

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D13/98

**Profits tax** – whether profits derived from the sale of three properties assessable to profits tax.

Panel: Robert Wei Wen Nam SC (chairman), Herbert Liang Hin Ying and William Tsui Hing Chuen.

Dates of hearing: 5 and 10 December 1997.

Date of decision: 14 April 1998.

The taxpayers (the First and Second Taxpayers) were married couples. They appealed against 3 different profits tax assessment raised on them in respect of the profits derived by them from the sale of three properties. That is, the profits tax assessment for the year of assessment 1993/94; the additional profits tax assessment for the year of assessment 1993/94 as revised and the profits tax assessment for the year of assessment 1994/95.

In relation to the profit tax assessment for the year of assessment 1993/94, two properties were involved, that is, Property 1 and Property 2:

With respect to Property 1, although the taxpayers had previously entered into a provisional agreement to purchase Property 1 at a price of \$1,435,000, which was the true consideration, they have subsequently executed an assignment to acquire Property 1 at a much lower price of \$1,300,000 on 20 September 1993. On 16 December 1993, the taxpayers sold Property 1 at a price of \$1,700,000. The assessor was of the view that the purchase and sale of Property 1 by the taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax. The Commissioner of Inland Revenue subsequently adopted such view, although the quantum of tax payable was slightly revised, upon the objections of the taxpayers.

With respect of Property 2, which was a flat of Private Housing Estate B at District C, the taxpayers purchased Property 2 under construction at a price of \$2,728,000 on November 1993. The occupation permit was issued on 20 December 1993. The letter of consent to assign was issued on 28 March 1994. On 27 January 1994, the taxpayers sold Property 2 at a price of \$3,480,000. They executed the assignment in the capacity of confirmors. Again, the assessor was of the view that the purchase and sale of Property 2 by the taxpayers was trading adventure and that the profit arising therefrom was assessable to profits tax. The taxpayers raised objections to this assessment. However, when the assessor asked the taxpayers to supply further information and documentary evidence to support the taxpayers' objection, no reply was ever received by the assessor.

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Besides, in relation to the profit tax assessment for the year of assessment 1994/95, two properties were relevant, that is, Property 3 and Property 4.

On 28 November 1993, the taxpayers purchased Property 3 under construction at a price of \$2,580,000. Property 3 was situated in the same private housing estate as Property 2. The occupation permit and the letter of consent to assign were issued on 2 February 1994 and 28 March 1994 respectively. On 15 May 1994, the taxpayers sold Property 3 at a price of \$3,258,000. They later executed the assignment in the capacity of confirmors. Again, the assessor was of the view that the purchase and sale of Property 3 by the taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax.

Property 4 was also a flat in the same private housing estate as Properties 2 and 3 were located. On 22 March 1994, the taxpayers bought Property 4 at a price of \$4,203,000. On 25 May 1994, they obtained a bank loan of \$2,700,000 to finance the purchase of Property 4. On the same day, the purchase of Property 4 was completed when the title to it was assigned to them. Between 25 September 1994 and 17 January 1996, the taxpayers let out Property 4. The rent received for such period was in a total sum of \$157,741. On 1 August 1996, the taxpayers sold Property 4 at the price of \$3,630,000. The sale was completed on 17 August 1996 when the assignment was executed. It was revealed to the assessor that the electricity account of Property 4 was registered in the name of the husband (First Taxpayer) for the period of 24 February 1994 to 22 August 1996. The assessor was of the view that the purchase and sale of Property 4 by the taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax. The taxpayers objected to such assessment. In response to the taxpayers' objections, the assessor asked the taxpayers to supply further information and documentary evidence to support their objections. However, despite repeated requests, no reply was ever received.

By his determination dated 30 April 1997, the Commissioner of Inland Revenue determined against the taxpayers' objections and confirmed the assessments concerned.

Held:

1. At start of the hearing, the First Taxpayer, who represented the taxpayers, applied for leave to raise the issue of liability. The Board refused the application but allowed him to contest the issue of quantum. Despite so, in the course of his evidence in relation to Property 1, the First Taxpayers sought to raise the issue of whether the taxpayers were liable to pay profits at all, an issue which he was not allowed to raise. The evidence must therefore be disregarded. Further, in any event, the evidence could have little credibility, considering the fact that liability was neither raised as a ground of objection before the Commissioner nor as a ground of appeal in the notice of appeal.
2. The implication of the evidence before the Board was that the First Taxpayer had no intention to understate the purchase price but, at the solicitors' firm,

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someone who knew that the assignment understated the purchase price rushed the First Taxpayer into signing it. The story bordered on the bizarre and required the support of clear and strong evidence before it could be accepted.

