lands officer, District B, after inspecting the Properties, issued to the Taxpayer a certificate of compliance certifying that all the positive obligations under the Licence had been complied with to his satisfaction.

12. On 20 August 1997, the Representatives applied to the district lands officer, District B for the removal of the five-year non-assignment restriction referred to in paragraph 8(b) above by paying a premium to the Government so that he could sell the Properties.

13. On 5 January 1998, the district lands officer, District B gave his consent for the removal of the non-assignment restriction on the condition that the Taxpayer paid to the Government a premium of \$974,800 ('the Premium') on or before 2 February 1998.

14. The Premium was fully paid on 13 January 1998.

15. On divers dates, the Taxpayer sold the three storeys of the Properties as follows:

Location	Date of provisional agreement for sale and purchase	Date of assignment	Sale consideration \$
G/F and garden	4-12-1996	10-2-1998	1,480,000
1/F	27-3-1997	10-2-1998	1,700,000
2/F and roof	25-11-1996	9-2-1998	<u>1,510,000</u>
		Total	<u><u>4,690,000</u></u>

It was stipulated in the provisional agreements that the Taxpayer, as the vendor, would be responsible for payment of the premium in the amount of \$600,000 only and that each purchaser agreed to bear one-third of the premium in excess of \$600,000.

16. In response to the assessor's enquiries concerning the construction and sale of the Properties by the Taxpayer, the Representatives made the following claims:

- (a) The Land had been owned by *Tso C* since 1937. The Taxpayer and his brother, Mr D, were members of *Tso C*. In 1989, members of *Tso C* decided to have a

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division of *Tso C*'s properties. The Lot was therefore divided and given to the Taxpayer and Mr D by agreement.

- (b) In 1992, the Taxpayer applied for a licence with a view to erecting a new accommodation for his family.
- (c) 'After completion of construction, the Taxpayer found the Properties was not a suitable place to reside because of the *fung shui* problem and decided to sell out the flats of the three-storeyed house and therefore apply for modification for removal of restriction on alienation as stipulated in the Licence by paying to the Government a premium.'
- (d) The Taxpayer made a profit of \$2,112,700 from the sale of the Properties, computed as follows:

	\$	\$
Sale proceeds		4,690,000
<u>Less:</u> Cost of land	100,000	
Construction costs	850,000	
Plan fee	5,000	
Administration fee paid to the Government	4,900	
Fee paid to the Law Society of Hong Kong	3,000	
Premium	974,800	
'Toi Dee Fee' paid to local persons	100,000	
Agency commission	56,600	
Decoration costs	348,000	
Steel works	<u>135,000</u>	<u>2,577,300</u>
Gain		<u><u>2,112,700</u></u>

- (e) The Taxpayer paid the construction costs out of the deposits received from the purchasers of the Properties.
- (f) The Taxpayer did not know the address nor the business registration number of the recipient of decoration costs of \$348,000. The recipient was a contractor introduced to the Taxpayer through his friend.
- (g) The *fung shui* master was Mr E. He was a Macau resident and operated his business under the trade name of 'Fung Shui Master F'. The Taxpayer did not know his full name nor his address in Macau. The Taxpayer could not recall the exact date when the *fung shui* master visited the site. The advice given by the

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fung shui master was that the Properties were not suitable for residential use and if the Taxpayer and his family were to move in, they would suffer from financial loss or bad health.

