

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D137/99

Profits Tax – whether gain on sale of property capital or trade in nature.

Panel: Robert Wei Wen Nam SC (chairman), Edward Chow Kam Wah and David Lam Tai Wai.

Date of hearing: 13 July 1999.

Date of decision: 9 March 2000.

At all relevant times, the taxpayer was a senior staff of the Hong Kong Government and resided in government quarters.

On 17 July 1993, the taxpayer entered into a memorandum for sale to purchase a flat (the Subject Property) at \$4,022,000. On 17 March 1994, the taxpayers sold the Subject Property for \$5,150,000.

In response to an enquiry raised by the assessor, the taxpayer claimed the Subject Property was intended to be used as her residence. It was sold because of the traffic condition and the family decided to find another more suitable and convenient location. The assessor was of the view that the profits from the sale of the Subject Property was trading profits and should be assessable to profits tax.

Held :

1. The question to be asked is whether the asset was acquired with the intention of disposing of it at a profit, or acquired as a permanent investment. If the former, the asset is trading stock, and profits on resale is assessable to profits tax. If the latter is capital asset and profits on sale is not assessable to profits tax (Simmons v IRC followed). An intention to invest must be shown to be genuinely held, realistic and realisable (All Best Wishes Limited v CIR followed).
2. The Board found that the lack of inquiries about the traffic condition and the lack of concern about their daughter's schooling was inconsistent with the existence of an intention to hold the Subject Property on a long-term basis as their residence. On the contrary, they are clearly indicative of an intention to acquire the property for trading purposes.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Appeal dismissed.

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR 3 HKTC 750

Doris Lee for the Commissioner of Inland Revenue.
Taxpayer represented by her husband.

Decision:

Nature of this appeal

1. This is an appeal by the Taxpayer against the profits tax assessment raised on her for the year of assessment 1994/95. She claims that the profit derived by her from the sale of a property should not be subject to profits tax.
2. At all relevant times, the Taxpayer was a senior staff of the Hong Kong Government and resided in government quarters. Prior to about 9 July 1993 the Taxpayer and her family had resided in a flat in District A (Quarters 1). On 29 June 1993, she applied for a change of quarters and approval was given to her to move to a flat in District B (Quarters 2) on 9 July 1993.
3. Quarters 1 has a gross area of 1,755 square feet whereas Quarters 2 has a gross area of 1,735 square feet.
4. On 17 July 1993, the Taxpayer entered into a memorandum for sale to purchase a flat in District C of the New Territories (the Subject Property) at \$4,022,000. The Subject Property has a gross area of 998 square feet and was still under construction at the time of the agreement.
5. On 17 March 1994, the Taxpayer, in the capacity of a confirmor, sold the Subject Property for \$5,150,000. The sale was completed on 16 February 1995.
6. In response to an enquiry raised by the assessor, the Taxpayer claimed that the Subject Property was intended to be used as her residence. The property was sold because she was concerned about the traffic conditions around District C, and the family decided to find another more suitable and convenient location. She claimed that the profit from the sale of the Subject Property was a capital gain and should not be subject to profits tax.

INLAND REVENUE BOARD OF REVIEW DECISIONS

7. The assessor was of the view that the profit from the sale of the Subject Property was trading profit and should be assessable to profits tax. The assessor raised on the Taxpayer an estimated profits tax assessment for the year of assessment 1994/95 as follows:

Assessable profits	<u>\$950,000</u>
Tax payable thereon	<u>\$142,500</u>

8. The Taxpayer objected to the assessment. She claimed that the Subject Property was for long-term investment. She explained the reason for selling the Subject Property in the following terms:

‘ I had viewed the show flat, it had good size and view. However, the traffic condition in District D, District E and District C were getting worse since 1994 with a number of major traffic accidents. The traffic condition made me to (sic) believe that the flat was no longer a good long term investment.’

