

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D128/02

Profits tax – sale of property – intention at the time of acquisition – whether a property is a capital asset or a trading asset – section 68(4) of the Inland Revenue Ordinance ('IRO') – badges of trade.

Panel: Ronny Wong Fook Hum SC (chairman), Donald Liu Tit Shing and Paul Mok Yun Lee.

Date of hearing: 23 January 2003.

Date of decision: 14 March 2003.

The appellant purchased a property on 20 September 1996 and became the registered owner of the property on 16 July 1997. On 22 September 1997, the appellant sold the said property. The issue is whether the appellant is liable for profits tax in respect of the gains she made from the dealings with the property. The appellant's case was that she purchased the property with the intention of using the same as her residence.

Held:

1. The intention of the appellant at the time of acquisition of the property is crucial in determining whether that flat is capital asset or trading asset. An intention to hold property as a capital investment must be define. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the appellant (Simmons v IRC (1980) 53 TC 461 and All Best Wishes Ltd v CIR (1992) 3 HKTC 750 followed).
2. The Board accepts that the appellant is a witness of truth. By reference to the 'badges of trade', the Board holds on a balance of probabilities that she successfully discharged her onus in demonstrating that she did not embark upon a trade in the acquisition of the property (Marson v Morton [1986] 1 WLR 1343 followed).

Appeal allowed.

Cases referred to:

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Simmons v IRC (1980) 53 TC 461
All Best Wishes Ltd v CIR (1992) 3 HKTC 750
Marson v Morton [1986] 1 WLR 1343

Yeung Siu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. On 20 September 1996, the Appellant entered into a preliminary agreement for the purchase of a flat at Address A ('Property 1') for \$2,967,345. Property 1 was being constructed at the date of the preliminary agreement. 30 April 1997 was the anticipated date of completion.
2. The occupation permit in respect of Property 1 was issued on 11 April 1997. The Appellant became the registered owner of that flat on 16 July 1997. On the same day, the Appellant mortgaged Property 1 in favour of Bank B for a loan of \$2,077,000 repayable by 360 monthly instalments of \$16,339.77 each.
3. By an agreement dated 22 September 1997, the Appellant sold Property 1 for \$4,580,000.
4. On or about 1 March 1998, the Appellant purchased a flat at Address C ('Property 2') for \$3,713,040.
5. On 22 May 1998, the Appellant submitted her return for the year of assessment 1997/98. Address D ('Property 3') was stated to be her residential address in this return. She reported to the Revenue that she earned a total of \$221,400 from Company E for the period between 1 April 1997 and 31 March 1998. She further reported to the Revenue that she was a partner of Company F. She held 80% interest in that partnership. According to the profit and loss account of Company F for the year ended 31 March 1997, its profit for the year was \$66,824.
6. The issue before us is whether the Appellant is liable for profits tax in respect of the gains she made from her dealings with Property 1.

Case of the Appellant

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7. In a questionnaire submitted to the Revenue on 9 June 1998, the Appellant maintained that she purchased Property 1 with the intention of using the same as her residence. She allegedly spent \$275,000 in decorating Property 1. After moving into the flat, she discovered a staircase at the back of the flat. Her mother was concerned with the flat's security and suggested that the Appellant should look for another unit near her. In support for her case, the Appellant submitted various receipts in respect of payments for gas, electricity and insurance. In subsequent correspondence with the Revenue, the Appellant asserted that in June 1998 she also forwarded to the Revenue photographs of her decorations in Property 1.

8. The Appellant laid considerable emphasis on the fact that Property 1 was the first flat that she ever purchased. She purchased Property 2 after selling Property 1 and she has been residing in Property 2 ever since.

Case of the Revenue

9. The Revenue produced before us various correspondence it had with various estate agents.

- (a) According to Estate Agent G, Property 1 was first in the market on 4 July 1997. It was being offered at \$4,600,000. The records maintained by Estate Agent G indicate that Property 1 was then in 'self-use'.
- (b) According to Estate Agent H, they were appointed by the Appellant to sell Property 1 on 21 July 1997 at \$4,800,000.
- (c) According to Estate Agent I, the Appellant put Property 1 for sale through their company on 30 August 1997 and the asking price was \$4,700,000. The asking price was reduced to \$4,600,000 on 6 September 1997.

10. The Revenue contends that the Appellant did not reside in Property 1. Reliance is placed on the water and electricity bills submitted by the Appellant. Between 6 August 1997 and 26 November 1997 one cubic metre of water was consumed in Property 1. As far as electricity is concerned, three units were consumed prior to 9 September 1997 whilst 67 units were consumed between 9 September 1997 and 8 October 1997.

