

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D137/98

Profits Tax – assessable tax – sales proceeds from sale and purchase of property – capital gain – whether the sale of the property amounted to trade – section 2 and section 68(4) of the Inland Revenue Ordinance, Chapter 112.

Panel: Robert Wei Wen Nam SC (chairman), Eugene Ho and Douglas C Oxley.

Dates of hearing: 18 and 24 September 1998.

Date of decision: 22 December 1998.

On 29 October 1993, Ms A, B and C as tenants-in-common bought a flat and carparking space ('the Property') at \$4,950,000. On 28 March 1994, they sold the Property for \$8,075,000. The Property was not used to secure banking facilities during the period of ownership.

The capital profit after deducting costs was distributed in the following manner: Ms A 20%, Ms B 50% and Ms C 30%. They contended that the profit made by them on the sale of the Property was capital gain and therefore not subject to profits tax. They submitted that the Property was purchased in anticipation that the father-in-law of Ms C would move back to live in Hong Kong and the Property could be used for residential purpose for Ms C, her husband and Ms C's father-in-law. It was anticipated that Ms C's father-in-law would provide the finance for the Property. The subsequent sale of the Property was due to the sudden and untimely death of Ms C's father-in-law.

They also submitted that (1) this was just one isolated property transaction and (2) if it were meant for property speculation, they would not carry out elaborate and personal decoration to the Property.

Ms C, in particular, submitted that the reason why her husband was not named a buyer of the Property was because her husband's company has a policy of allowing their senior employee the option of buying a flat from the company's products at a special discount provided that he has no other property interests.

However, the Board found that Ms C's father-in-law had a stroke in mid-October 1993 and Ms C's husband's company does not have the said policy as alleged by Ms C.

Further, when asked why Ms A and Ms B did not simply lend the money to Ms C without adding their names to the Property, Ms A stated that that sort of thought did not enter her mind. Since the Property was such a good bargain, she would just like to take hold of it. If she put the money there, she would acquire an interest in it and control of it.

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Held:

1. The taxability or otherwise of a profit derived by a person from the sale of an asset turns on his intention at the time of its acquisition. If the intention was to dispose of it at a profit, the asset was a trading asset, and the profit is a trading profit and is taxable. If the intention was to hold it as a long-term investment, the asset was a capital asset, and the profit is a capital gain and is not taxable. At any given time, an asset is either a trading asset or a long-term investment; it cannot be both; it cannot be neither. (per Lord Wilberforce in Lionel Simmons Properties Ltd (in liquidation) and Others v IRC [1980] 53 TC 461 at 491).
2. Trade is defined in section 2 of the Inland Revenue Ordinance (the IRO) as including 'every trade and manufacture, and every adventure and concern in the nature of trade.'
3. A mere statement of intention is not decisive and has to be tested against the circumstances. The intention must be genuinely held, realistic and realisable. (per Mortimer J, in All Best Wishes Ltd v CIR [1992] 3 HKTC 750).
4. 'Intention' connotes an ability to carry it into effect. (D11/80 IRBRD, vol 1, 374 applied.).
5. In case where a property is acquired by two or more persons as tenants-in-common, the question is whether the individual intention of each co-owner and the collective intention of all the co-owners are genuinely held, realistic and realisable. (D121/95 IRBRD, vol 11, 183 applied).
6. As to taxpayers' onus of proof, section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer. To discharge that onus of proof, the taxpayers in the present case have to prove that in acquiring the Property, they intended to hold it as a long-term investment for Ms C's residential purposes.
7. Having considered the above legal principles and the evidence presented, the Board found that the taxpayers failed to discharge the onus of proving that the assessment is excessive or incorrect on the following grounds:
 - (a) Ms C lacked the ability to carry into effect a long-term investment intention. She had no funds to take up the full ownership of the Property. At the time of the acquisition of the Property, her father-in-law had had a stroke, and the prospect of a remittance to

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Hong Kong was receding, although she hoped that her father-in-law might recover and put her in funds to settle the Property's purchase cost. Her assertion of a long-term-investment intention cannot pass the test of being genuinely held, realistic and realisable.

- (b) Neither Ms A nor Ms B had any intention of taking up part-ownership of the property on a long-term basis. Their contributions totalling 90% of the purchase cost were meant to be temporary loans.
 - (c) The taxpayer as tenants-in-common therefore had no intention, whether individually or collectively, of holding the Property as a long-term investment at the time of its acquisition.
8. Further, the Board found that Ms A, Ms B and Ms C were all attracted by the Property's profitability and that they acquired the Property with the intention of selling it at a profit, subject to a mere contingency of a funding coming from Ms C's father-in-law and, upon his death, from the mother-in-law, to enable Ms C to take up 100% of the ownership.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd (in liquidation) and Others v IRC [1980] 53 TC
461
All Best Wishes Limited v CIR [1992] 3 HKTC 750
D11/80, IRBRD, vol 1, 374
D121/95, IRBRD, vol 11, 183

Wong Ki Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

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Nature of appeal

1. This is an appeal by three individuals (the Taxpayers collectively and Ms A, Ms B and Ms C, singly) against the profits tax assessment raised on them for the year of assessment 1993/94 as revised by the Commissioner of Inland Revenue in his determination dated 21 May 1998. They contend that the profit made by them on the sale of a property (the Subject Property) is capital gain and therefore not subject to profits tax.