9. The Taxpayer stated that:

(a) She had incurred \$130,275 in total on legal fees and agency fee in the transaction.

(b) Her daughter, born on 28 April 1989, studied at:

Kindergarten 1	September 1992 to June 1993
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Kindergarten 2	September 1993 to June 1995
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Primary School 1	Since September 1995
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10. The Taxpayer further claimed that:

(a) The reason for the purchase of the Subject Property was that she was residing in quarters and both she and her husband did not own any property. As the property price was going up, they felt that it was time for them to preserve their buying power by acquiring a long term investment before it was too late.

(b) Her brother was living in District F of the New Territories. The Subject Property would allow the two families to maintain closer contact.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (c) She was able to finance the purchase of the Subject Property as she was entitled to the Government Home Financing Scheme.
- (d) Although the traffic problems in District C were not new, on a few occasions in mid to late 1993, the traffic in the area was in a complete standstill caused by landslide, rainstorm and cargo containers.
- (e) Her younger brother was residing some distance north of the Subject Property. It took him two to three hours every single journey to reach his office in Kowloon.
- (f) The Taxpayer then considered that the Subject Property was not right for her as she was working in the Government and it was a policy of her department to post officers to different district offices every six to twelve months. It was important for her not to get trapped in serious traffic jams.
- (g) She did not buy another property immediately after the disposal of the Subject Property as buying a property was a substantial investment.
- (h) She should not be treated as a property trader as her last acquisition of property was made some eight to ten years ago. One single transaction in ten years should not amount to trading.

11. The assessor has ascertained that the Taxpayer had not applied for joining the Government Home Financing Scheme in 1993 and 1994. The Scheme assists an eligible civil servant to purchase a property as residence. A civil servant who has been provided with quarters has to forfeit the quarters benefit on joining the Scheme.

12. The assessor considers that the profits tax assessment for the year of assessment 1994/95 should be revised as follows:

	\$
Selling price	5,150,000
<u>Less: Purchase price</u>	4,022,000
Expenses	<u>130,275</u>
Revised assessable profits	<u>997,725</u>
Tax payable thereon	<u>149,658</u>

13. On 5 February 1999, the Commissioner of Inland Revenue determined the objection against the Taxpayer and revised the assessment in question as per paragraph 12 above.

INLAND REVENUE BOARD OF REVIEW DECISIONS

The grounds of appeal

14. The Taxpayer's grounds of appeal may be summarised as follows:

14.1 The decision to sell the property was prompted not by the bad traffic conditions, but more accurately by the deteriorating traffic conditions in the area. Her husband has all along been working in the Kowloon district. Her daughter was only in kindergarten. She did not foresee any problem in enrolling her in a school nearby, say, in District D. The only consideration was that if they decided to move, the move or the preparation therefor preferably be made before September 1995 (when she started her primary one study) so as to minimize the degree of disturbance to her school life.

14.2 The fact that her job required her to work in different district offices has no direct bearing on her decision to sell the property. In fact, the location of the property was one of the factors in her decision to buy the property. Most of the departmental district offices were in Kowloon and the New Territories. It would be more convenient for her to travel to such offices from the property than from where she resided at the material times. It was the deteriorating traffic conditions that caused concern. The advantages of residing at the property including the design and the layout of the development, the view and the purchase price were to a great extent set off by the worsening traffic conditions and the impact that would be brought about.

14.3 The fact that she had not applied for joining the Home Finance Scheme in 1993 and 1994 should not be taken as evidence that she had no intention to move to the Subject Property. Home Finance Allowance as she understands cannot be applied to repay instalments under equitable mortgage. Even if she was wrong in that respect, she would not apply for the allowance before she could move into the property, for the simple reason that she had to give up the quarters as soon as she received allowance under the Scheme.

It was her understanding that approval to joining the Scheme would be given within short time after the papers were lodged. There was no hurry to join the Scheme until such time that the property was ready for occupation.