3. At the objection stage, the taxpayers did not submit any documentary evidence to prove their claim despite the assessor's repeated requests. Under the cover of their notice of appeal and at the hearing they provided three copy agreements, which have one thing in common: neither the vendor's name nor his signature appeared in the agreement; all the spaces for his name or signature were left blank. There was thus no documentary evidence to show that Company E was a party to the relevant \$1,435,000 agreement. Besides, the belated submission of the second copy agreement raised a doubt as to whether it was signed by the taxpayers and the property agent on the relevant date of the purported agreement.
4. All the receipted payments and the bank loan of \$910,000 did not add up to a purchase price of \$1,435,000. As for the purported payment of \$295,000, there was not even a copy receipt for it. Moreover, there was no statement of account from the solicitors on the basis that the purchase price was \$1,435,000. On the other hand, the stamp duty of \$26,100 paid on the property was confirmatory of the purchase price of \$1,300,000 calculated at 2% plus \$100 being stamp duty payable on the deed of assignment.
5. Viewing the evidence as a whole, the Board accepted the submission of the representative for the Commissioner of Inland Revenue that there was no satisfactory or concrete evidence that the taxpayers purchased Property 1 at a price of \$1,435,000. The taxpayers have therefore failed to discharge their onus of proof in this regard. On the other hand, there was clear evidence and the Board found that they purchased it at a price of \$1,300,000.
6. The question of whether the profits which the taxpayers derived from the sale of Property 2 was subject to profits tax turned on the intention of the taxpayers at the time of acquiring it. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? The onus was on the taxpayers to prove their case. See Lionel Simmons Properties Ltd (in liquidation) and Others v CIR 53 TC 461 at 491.
7. As to the evidence of intention, "the stated intention of the taxpayer cannot be decisive...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." See All Best Wishes Ltd v CIR 3 HKTC 750 at 771.
8. Property 2 was owned for a period of two months. The taxpayers sold it as confirmors and they never took possession of the property.

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9. Within five days after they had purchased Property 2, the taxpayers purchased Property 3. The two properties were comparable in terms of size, value, and time of completion of construction and the letter of consent to assign was issued on the same day. The taxpayers accepted liability to profits tax on Property 3, that is, they accepted that Property 3 was their trading stock.
10. The taxpayers have been residing at rented premises for five years. During that period, they had owned Property 1, Property 2, Property 3 and then Property 4. However, they did not move to any those properties but sold them off one after the other within relatively short periods.
11. According to the First Taxpayer, Property 4 was intended to replace Property 2 and was acquired for self-residence. But the taxpayers never moved into Property 4. On the contrary, they left it vacant for five months after taking possession. When they first put it to use, they let it out. Before selling it in August 1996, they again had left it vacant for seven months. In the meantime, the taxpayers were paying rent for their then residence.
12. The taxpayers gave two reasons for selling Property 2: the noise problem and the fung shui problem. As regards fung shui, they alleged completely different problems at different stages: the car park exit and entrance problem in their representations to the assessor and the graveyard problem in the notice of appeal. It was never explained why the graveyard issue was not mentioned in their correspondences with the assessor.
13. The occupation permit of property 2 was issued within one month after the purchase. In other word, the construction was substantially completed at the time of purchase. By that time, the taxpayers had been residing at Private Housing Estate B for some time. They had ample opportunities of assessing the surroundings of the property before they made the purchase. The First Taxpayer in his evidence stated that he was aware of the size of the flat and that the property faced the road on which the buses ran. It was only his bare assertion that the taxpayers did not learn about the alleged bus terminal and bus stop problems until one month after the purchase.
14. Property 3 and Property 4 did not have any noise or fung shui problems alleged by the taxpayers in respect of Property 2. One would have expected them to occupy Property 3 or Property 4 as their residence. But they did not do so. The taxpayers' reason for not moving into Property 4, that is, that it was of a smaller size than their then rented residence, was unconvincing. The taxpayers knew and had considered the size of Property 4 (which was similar in size to Property 2) when they purchased it.