Agreed facts

2. The following facts are agreed or not in dispute.

2.1 Ms A is the mother of Ms B the first daughter and Ms C the second daughter.

2.2 Ms B and her husband owned the following properties which were used by them as their residence during the periods of ownership:

Location	Purchase	Sale
A flat and carparking space in Building D, District E	Date: 8-4-1992 Price: \$4,650,000	Date: 26-8-1993 Price: \$7,200,000
A flat and carparking space in District E	Date: 8-11-1993 Price: \$8,180,000	Date: 18-12-1996 Price: 14,900,000

2.3 On 29 October 1993, the Taxpayers, as tenants-in-common each having a one third undivided share, bought a flat and carparking space in Building D, District E (the Subject Property) at \$4,950,000. The property was assigned to them on 23 November 1993. It has an area of 1,650 square feet with four bedrooms.

2.4 On 28 March 1994, the Taxpayers sold the Subject Property for \$8,075,000.

2.5 The Subject Property was not used to secure banking facilities during the period of ownership.

2.6 By a letter dated 22 November 1994, Ms A answered the assessor's query concerning the purchase and sale of the Subject Property as follows:

'[the Subject Property] was originally planned for my daughter Ms C for residential purposes. She needed a bigger premises to house her parents-in-law, who aimed to come back to Hong Kong to live together

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after they obtained their citizenship in Country G. My daughter's father-in-law Mr F promised to remit funds to finance the purchase. The property was bought upon the recommendation of a good friend of my other daughter Ms B working in a real estate agency. The overall condition of the property was pretty poor and needed repair and renovation, but the vendor was willing to sell at a bargain price on the requisite condition, instant deposit and early completion. The decision had to be a quick one. Unfortunately, my daughter Ms C had not got funds immediately available. My other daughter Ms B, who works in a bank, was called in for help, hoping she can get easier finance from her work as well as myself to back her up. That was why the property was acquired in three persons' names. Myself and two daughters then signed in the preliminary sale and purchase agreement provided by the real estate agency. There could be a last minute deletion of my name and my other daughter Ms B's name when the formal agreement was signed. Accident did occur. Ms C's father-in-law suddenly had a stroke. He eventually died in Country G on 14 December 1993. Ms C could no longer buy the property in her own right. The property was therefore stuck in three persons' hands. I, as the mother, was the main financier. As it was not my intention to buy that property, the property had to be disposed of. That was the reason for sale. As the property was in a poor condition, it badly needed repair and renovation before it was marketable. By the time the renovation work was done, the Hong Kong property market suddenly boomed. We were able to sell at a capital gain. This is just an isolated transaction arising to capital profit, and should not constitute a business subject to taxation.'

- 2.7 The Taxpayers computed the profit made from the Subject Property as follows:

Selling price	\$8,075,000
	<u>4,950,000</u>
	\$3,125,000
<u>Less:</u>	
Costs and expenses	<u>647,309</u>
Net profit	<u>\$2,477,691</u>

- 2.8 The assessor did not accept the explanations contained in the letter dated 22 November 1994 and raised on the Taxpayers the following profits tax assessment for the years of assessment 1993/94:

Profits tax computation	\$2,477,691
<u>Add: Maid's wages</u>	<u>20,000</u>
Assessable profits	<u>\$2,497,691</u>
Tax payable thereon	<u>\$251,017</u>

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2.9 The Taxpayers objected to the assessment on the ground that the profit from the sale of the Subject Property was capital in nature and should not be assessed to profits tax. It was said that they did not have a history of profit transactions except that husband and wife team bought property for own use and changed it for a better one.