14.4 With regard to the size of the property as compared with her quarters, she would definitely prefer to reside in a more spacious apartment. However, her financial status did not permit that.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Further, so long as the apartment was not so small as to affect individual privacy, the cut in size was not unacceptable.

Her parents had been residing with her since 1989. However, they purchased a property in 1993/94. The plan was that when the Taxpayer moved to the Subject Property, they would not be residing with her any more. Thus, the impact of the reduction in size was not substantial.

The hearing of the appeal

15. At the hearing of this appeal, the Taxpayer was represented by Mr G, her husband as her authorised representative, while the Commissioner of Inland Revenue was represented by Ms Doris Lee, senior assessor. Mr G gave evidence for the Taxpayer. No other witness was called.

Testimony of Mr G

16. The testimony of Mr G is briefly as follows:

Examination by the Board

- 16.1 So far his wife the Taxpayer has purchased four properties. The first such property was purchased in 1985. It was at District H. It was purchased for the purpose of their marriage. His wife joined the Government in 1986. They got married in January 1987. They decided to rent a flat in order to get the housing allowance and they sold the property at District H and made a profit of \$60,000.
- 16.2 His wife was promoted in 1989 to senior-staff rank in the Government. Then they decided to apply for government quarters. In 1990, she succeeded in her application for quarters in District A (Quarters 1).
- 16.3 Their daughter was born in April 1989 and was four in 1993. In Quarters 1 there was no playground facilities. She liked cycling, so everytime his father-in-law and the maid would carry the bicycle and bottles of water and go with her down the slope to the park.
- 16.4 In March 1993 their son was born. Then they looked for an apartment which provided club facilities. They looked at the flat in District C and on 29 June 1993 they applied for quarters in District B, the only quarters where they have club facilities. They went both ways, applying for quarters while looking

INLAND REVENUE BOARD OF REVIEW DECISIONS

- for a flat. They also queued up to buy the flat in District C. That would also be end of June 1993.
- 16.5 Their application for quarters was approved on 9 July 1993 and also in July 1993 they were allocated one flat in District C.
- 16.6 They were not sure whether District B was a good place to live in. Then on 17 July 1993 they purchased the flat in District C, that is, the Subject Property. Renovation was finished in August 1993.
- 16.7 Then they moved into the flat at District B; they found the facilities there quite sufficient. Their daughter could go cycling and swimming.
- 16.8 They found there were always traffic jams in District C. His brother-in-law who lived at District F at that time persuaded them not to move out of District B. He complained that it took him more than an hour to get to Kowloon from District F. And in the rainy season there were landslides. So they decided to sell the Subject Property. On 17 March 1994 they signed an agreement and on 16 February 1995 they executed an assignment and completed the sale. They made a profit of about \$900,000.
- 16.9 Then they looked for a flat in the urban area, because they all along would like to own a property. On 6 May 1995 they bought a flat at District I. His daughter was enrolled in primary school around the end of May or the beginning of June 1995. She was allocated to Primary School 1. That is a good school at District B. So they sold the flat at District I on 8 June 1995. They made a profit of over a hundred thousand dollars.
- 16.10 Later on property prices sky-rocketed and they thought it was not a good time to buy. After the onset of the Asian crisis, property prices tumbled. In September 1998 they purchased a flat at District B, just the next house to the government quarters. They settled down after that.