11. The Revenue further submits that given the financial conditions of the Appellant as reflected in her tax returns, she was not in a position to sustain the purchase of Property 1 on a long term basis.

Sworn testimony of the Appellant

12. According to the sworn testimony of the Appellant:

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- (a) She was educated in England but she emigrated to Canada in the early nineties.
- (b) She returned to Hong Kong in about 1994 or 1995 and she resided in Property 3 with her mother, her brother, her sister-in-law and a servant. She did not get along with her sister-in-law. She wanted to have a flat of her own.
- (c) Property 1 was her first purchase. She deliberately selected that flat as it reflects her birthday on 29 March.
- (d) She did not expect any difficulty in funding her purchase. Her mother and her boy friend would help in case of need. After her acquisition of Property 2 in March 1998, she duly discharged monthly mortgage instalments in respect of that flat ranging between \$11,899 and \$18,590.
- (e) She took possession of Property 1 in about July 1997.
- (f) She redecorated Property 1. She re-painted it. She also purchased new closets, sofa, dining table, hi-fi, television and computer for use in that flat. She spent about a week in having all these in place. Given the passage of time, she cannot locate any receipt in support of these items.
- (g) She was then working in District J. She had long working hours and she returned home late. She also took regular business trips away from Hong Kong. She rarely cooked nor did she do her laundry in Property 1. She argued that it is unfair to test her case by reference to the water consumption of one cubic metre for the period between 6 August 1997 and 26 November 1997. She says that is not evidence on the amount of water which she consumed between July and 5 August 1997. Furthermore she moved out of Property 1 in the latter part of September 1997.
- (h) Her mother stayed with her in Property 1. No one was occupying the adjoining flats and they were concerned that the staircase abutting the window of Property 1 might pose security problems. She therefore decided to sell the flat through Estate Agent I.
- (i) She hotly disputes the accuracy of the alleged records maintained by the various estate agents. She strongly refutes the suggestion that she ever retained Estate Agents G and H for sale of Property 1.

The applicable law

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13. The intention of the Appellant at the time of acquisition of Property 1 is crucial in determining whether that flat is 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?’.

14. An intention to hold property as a capital investment must be define. 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’.

15. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the appellant.

Our decision

16. We are generally impressed by the demeanour of the Appellant as a witness. We accept that she is a witness of truth.

17. We would consider the issue raised in this appeal by reference to the ‘badges of trade’ as explained by Sir Nicolas Browne-Wilkinson in the leading case of Marson v Morton [1986] 1 WLR 1343:

- (a) Is the transaction in question a one-off transaction?: We accept that Property 1 was the first purchase ever made by the Appellant. We further accept that after disposing of Property 1, the Appellant purchased Property 2 which has since been used as her residence.

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- (b) Is the transaction in question in some way related to the trade which the Appellant otherwise carries on?: The purchase of Property 1 is unrelated to the business of Company E or Company F.
- (c) The nature of the subject matter: Property 1 was under construction at the date of purchase. We accept the Appellant's evidence that it was near her then work place in District J.
- (d) The way in which the transaction was carried through: The Appellant completed the purchase of Property 1. We are however of the view that this factor is neutral in testing her intention as her agreement with the developer prevented her from disposing of her interests prior to completion.
- (e) The source of finance of the transaction: There is no evidence before us on how the Appellant financed the initial instalments. There is also no evidence on the financial standings of the Appellant's mother and her boy friend. The monthly instalment payments in respect of Property 1 was \$16,339. We accept her evidence that she had no difficulty in discharging the monthly instalments in respect of Property 2.
- (f) Was the interest which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale?: We accept the Appellant's evidence that she effected some decoration to Property 1.
- (g) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots?: Completion of Property 1 took place on 16 July 1997. It was sold on 22 September 1997.
- (h) What was the Appellant's intention as to resale at the time of purchase?: We accept that the Appellant's choice of Property 1 by reference to her birthday is some evidence in support of her contention that the same was acquired for her personal use. Had she intended to acquire a flat for speculative purpose, the address of the flat would not be of any significance.
- (i) Did the item purchased either provide enjoyment for the purchaser or produce income pending resale?: We accept the Appellant's evidence that she did reside in Property 1. We further accept her evidence that there was a staircase which posed as a security threat and which prompted her to sell the property.

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18. Whilst we entertain some doubt on the financial position of the Appellant, we hold on a balance of probabilities that she successfully discharged her onus in demonstrating that she did not embark upon a trade in the acquisition of Property 1.
19. We allow the appeal and discharge the assessment.