2.10 By a letter 24 January 1997, the Taxpayers made the following statements in response to further enquiries:

‘The intended usage of [the Subject Property] was for residence by Ms C with her husband, [her] son and also parents-in-law. The original provisional agreement for purchase was signed by Ms C only. The names of Ms A and Ms B were added later. The reason for this sudden addition of names was after signing of the purchase agreement accident occurred. She received telephone call from Country G that her father-in-law had a stroke and was admitted to hospital. The original idea of buying a bigger property at [the Subject Property] was to house Ms C’s family plus her in-laws who were ready to come back from Country G to settle down in Hong Kong. The property [was] meant to be financed by her father-in-law. This unexpected happening upset the deal. Our names were added to help to solve the financial problem. Ms B, the sister who worked in the bank, with her inclusion, we could get better finance from the bank, and of course with the inclusion of the name of the mother who is the main financial back up. The completion of the purchase could be finalised. The purchase was financed by Ms A the mother using her own resources and also bank facility. In the meantime, renovation and repair work (the property was in a bad shape) had to be done to get the flat ready for occupation. We thought that the loan was just a temporary one, hoping that Ms C’s father-in-law in Country G would recover and remit the funds to settle the whole property purchase. But things turned otherwise, Ms C’s father-in-law passed away in Country G on 14 December 1993. That ended in us three persons as the co-owners of the property concerned. That was the reason for selling the property as it was not the intention of the second and third parties to own the flat in the first instance. It was originally a genuine home bought for Ms C and her family; she chose the site, because she wanted to be neighbour with her sister Ms B who was living at [Building D]. Circumstances made us sell the flat and the profit derived from it is capital profit and would not be subject to profits tax.’

2.11 In response to further enquiries, the Taxpayers stated the following in their letter dated 10 March 1997:

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- (a) Reasons why Mr H, Ms C's husband, was not named a buyer of the Subject Property

“Mr H works in a big property development company – Company I. Company I has the policy of allowing their senior employee the option of buying a flat from the company's products at a special discount provided he has no other property interests. [Mr H] reserved his right and waits for the right opportunity to buy a flat from his own employer when the right product arrives.’

- (b) Sources of finance to purchase the Subject Property

‘The purchase was financed by Ms C (10%). Source of funds from personal savings of herself and husband, both working. Ms B (5%). 85% from Ms A, who is a housewife and has a portfolio of listed securities over the value of \$30,000,000. Her husband is a director of a large firm and has an annual income from the firm of \$5,000,000.’

- (c) Distribution of the profit from the sale of the Subject Property

‘The capital profit after deducting costs was distributed in the following manner:

Ms A	20%
Ms B	50%
Ms C	30%’

- 2.12 In reply to the assessor's further queries, the Taxpayers made, inter alia, the following statements in their letter dated 15 January 1998:

‘Whilst we claimed that it was a desirable preference that the sisters should choose to live near each other, the most decisive factor of Ms C buying the property in question was that the property was at bargain price. It was always the intention of Ms C's parents-in-law to buy back a flat in Hong Kong after they sold their own property in Hong Kong when they migrated to Country G and they found that property in Hong Kong was getting more and more expensive. They told their daughter-in-law to be alert to watch out to find a reasonable bargain flat large enough to house themselves together with their son's young family. The fact was Ms C's sister Ms B, while living at Building D, found out that her neighbour was urgently in need of money and wanted a quick sale of their home. The property was sold at a discount to then current market price. It worked out at \$3,000 per square foot. The explained why the property was bought by Ms C so quickly to avoid change of mind of the vendor. Please bear in mind the fact that the

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property at Building D was an additional property purchased with funds meant to be financed wholly by Mr F [the father-in-law] whose untimely death disrupted the whole picture as explained in our last letter. After his death, his money became his deceased estate. Mr F had three other children and there was more complication in dealing with money matters. The sale of the Subject Property became inevitable coupled with the fact that Mrs F considered it was bad 'fung shui'.

When Ms B sold her home in Building D, she planned to lease back this property to live in. The parties involved had a plan of swapping places to live to meet each other's needs and convenience, but somehow more technical problems emerged and this plan had to be dropped eventually.'

- 2.13 By his determination dated 21 May 1998, the Commissioner of Inland Revenue revised the profits tax assessment for the year of assessment 1993/94 as follows, adopting the assessor's view that it should be so revised:

Profits already assessed	\$2,497,691
<u>Less: Air conditioners</u>	<u>15,000</u>
	<u>\$2,482,691</u>
Tax payable thereon	<u>\$372,403</u>

- 2.14 In answer to the assessor's enquiries, Ms C made, inter alia, the following statements in her letter dated 24 August 1998:

- '1. Mrs F is at present in Country G, I am therefore unable to supply you with the required information until she comes back, her tentative date of return being mid-October 1998.
2. Mr H acquired his citizenship in Country J on 10 December 1986...
3. Mr F died in Country G. Only his widow had a clear picture of her late husband's financial situation (Hong Kong and overseas account). As Mrs F is not in Hong Kong at present, from long distance enquiry, it is learnt that Mrs F is reluctant to supply such information. She regards such disclosure as an intrusion into the privacy of the family affairs. Based on my personal understanding, most of the accounts of Mr F are in joint names with Mrs F; that could be the reason why she is not willing to supply the information.'

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- 2.15 In answer to the assessor's enquiries, inter alia, as to whether Mr H was entitled to acquire a flat in any Company I's development at a discount, Company I stated the following in its letter dated 7 September 1998:

'There is no group policy on offering discount to our staff for purchase of properties. However, our staff are, of course, not prohibited from purchasing properties developed by us. We hereby confirm that no staff has any entitlement or right to purchase properties at a discount.'