- (h) The Taxpayer's residential address since 1 April 1989 was at 1 Village A, District B, New Territories. It was a two-storey building erected on lot number X and lot number XXXX in 1975. It had an area of 600 square feet and two bedrooms on each floor. The Taxpayer and members of his family occupied the first floor of the building while Mr D's family occupied the ground floor. In 1998, Mr D intended to move out. The Taxpayer then acquired Mr D's interest on lot number XXXX and became the owner.
 - (i) The reasons for contending that the profit on sale of the properties should not be subject to profits tax were:
 - (ia) '... the Lot was a family property which was owned by *Tso C* for at least 52 years before the assignment of the same to the Taxpayer and Mr D in 1989. The long period of ownership by the Taxpayer and Mr D of the Lot is also another strong proof of his non-trading activity.'
 - (ib) 'The house was originally decided to be an accommodation of the Taxpayer's family but due to *fung shui* problem, the Taxpayer decide to sell it out. Indeed, the Taxpayer had subsequently utilised part of the sale proceeds in the purchase of two properties, namely
 - (i) lot number XXXX in DDXXX as accommodation of his family in Hong Kong; and
 - (ii) Address G ('the Country H Property') as accommodation of his children who are currently studying in Country H.'
17. (a) Lot number XXXX in DDXXX was acquired by the Taxpayer from Mr D on 28 February 1998 at a consideration of \$400,000.
- (b) The Country H Property was purchased by the Taxpayer's wife, Madam I, on 22 September 1997 at a consideration of £48,000.

18. The assessor was of the view that the profits on sale of the Properties were trading in nature. She raised on the Taxpayer the following profits tax assessment for the year of assessment 1997/98:

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Gain as computed in paragraph 16(d) above	2,112,700
<u>Add:</u> Decoration cost disallowed due to the absence of particulars of the recipient	<u>348,000</u>
Assessable profits	<u><u>2,460,700</u></u>
 Tax payable thereon	 <u><u>332,194</u></u>

19. The Taxpayer objected to the above assessment on the ground that he did not have any intention to trade with the Properties. He further contended that the Properties were disposed of because of *fung shui* reason. He stressed that he believed strongly in the undesirable consequences caused by *fung shui*.

20. In reply to the assessor's enquiries, the Taxpayer made further assertions as follows:

- (a) 'My family had been squeezed in a flat of 600 square feet with two bedrooms for more than 20 years. It has always been the wishes of the family to have a larger house so that my four children would not have to share only one bedroom especially because all my four children have grown up now. It would be very inconvenient if they share one bedroom.'
- (b) He paid construction cost of \$850,000 to Company J by eight instalments as follows:

Date	Amount	Nature
	\$	
31-5-1996	10,000	1 st instalment (initial deposit)
4-6-1996	90,000	1 st instalment (balance)
16-9-1996	100,000	2 nd instalment
3-10-1996	150,000	3 rd instalment
7-11-1996	130,000	4 th instalment
18-1-1996	130,000	5 th instalment
30-11-1996	130,000	6 th instalment
25-3-1997	60,000	7 th instalment
26-9-1997	<u>50,000</u>	8 th instalment
	<u><u>850,000</u></u>	

- (c) He had paid up a total sum of \$610,000 to Company J before he successfully sold the first unit in the small house. The construction costs were paid out of his past savings instead of the deposits received from the purchasers. He had sufficient funds to meet the construction costs.

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- (d) ‘Advice was sought from the *fung shui* master after the levelling of the site. The reason being that the *fung shui* master would advise on the following matters:
- (i) colour scheme of the said building;
 - (ii) the position for the opening of the main entrance door;
 - (iii) the position for the balconies of the said building;
 - (iv) the position for the opening of the windows;
 - (v) the position of the staircases;
 - (vi) the partitioning of the bedrooms ... etc.

It is therefore much better for the *fung shui* master to give his advice well before the commencement of the construction works and it would be too late or it would cost extra renovation fee if the *fung shui* master requests any rectification works to be carried out to the existing design upon completion of the construction works of the said building.’

- (e) The Taxpayer contended in the following terms with regard to his decision to proceed with the construction of the small house notwithstanding the poor *fung shui* advice:

‘... I had been waiting for three and a half years before the building licence number XXXX was issued to me on 10 July 1996. By the time the *fung shui* master told me that the land was not suitable for my family to erect the said building, levelling of the site has already been completed and payments had already been made to Company J.

The building licence granted to me is the entitlement by me once in my whole life. There is no reason for me to forgo the building licence as well as the land and not to continue the construction of the said building. I have no option but to complete the said building.