Cross-examination

- 16.11 At the time when the Subject Property was purchased, there were seven people living together: his wife and himself, daughter, newborn, parents-in-law and a maid.
- 16.12 Quarters 1 had an area of about 1,700 square feet with three rooms: one room for parents-in-law, one room for himself and his wife, one room for daughter and son and an amah's quarters for the maid.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 16.13 The quarters at District B (Quarters 2) was also about the same size as that at District A. There were four room and a maid's quarters. Parents-in-law in one room, he and wife in another, daughter in one room, son in one room and the maid in her quarters. The parents-in-law stayed with them on weekdays to look after the children. They had a holiday on Saturdays and Sundays in their own house in District J. They moved to District J in September 1993.
- 16.14 He and his wife viewed the show flat at the Subject Property's development before lodging the application. The show flat was at the site at District C. They drove to the site. He was not aware of any traffic problem around that area at the time when they lodged the application. He made no enquiry about any traffic problem. They were just looking for a house with good facilities. The house in District C had their own club house, their own tennis court and swimming pool. It was seldom to have club house facilities. Once they bought the house, they just paid more attention to the area around the house. They produced a brochure to show the layout of the house, a big club house, and a swimming pool. He could not see the site of the swimming pool. It was just from the pamphlets. They also went to the site and looked at the very good sea view. At that time they did not have the bridge there.
- 16.15 After they sold the Subject Property, they bought a property in District I. They were also attracted by the club house there. It was in an urban area and was also within their budget. It was also close to the MTR. They also had a podium for the children so they could run and cycle there.
- 16.16 When asked whether it was also because his daughter was offered a place in a school in District K, he said no, because at that time they already applied for the primary school for the daughter through the Government. They had to wait for allocation. After they got the house in District I, the Government announced that his daughter has been allocated Primary School 1. His daughter was never offered a place in District K. They had applied for a primary school in their own area.
- 16.17 In 1993 his wife was in District L of the Hong Kong Island. In 1994 she was in District M of the Hong Kong Island. There were possibilities that she might be posted to Kowloon and the New Territories as well. In October 1994 she had a temporary office in the New Territories for a very short period.
- 16.18 One of the reasons he considered District I was because of the school district in District K nearby. In the school area in District B, there are only two famous schools: one is Primary School 1 and the other is Primary School 2.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 16.19 If he moved to the Subject Property, he would send his children to school in District D. He had no school in mind. She was still young, only four. They did not think about primary school at that time because she was in kindergarten. They were just looking for the area where they had good facilities for her so his father-in-law would not have to carry the bicycle down the slope to the park and his maid would not have to carry a bag of coke and water.
- 16.20 The Subject Property had three bedrooms and maid's quarters, exactly like Quarters 1.
- 16.21 At that time the daughter was still young. She was in kindergarten. At that time it was very seldom to have a property available with club facilities.
- 16.22 He did not make any inquiries during the period when they were in ownership of the Subject Property about schools in the neighbourhood in District D. At that time the cost of the properties rose very quickly and they wanted a property.
- 16.23 His daughter is still studying in Primary School 1. She is in primary four and going to primary five next year.
- 16.24 The Subject Property was available for occupation in February 1995. At that time he had already lodged an application for primary school. At that time his address was still at District B. He only applied to the District B. If he was given the choice between moving to the Subject Property, which was already completed and staying in District B to let his daughter go to Primary School 1, then, to be honest, he must stay in District B.

The law

17. Normally the question to be asked is whether the asset was acquired with the intention of disposing of it at a profit, or acquired as a permanent investment (see Simmons v IRC [1980] 1 WLR 1196 at 1199, per Lord Wilberforce). If the former, the asset is trading stock, and profit on resale is assessable to profits tax. If the latter, the asset is capital asset, and profit on sale is not assessable to profits tax.

18. An intention to invest must be shown to be genuinely held, realistic and realisable (see All Best Wishes Limited v CIR 3 HKTC 750 at 771). 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

INLAND REVENUE BOARD OF REVIEW DECISIONS

intention can only be judged by considering the whole of the surrounding circumstances, including things said and things done at the time, before and after. Often it is rightly said that actions speak louder than words (ibid, 771, per Mortimer J).

Findings and reasons

19. The Taxpayer's case is that the Subject Property was acquired as a long-term investment, that is, as the residence of her and her family. It was sold because she was concerned about the traffic conditions around District C, and she decided to find another more suitable and convenient property. The profit from the sale of the Subject Property was therefore a capital gain and should not be subject to profits tax (see paragraphs 6 and 17 above).