Grounds of appeal

3. By a letter dated 19 June 1998 (the Appeal Letter), the Taxpayers gave notice of appeal and stated the following grounds of appeal:

- 3.1 'The Subject Property was bought genuinely for own use right from the start by Ms C'
- 3.1.1 Ms C's parents-in-law immigrated to Country G in early 1992. They sold their residential property when leaving Hong Kong. After migrating to Country G, they found that they were not adapted to foreign living. They contemplated to return to Hong Kong after they got their citizenship in 1994.'
- 3.1.2 'Property market had gone up a lot since Mr F left. He gave ideas to his son and daughter-in-law to look for a flat which offered a good bargain. He was willing to buy the property with his own money. Being in old age, he suggested the property should be bought not in his name but either in the name of his son or of his daughter-in-law. He preferred to use his daughter-in-law's name rather than his son. As his son is a citizen of Country J, he did not like to involve him in Country J's world wide tax.'
- 3.1.3 'The provisional purchase and sale agreement was first signed by Ms C alone at night time in October 1993.'
- 3.1.4 'The names of mother Ms A and sister Ms B were added later with verbal agreement that the additional names would be deleted when the formal purchase and sale agreement was signed later. Since the addition of names in the provisional agreement produced by the real estate agent needed a lot of initialling and alteration and looked very messy, a fresh provisional purchase and sale agreement was signed again, which was the one submitted. We did not have the copy ourselves. The date was 29 October 1993. The addition of the names of mother and sister was meant to be a temporary one.'

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Legislation was trying to straighten up then. It normally did not allow alteration and addition of names. We were able to do so thanks to the help of the real estate agent who is a close friend of Ms B. The inclusion of names of family members could be passed. Reasons for the sudden inclusion of the two names were explained [in paragraph 2.10 above].

- 3.1.5 'No business venture has ever been contemplated. If the purchase of the property was meant for business in the first instance, we should not take the trouble of adding names and signing another agreement causing a lot of negotiation and inconvenience with the real estate agent.'
- 3.1.6 'The driving reason for Ms C to buy the Subject Property was it was a real bargain... Reason for such bargain was that owner needed cash urgently. Ms B was lucky to be her neighbour to have the first information. Ms B was alert. She knew that the price the owner asked for was within the price budget that her sister's father-in-law could afford to buy. She arranged her real estate friend to prepare the preliminary purchase and sale agreement and get Ms C and the owner to sign it that very evening. She wanted it binding before the owner changed his mind.'
- 3.1.7 'No history of property dealing. This is just one isolated property transaction.'
- 3.2 By the Appeal Letter, and by way of a further reply against the determination of the Commissioner of Inland Revenue, the Taxpayers took certain points including the following:
 - 3.2.1 'The very fact that the property was able to be sold for a substantial profit after renovation proved that the property was a real bargain at the time of purchase.'
 - 3.2.2 'The renovation included change of aluminium windows, partition of additional rooms, carpeting, new curtains, new air-conditioning, fire-place, etc. It was designed for own use. If it were meant for property speculation, no such elaborate decoration would be needed. Money spent would be a waste, as different owner will have different taste.'
 - 3.2.3 'The property could not be assigned to Ms C the intended buyer alone because Ms C could not get funds from her father-in-law, which was tied up in the estate. The other joint-owners were reluctant owners.'

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- 3.2.4 ‘During the course of revocation, there was still hope that Mrs F would be able to release her own resources to finance the Subject Property. After the initial months of mourning, the widow still could not recover from her bereavement. She hung on to her own money and refused to help. Being superstitious, she considered the Subject Property as bad “fung shui”. Though Ms C spent a lot of time and energy to decorate the flat to her own liking and design, she had to give it up. The additional gift from her father-in-law never materialised. She had no funds to take up the full share of the property. The sale of the property was inevitable.’
- 3.2.5 ‘There was no need for long-term finance. The property could be funded wholly by the late Mr F. His untimely death disrupted the whole case. The funding which came from Ms A’s resources was meant to be a temporary one. She had no intention of taking up part ownership of the property.’
- 3.2.6 ‘Since the property was stuck to two unwilling owners its early disposal was a relief to all parties concerned. It just happened that we were lucky to catch a bull market. Should the market turned otherwise, we had to dispose of it even at a loss.’
- 3.2.7 ‘Whilst it was the full intention of Ms C to use the property as residence for her family, she could not for reasons already explained and the fact that she was only a part owner move in to live.’
- 3.2.8 ‘Ms C did need a bigger flat to house the additional members of the family. The Subject Property was ideal for her to keep and not for sale, if she could have enough funds to keep it. The sale of the flat was not because of the death of a family member but because of lack of funds.’