... I have subsequently spent the money derived from the sale of the units in purchasing an accommodation for my family in Hong Kong and a house for my three children who are currently studying in Country H. I would not have to purchase the accommodation (namely lot number XXXX in DDXXX) in Hong Kong if the said building was found suitable for my family to live in according to the advice of the *fung shui* master. Further, if I intend to build the said building

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for sale purpose only, I would not definitely have used my building licence which was enjoyed by me once in my life time and I would not have used the land to build the said building which land was a family property.’

The Taxpayer also adduced copies of the following bank statements to support his claim that he had adequate funds to build the small house.

- (a) Bank statements in respect of an account opened with Bank K covering the periods from 7 September 1996 to 7 January 1997 and from 7 March 1997 to 7 April 1997. The opening balance of the account as on 7 September 1996 was \$115,252.18.
- (b) Bank statement in respect of another account also opened with Bank K covering the period from 16 September 1997 to 16 October 1997.

21. In his tax returns – individuals for the years of assessment 1993/94 to 1998/99, the Taxpayer declared the following particulars:

- (a) his residential address was at 1 Village A, District B;
- (b) he was employed by Hong Kong Police Force as a police constable. He had derived the following amounts of employment income:

Year	Amount
	\$
1993/94	186,300
1994/95	204,720
1995/96	225,480
1996/97	384,728
1997/98	301,285
1998/99	313,751

- (c) his wife did not have any income chargeable to salaries tax during the years and he should be entitled to claim married person’s allowance;
- (d) besides salaried income, he had not derived any income or profits from other sources; and
- (e) three of his children were attending schools in Country H during the year of assessment 1997/98.

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22. The assessor still held the view that the profits on sale of the Properties were assessable to profits tax. Having regard to the agreement reached between the Taxpayer and the purchasers of the Properties as shown on the provisional agreements, the assessor considered that the profits tax assessment for the year of assessment 1997/98 should be revised as follows:

	\$
Profits previously assessed	2,460,700
<u>Add:</u> Premium agreed to be borne by the purchasers (\$974,800 - \$600,000)	<u>374,800</u>
Revised assessable profits	<u><u>2,835,500</u></u>
Revised tax payable thereon	<u><u>382,792</u></u>

Such revised assessment was confirmed by the Commissioner in the determination.

The law

23. Section 14(1) of the IRO reads as follows:

‘ 14. *Charge of profits tax*

(1) *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.*’

Section 2 of the IRO defines ‘trade’ as follows:

‘ “trade” (行業 生意) *includes every trade and manufacture, and every adventure and concern in the nature of trade.*’

24. It is well established by the decided cases in both England and Hong Kong that whether a taxpayer in selling a piece of property and making a profit is engaged in a trading activity thus rendering him liable to pay tax on such profit depends on his intention at the time of his acquisition of the property. Thus in the case of Lionel Simmons Properties Limited (in liquidation) v Commissioners of Inland Revenue [1980] 1 WLR 1196 at 1199, Lord Wilberforce stated the test as follows:

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‘ 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 it at a profit, or was it acquired as a permanent investment?’

This has been elaborated upon by Mr Justice Mortimer in Hong Kong in his oft-quoted judgement in the case of All Best Wishes Limited v Commissioner of Inland Revenue [1992] 3 HKTC 750 at 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.’

Thus, the Commissioner and any tribunal in ascertaining the true intention of a taxpayer at the time of his acquisition of the asset in question must look at all the surrounding circumstances and draw an inference therefrom.

The case of the Taxpayer

25. The case of the Taxpayer is that he had originally intended to acquire the Lot for the purpose of redeveloping it into a three-storey house to be used as a residence for him and his family, that he had the financial resources to undertake such a redevelopment and that eventually he decided to sell the Properties because he was advised by a *fung shui* master that the ‘the Properties were not suitable for residential use’ (see paragraph 16(g) above).