20. The question is what was her intention at the time of acquisition of the Subject Property? Did she intend to use it as her residence, or to sell it later at a profit? The Revenue's view is that her intention was the latter, and therefore the profit on resale is subject to profits tax as per paragraph 12 above. The onus is on the Taxpayer to prove that the assessment in question is excessive or incorrect (see section 68(4) of the Inland Revenue Ordinance) and for that purpose to prove that her intention in purchasing the Subject Property was to acquire it as a long-term investment and to use it as her residence.

21. She explained in her grounds of appeal that the decision to sell the Subject Property was prompted, not by the bad traffic conditions, but by the deteriorating traffic conditions in the area (see paragraph 14.1 above). They found there were always traffic jams in District C. Her brother who lived in District F urged them not to move out of District B, because it took him more than an hour to get to Kowloon from District F. And in the rainy season there were landslides (see paragraph 16.8 above). The traffic problems in the District C were not new, but on a few occasions in mid to late 1993, the traffic in the area was at a complete standstill caused by landslide, rainstorm and cargo containers (see paragraph 10(d) above).

22. In her representations to the Revenue, the Taxpayer stated that the Subject Property was not right for her as she was working in the Government department and it was the policy of her department to post officers to different district offices every six to twelve months. It was important for her not to get trapped in serious traffic jams (see paragraph 10(f) above).

23. Against that background, the traffic conditions in the District C should have been one of the first considerations for the Taxpayer in deciding whether to acquire the Subject Property as her residence. Yet, the evidence is that, before the purchase, no inquiries were made at all about the traffic conditions (see paragraph 16.14 above). They were just looking for a house with good facilities. The house in District C had their own club house, tennis court and swimming pool. They also looked at the very good sea view (see paragraph 16.14 above). There was produced a brochure to show the layout of the house, a big club house, and a swimming pool. He could not see the site of the swimming pool. It was just from the pamphlets (see paragraph 16.14). They were so

INLAND REVENUE BOARD OF REVIEW DECISIONS

attracted by the surroundings as depicted in the brochure and the pamphlets that they took the plunge, without giving a thought to what the traffic conditions might be like. Such a scenario is within the realm of possibilities, but outside the realm of probabilities.

24. At the time when the Subject Property was acquired, their daughter was four years old and was in kindergarten, but in two years' time she was expected to be in primary 1. Mr G's evidence is that they did not think about primary school at that time because she was in kindergarten. They were just looking for a place where they had good facilities for their daughter so his father-in-law would not have to carry the bicycle down the slope to the park for her and the maid would not have to carry a bag of coke and water (see paragraph 16.19 above). He did not make any inquiries during the period when they were owners of the Subject Property about schools in the neighbourhood of District D. At that time the property prices rose very quickly and they wanted a property (see paragraph 16.22 above). The Taxpayer did not foresee any problem in enrolling her daughter in a school nearby, say, in District D (see paragraph 14.1 above). No explanation was proffered throughout the hearing of this appeal as to why she should have such confidence at the time of the acquisition of the Subject Property about finding a school for her daughter two years later.

25. In our view, the lack of inquiries about traffic conditions and the lack of concern about their daughter's schooling were inconsistent with the existence of an intention to hold the Subject Property on a long-term basis as their residence. On the contrary, they are clearly indicative of an intention to acquire the property for trading purposes.

26. On the whole of the evidence, the Taxpayer has not proved, on a balance of probabilities, that, in purchasing the Subject Property, she intended to hold it as a long-term investment and for use as her residence. Indeed, we will go further and find that, in purchasing the Subject Property, she intended to treat it as trading stock for resale at a profit.

27. It follows that this appeal is dismissed and that the assessment as per paragraph 12 above is hereby confirmed.