Hearing, parties and witnesses

4. At the hearing of this appeal, the First Taxpayer appeared in person and the Second and Third Taxpayers appeared by their authorised representative the First Taxpayer, whilst the Commissioner of Inland Revenue was represented by Miss Wong Ki-fong, assessor. The First Taxpayer gave evidence for the Taxpayers. No other witness was called.

Testimony of the First Taxpayer

5. The First Taxpayer’s testimony is to the following effect.

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In Chief

- 5.1 Subject Property was for Ms C's own use right from the start. No intention to trade at time of acquisition. Reasons for subsequent disposal already given in Appeal Letter dated 19 June 1998.
- 5.2 Subject Property was not done up for a quick sale. It was done up in detail according to the needs of Ms C and her family members. She spent a lot of time and energy supervising the renovation. It was quite personal. Marble laid entrance. Fireplace in sitting room. She chose colour of paint for the bedrooms with matching carpets and curtains to suit each individual member of the family (including a three-year-old son and the-in-laws coming). She chose special wallpaper for her son's room. The First Taxpayer saw all this happening. Ms C turned part of the utility room into a room for the Filipino maid and had a bunker bed fitted. Ms C designed a unique functional kitchen for the mother-in-law who is a good cook. She even arranged for the 'fung shui' man to view the flat, the position of the stove, the beds, etc. She really wanted to decorate the flat into a warm home to welcome the return of the mother-in-law who had just lost her husband. Had it been trading stock, no such detailed and elaborate renovation would have been needed. Different people have different tastes. The purchaser of the flat had the carpets removed because his son was allergic to carpets.
- 5.3 It was really a misfortunate that Mr F suddenly died. First he had a stroke. Immediately he was sent to hospital. He never recovered. He was in Country G. During his illness he could not communicate with anybody. The First Taxpayer has no idea what the late Mr F's estate is like.
- 5.4 Ms C still had high hopes that her mother-in-law could release money of her own to let Ms C take up the 100% ownership of the property. This was after the death of the father-in-law and that was why the decoration continued.
- 5.5 As to why Ms C had such high hopes, in the circumstances, if the mother-in-law had the money, it was only fair that she should release it. The mother-in-law would not be called as a witness. She was quite unsettled, that sort of thing.
- 5.6 To Ms C's surprise, the mother-in-law changed her personality completely after her husband died. She felt very insecure and hung on the her money.

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- 5.7 The First Taxpayer had financial resources, and could trade if she had wanted to. Her husband had a handsome annual income of \$3,000,000. Neither of them took any interest in property trading. The Subject Property was bought for self-occupation and not for trade.
- 5.8 They had not got the provisional agreement signed by Ms C alone. They could not locate the lady of the real estate firm to get her to testify that the first provisional agreement was signed by Ms C alone.
- 5.9 If trading was intended, why bother to have two or three persons? Why not let Ms C have the property at the time and sell it?

In corss-examination

- 5.10 The late Mr F had a property in District K. He sold it before his emigration to Country G. The First Taxpayer does not know for how much it was sold. She does not know whether the mother-in-law owned any properties in Hong Kong. Mr and Mrs F emigrated to Country G together in 1992. Mr H (Ms C's husband) has two sisters who live in Hong Kong and a brother who is in Country J.
- 5.11 The late Mr F had a stroke in mid-October 1993. He was hospitalised. The First Taxpayer does not have any documentary evidence of his hospitalisation. His health condition had been very good but deteriorated after the stroke. H died on 14 December 1993. She does not know whether he made a will, nor who was the personal representative of his estate, nor anything about his assets or liabilities, nor how much Mr H or Ms C inherited from his estate.
- 5.12 She thinks that, when Mr and Mrs F left for Country G, or when he sold his property, they gave some money to Mr H. She does not know how much. She does not know how the estate of the late Mr F was distributed.
- 5.13 The vendor sold the Subject Property because apparently they needed cash. A very good bargain because the owner was anxious to sell. Ms C was too glad to take it because it was really a bargain. And it was within the price bracket his father-in-law was willing to pay. It only took one or two days before Ms C signed the provisional agreement. Three days later the First Taxpayer and Ms B signed the second provisional agreement.
- 5.14 Ms C informed her father-in-law about the commitment to buy a property and the location, the size and the price.