The case of the Commissioner

26. The Commissioner argues that the Taxpayer did not have the intention to redevelop the Lot as a residence for him and his family but the intention to redevelop it for the purpose of sale and making a profit. The Commissioner further argues that the latter intention can be inferred from the following facts:

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- (a) The lack of convincing evidence regarding the *fung shui* problem.
- (b) The fact that the Taxpayer already agreed to sell two of the three Properties only four or five months after the certificates of exemption had been issued and before the building works had been completed and agreed to sell the remaining Property soon after completion of the building works.
- (c) The fact that there is evidence indicating that the Taxpayer would not have had the financial resources to redevelop the Lot without contribution by the prospective purchasers.

Conclusion

27. We have considered all the documentary evidence which has been put before us. Without disrespect to Mr Lam who argued the case for his client ably and vigorously, we are not impressed by the argument advanced by or on behalf of the Taxpayer.

28. First, the fact that the Taxpayer and his family never resided at and never took any action which manifested an intention to reside at the Lot after the completion of the redevelopment (other than the bare assertion of the Taxpayer) would naturally whittle at such alleged intention.

29. Secondly, on the *fung shui* question, we do not accept the Taxpayer's allegation that he thought it was possible to get a *fung shui* master to inspect the site only after it had been levelled. If he was intent on getting the service of a *fung shui* master, *fung shui* being of primary importance to him, he would have asked such a master to visit the Lot first before even a stone was turned. The disposition of the house to be built would have been important. Furthermore, the levelling work itself might have destroyed whatever good *fung shui* there existed. It might have been another matter if a *fung shui* master had visited the Lot and advised that he could not do anything at that stage but would have to come back after the levelling. This, however, is not the allegation. There is also no evidence that the *fung shui* master was asked how the bad *fung shui* could be remedied. Moreover, we find it difficult to accept that the Taxpayer did not even have the address or telephone number of the *fung shui* master in question so as to enable him to be called as a witness in order to add credence to the Taxpayer's story.

30. Thirdly, although it appears that the money for the construction of the Properties had come out of the bank account or accounts of the Taxpayer, such money appears to have been derived from other sums of money deposited into such account or accounts and there is no explanation by the Taxpayer as to the source of such other sums of money. For example, in the bank statement dated 7 October 1996, there is shown a cheque deposit in the sum of \$329,985 which has not been explained. It is to be borne in mind that the Taxpayer is not in business but a civil servant. It is difficult to conceive that he had sources of income other than his salary.

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Furthermore, under the agreements for sale and purchase of the Properties, the purchasers were expressly liable to pay part of the premium payable to the Government. It is certainly open to the Commissioner and the Board to draw the inference that the sums injected into the account or accounts of the Taxpayer which were used to pay for the construction had originated from the purchasers and not the savings of the Taxpayer.

31. Fourthly, since the original intention of the Taxpayer was to have larger accommodation for him and his family, one would expect that the original design of the house was a single house of three storeys with internal staircases. As it turned out, the house completed was divided into three self-contained flats (two of which were agreed to be sold well before completion). There is no evidence before us that there was a change of design at any stage. Such evidence would have supported the Taxpayer's case at least to some extent.

32. Finally and most importantly, section 68(4) of the IRO provides that on an appeal the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant. This is particularly significant in the context of ascertaining the 'intention' on the part of the Taxpayer at a particular time. Only he himself can speak about his own 'intention', subject to being tested in cross-examination. By not being present and giving evidence, he has deprived the Board of the chance to consider the most relevant and direct evidence of his own intention.

33. In all the circumstances, we find that the Taxpayer has failed to discharge the onus on him in this appeal which must accordingly be dismissed.

34. Bearing in mind all the circumstances, in particular, the failure of the Taxpayer to be present, to give evidence and to call any other evidence when he must have been advised by his legal advisers of the onus he has to discharge on appeal, we find that this appeal is unmeritorious and frivolous. We order that the Taxpayer do pay costs in the sum of \$5,000.