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- 5.15 When asked what did the old man say, the First Taxpayer stated that ‘Because probably, I didn’t go into details... I don’t bother to go into details.’
- 5.16 Ms C informed her father-in-law about the commitment, she thinks, right after Ms C signed the first sale and purchase agreement but before he had had the stroke, which happened one or two days later. The mother-in-law said on the phone that he was hospitalised.
- 5.17 It was suggested to the First Taxpayer that Ms C had not secured the father-in-law’s promise to purchase the Subject Property before she signed the provisional agreement in 1993. The first Taxpayer stated that ‘Ms C got the “signal” all the time, because within this sort of price bracket, if she can find a suitable one, she just buy one, so by the time she committed it then she just got the property and have signed it.’ She had got his approval to buy; he must have the funds to buy it.
- 5.18 The First taxpayer was referred to the following words in the Taxpayer’ letter dated 15 January 1998 (see paragraph 2.12 above): ‘After his death, his money became his deceased estate. Mr F had three other children and there was more complication in dealing with money matters.’ Ms Wong suggested that there had never been any commitment or even common understanding that the father-in-law would make a gift of \$4,900,000 to Ms C. The First Taxpayer stated that she had no idea. She did not know how big his estate was or how good his relations were with the three other children, but, as far as she knew, he was counting the sons only. The daughters did not have much significance.
- 5.19 The First Taxpayer was referred to the statement that ‘Based on my personal understanding, most of the accounts of Mr F are in joint names with Mrs F’ in Ms C’s letter dated 24 August 1998 (see paragraph 2.14 above). It was suggested to the First Taxpayer that the mother-in-law did not agree that the late Mr F should use \$4,900,000 of their money to acquire the Subject Property in Ms C’s names. The First Taxpayer stated that Ms C told her that she had got approval from her father-in-law to buy a property large enough to house two families and they were to live there for the rest of their lives.
- 5.20 Ms C had an inspection of the Subject Property before she signed the provisional agreement. Neither the First Taxpayer nor her daughters consulted any professionals other than the property agents before the provisional agreement was signed.
- 5.21 The First Taxpayer was referred to the statement that ‘during the months of renovation, there was still hope that Mrs F would be able to

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release her own resources to finance the Subject Property' in the Appeal Letter (see paragraph 3.2.4 above). It was suggested to the First Taxpayer that the word 'hope' shows that there was no commitment to make the gift. The First Taxpayer stated that of course the widow had no commitment to the deal, because the commitment was made by her husband, so it was really perfectly fair for the widow to handle her money in her own way. Mrs F did not give any promise. She knew the promise that her husband made. It was just the First Taxpayer's own thinking that maybe Mrs F could contribute one or two million.

- 5.22 The First Taxpayer was reminded of her statement to the effect that Mr H could buy a property from Company I for self-occupation at a discount but it would be only once (see paragraph 2.11(a) above). She was asked if she had any documentary evidence to that effect. The First Taxpayer said no, and that Mr H told her that Company I do not make any hard and fast rules about this.
- 5.23 The First Taxpayer was shown the letter from Mr H's employer (see paragraph 2.15 above). She agreed that Mr H's employer denied that there was such an entitlement. She stated that there was such a rule, but she thinks every company changes rules now.
- 5.24 At the beginning of the second hearing, the First Taxpayer stated that she had made a mistake about the date when Mr and Mrs F emigrated to Country G. It should be 9 July 1990 and not 1992.
- 5.25 The First Taxpayer produced a chronology of events prepared by herself.
- 5.26 The late Mr F died intestate.
- 5.27 The First Taxpayer was referred to the date 'mid-1993' in the chronology where the recorded event was that 'Father-in-law asked Ms C and husband to start looking for a flat (in the region of \$5,000,000 for the intended return'. The First Taxpayer agreed that this was the first time she had mentioned the specific price tag of \$5,000,000. What she had mentioned before was that he asked Ms C to look for a flat 'when the price was right'. Surely he had given a budget to his son and in-law. The budget was about \$5,000,000. Ms C told her all this.
- 5.28 As to why the Subject Property was acquired with her and Ms B as tenants-in-common, it was because there were financial problems as a result of the father-in-law's stroke. The First Taxpayer's husband did not join in because he had business trips to take and was not readily available.

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- 5.29 When Ms C was stuck with the property, the obvious thing would be for the First Taxpayer to suggest that the First Taxpayer should take over the property herself. But the real estate agent said ‘no way’, because that would be a change of person completely. Then it was suggested that maybe just adding the names of family members would be acceptable to the vendor. So that was how the arrangement was worked out. In case even her funds were not readily available, she could obtain a loan from the bank, so it was always advantageous to have a banker. That is why Ms B’s name was added.
- 5.30 The First Taxpayer contributed 85% of the purchase cost. The contribution was meant to be a temporary one.
- 5.31 When asked why she and Ms B did not simply lend the money to Ms C without adding their names to the Subject Property, the First Taxpayer stated that that sort of thought did not enter her mind. Since the property was such a good bargain, she just liked to take hold of it. But, as she had said, this was not possible. If she put the money there, she would acquire an interest in it and control of it.
- 5.32 Ms C still had hopes that the mother-in-law could help. The mother-in-law did not make any promise to remit money.
- 5.33 No ‘fung shui’ master was engaged to do an assessment of the Subject Property before the purchase. They only had the ‘fung shui’ man come after they had bought it.
- 5.34 As to why Ms C did not move into the Subject property to live, the first reason is that she was only just a one-third owner; then her mother-in-law said that the property had bad ‘fung shui’; and third reason was the Ms C was pregnant. According to Chinese custom, pregnant women are not supposed to moved house. The financial problem could not be solved. How could she move in?

The Law

6. The following legal principles and propositions are applied in this case:
- 6.1 The taxability or otherwise of a profit derived by a person from the sale of an asset turns on his intention at the time of its acquisition. If the intention was to dispose of it at a profit, the asset was a trading asset, and the profit is a trading profit and is taxable. If the intention was to hold it as a long-term investment, the asset was a capital asset, and the profit is a capital gain and is not taxable. At any given time, an asset is either a trading asset or a long-term investment; it cannot be both; it cannot be neither. *‘Trading requires an intention to trade; normally*

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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? (per Lord Wilberforce in Lionel Simmons Properties Ltd (in liquidation) and Others v IRC [1980] 53 TC 461 at 491)

6.2 Trade is defined in section 2 of the Inland revenue Ordinance (the IRO) as including ‘*every trade and manufacture, and every adventure and concern in the nature of trade*’.

6.3 A mere statement of intention is not decisive and has to be tested against the circumstances. The intention must be genuinely held, realistic and realisable. In All Best Wishes Ltd v CIR [1992] 3 HKTC 750, Mortimer J, as he then was, said at page 771:

‘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 one 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.’

6.4 ‘Intention’ connotes an ability to carry it into effect. The Board in D11/80, IRBRD, vol 1, 374 states at 379:

“‘Intention” connotes an ability to carry it into effect. It is idle to speak of “intention” if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented.’

6.5 In case where a property is acquired by two or more persons as tenants-in-common, the question is whether the individual intention of each co-owner and the collective intention of all the co-owners are genuinely held, realistic and realisable. The Board in D121/95, IRBRD, vol 11, 183 states at 189:

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'This being a case of co-ownership, the intention and the ability to carry it into effect must be proved in respect of each co-owner individually and in respect of all the co-owners collectively.'

- 6.6 As to taxpayer's onus of proof, section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer. To discharge that onus of proof, the Taxpayers in the present case have to prove that, in acquiring the Subject Property, they intended to hold it as a long-term investment for Ms C's residential purposes.

Findings and reasons

7. It is the Taxpayers' case that originally the Subject Property was to be purchased by Ms C as a long-term investment for her own use as a family residence. Shortly afterwards, with the consent of the vendor, the Taxpayers, Ms A, Ms B and Ms C, as tenants-in-common, took over from Ms C as purchaser. Briefly, the story is as follows.

- 7.1 Mr and Mrs F, Ms C's parents-in-law, had emigrated to Country G in July 1990, but they could not adapt themselves to the new surroundings there, and were contemplating returning to Hong Kong to live with Mr H and Ms C after they had acquired citizenship in Country G.
- 7.2 In the meantime, property prices in Hong Kong had gone up. In mid-1993, Mr F asked Mr H and Ms C to start looking for a flat which offered a good bargain. Mr F was willing to pay for the flat. Being advanced in years, Mr F suggested that the property should not be purchased in his name, but in the name of Mr H or of Ms C. Mr F preferred to use Ms C's name, because, Mr H being a of Country G, Mr F did not like to involve him in Country G's world-wide tax (see paragraph 3.1.2 above).
- 7.3 Ms C's sister Ms B, while living at Building D, found out that her neighbour, he then owner of the Subject Property, was in urgent need of money and wanted a quick sale of it. It was bought by Ms C quickly to avoid a change of mind on the part of the vendor (see paragraph 2.12 above). Ms C was glad to take it because it was a real bargain and it was within the price bracket of her father-in-law. It only took one or two days before Ms C signed the provisional agreement (see paragraph 5.13 above). That was on about 16 October 1993.
- 7.4 Immediately after signing the provisional agreement, Ms C informed Mr F about the commitment to buy the Subject Property and the location, the size and the price.

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- 7.5 On about 18 October 1993, Mr F suffered a stroke in Country G (see paragraph 5.16 above). He was unable to communicate and died on 14 December 1993.
- 7.6 In the meantime, the Taxpayers tried to find a solution to the problem of financing the purchase of the Subject Property, as Mr F was unable to act. It was suggested to the real estate agent that the First Taxpayer should take over the property herself, whereupon the real estate agent objected as it would amount to a change of party completely. In the end, the three-party tenancy-in-common arrangement was worked out. Ms B's name was added because her connections with the bank might be useful (see paragraph 5.29 above). It never occurred to the First Taxpayer that she and Ms B could simply have lent the money to Ms C without adding their names to the Subject Property. As the property was such a good bargain, the First Taxpayer would have liked to take it, but that was not possible. If she put the money there, she would acquire an interest in it and control of it (see paragraph 5.31 above).
- 7.7 On 21 October 1993, the Taxpayers as tenants-in-common signed a new provisional sale and purchase agreement. This was followed by a formal sale and purchase agreement which they signed as tenants-in-common on 29 October 1993. On 23 November 1993, the Subject Property was assigned to the Taxpayers as tenants-in-common in equal undivided shares and the purchase was completed.
- 7.8 Ms A the First Taxpayer contributed 85% of the cost of purchase and Ms B the second Taxpayer 5%, while Ms C the third Taxpayer paid 10%. Ms A and Ms B's contributions were meant to be temporary ones as it was hoped in the first instance that Ms C's father-in-law would recover and remit funds from Country G to settle the Subject Property's purchase cost (see Paragraph 2.10 above). Upon the father-in-law's death, it was hoped that Mrs F the mother-in-law could release funds of her own to let Ms C take up 100% ownership of the property (see paragraph 5.4 above), even though she did not give any promise to do so (see paragraph 5.21 above). That hope did not materialise because Mrs F felt very insecure and clung to her money (see paragraph 5.6 above).
- 7.9 Ms A and Ms B had no intention of taking up part ownership of the property (see paragraphs 2.10 and 3.2.5 above) and became reluctant owners (see paragraph 3.2.3 above).
- 7.10 Ms C had no funds to take up full ownership of the property. The sale of the property was inevitable (see paragraph 3.2.4 above). It was sold on 28 March 1994 at a gross profit of \$3,125,000 (see paragraph 2.7 above).

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8. The onus is on the Taxpayers to prove that, in acquiring the Subject Property, they intended to hold it as a long-term investment for Ms C's residential purposes (see paragraphs 6.1 and 6.6 above), that it was therefore a capital asset and that the profit on its disposal is capital gain and is not assessable to profits tax.

9. This being a case of co-ownership by tenants-in-common, the long-term-investment intention and the ability to carry it into effect must be proved in respect of each Taxpayer individually and in respect of all three Taxpayers collectively (see paragraph 6.5 above). Having considered the facts, circumstances and evidence, we find as follows.

9.1 Ms C lacked the ability to carry into effect a long-term investment intention. She had no funds to take up the full ownership of the Subject Property. At the time of the acquisition of the Subject Property, her father-in-law had had a stroke, and the prospect of a remittance from Country G was receding, although she hoped that her father-in-law might recover and put her in funds to settle the Subject Property's purchase cost. Upon the father-in-law's death, she hoped that Mrs F the mother-in-law might release funds of her own to help Ms C take up 100% ownership of the property. That hope also failed to materialise because Mrs F felt very insecure and hung on to her money (see paragraph 7.8 above). Thus Ms C lacked the means to own and hold the whole property on a long-term basis. Her assertion of a long-term-investment intention cannot pass the test of being genuinely held, realistic and realisable (see paragraph 6.3 above).

9.2 Neither Ms A nor Ms B had any intention of taking up part-ownership of the property on a long-term basis. Their contributions totalling 90% of the purchase cost were meant to be temporary loans (see paragraphs 7.8 and 7.9 above).

9.3 the Taxpayers as tenants-in-common therefore had no intention, whether individually or collectively, of holding the Subject Property as a long-term investment at the time of its acquisition.

9.4 The Taxpayers have therefore failed to discharge their onus of proving that the assessment under appeal is incorrect (see paragraph 6.6 above).

10. That is sufficient to dispose of this appeal, but we shall further find as follows.

10.1 Ms C was very pleased to purchase the Subject Property because it was a real bargain (see paragraph 5.13 above). Ms A was also attracted by the bargain factor and would have liked to 'take hold of it'. She thought that, if she put the money there, she would acquire an interest in it and control of it (see paragraph 5.31 above). We find that that is why Ms A

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and Ms B did not simply lend the money to Ms C without adding their names as tenants-in-common. We find that Ms A, Ms B and Ms C were all attracted by the Subject Property's potential profitability. It is against this background that the Taxpayers took the Subject Property as tenants-in-common. Ms A and Ms B had no intention of taking up part-ownership of the property on a long-term basis. The purchase price was paid mostly with Ms A's money, which or part of which was meant to be a temporary loan (see paragraph 5.30 above). We find that the Taxpayers acquired the Subject Property with the intention of selling it at a profit, subject to a mere contingency of a funding coming from Ms C's father-in-law and, upon his death, from the mother-in-law, to enable Ms C to take up 100% of the ownership.

- 10.2 The contingency never materialised. The Taxpayers' intention to sell the Subject Property at a profit was never displaced. The Subject Property was a trading asset at the time of its acquisition, and remained so until it was sold. The profit arising from the sale is a trading profit and as such is assessable to profits tax (see paragraph 6.1 above).

Decision

11. It follows therefore that this appeal is dismissed and that the assessment under appeal is hereby confirmed.