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15. The quick sale of Property 2 was indicative of an intention to trade unless the taxpayers could explain it away by satisfactory evidence. Their explanation gave two reasons for the quick sale: bad fung shui and bus noise. The First Taxpayer's shift of ground over the nature of the fung shui problem has not only destroyed the credibility of the fung shui story but has also cast a serious doubt on the credibility of the noise story.
16. Further, looking at the surrounding circumstances, we found that the taxpayers' actions in purchasing and selling Properties 1, 2 and 3 within short periods of time were consistent with an intention to trade rather than with a self-residence or long term investment intention.
17. The Board was of the view that the taxpayers have failed to discharge their onus to prove that the profit from the sale of Property 2 was a capital gain not liable to profits tax. Further we found that in selling Property 2 the taxpayers carried out their intention to trade which they had formed at the time of the purchase. The profit was therefore subject to profit tax.
18. The taxpayers have conceded liability to profits tax on Property 3.

### **Appeal dismissed.**

Cases referred to:

Lionel Simmons Properties Ltd (in liquidation) and Others v CIR 3 TC 461  
All Best Wishes Ltd v CIR 3 HKTC 750

Tsui Siu Fong for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

#### **Nature of appeal**

1. This is an appeal by two individuals who are husband and wife (hereinafter referred to as the First Taxpayer and the Second Taxpayer respectively and as the Taxpayers collectively) against the profit tax assessment for the year of assessment 1993/94, the additional profits tax assessment for the year of assessment 1993/94 as revised and the profit tax assessment for the year of assessment 1994/95 raised on them in respect of the profits derived by them from the sale of properties.

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2. The Taxpayers claim that the profit assessed by the years of assessment 1993/94 and 1994/95 are capital gains not chargeable to profits tax, and that of the additional profits tax assessment for the year of assessment 1993/94 is excessive.

### Facts

#### Property 1

3. Property 1 is a ground floor flat in District A and is relevant to the additional assessment for the year of assessment 1993/94.

3.1 On 20 September 1993, the Taxpayers executed an assignment to acquire Property 1 at a price of \$1,300,000.

3.2 The Taxpayers' case is that, while agreeing with the facts in paragraph 3.1 above, they had entered into a provisional agreement to purchase Property 1 at a price of \$1,435,000, which was the true consideration.

4. On 16 December 1993, the Taxpayers signed an agreement to sell Property 1 at a price of \$1,700,000. The sale was completed on 30 December 1993 when the assignment was executed.

5. By a letter dated 27 March 1996, Messrs Albert Hung and Company, the representative of the Taxpayers, provided the assessor with a computation of profit arising from the sale of Property 1. The computation is as follows:

		\$
Selling price		1,700,000
<u>Less: Purchase price</u>		<u>1,435,000</u>
		265,000
<u>Less: Premium</u>	85,000	
Other expenses	167,671	<u>252,671</u>
Profit		<u>18,329</u> (sic)

6. The assessor was of the view that the purchase and sale of Property 1 by the Taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax. He did not accept that the Taxpayers purchased Property 1 at a price of \$1,435,000 or that they had incurred a premium of \$85,000. On 12 November 1996, the assessor raised on the Taxpayers the following additional profits tax assessment for the year of assessment 1993/94 to assess the profit arising from the sale of Property 1:

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Estimated assessable profit \$238,000

Tax payable thereon \$35,700

7. The Taxpayers' representative objected against the additional profits tax assessment for the year of assessment 1993/94 in the following terms:

'We are instructed to object to the assessment on the ground that the cost of purchase of the property was not included. In fact we have already mentioned in our letter dated 27 March 1996 setting out all the respective costs.'

8. The assessor has obtained from the District Land Registry a copy of the deed of assignment dated 20 September 1993 by which the Taxpayers were assigned the title to Property 1. According to the deed, the purchase price of Property 1 paid by the Taxpayers was \$1,300,000.

9. The Commissioner of Inland Revenue has adopted the view of the assessor that the additional profits tax assessment for the year of assessment 1993/94 should be revised as follows, and has revised the assessment accordingly:

	\$
Selling price	1,700,000
<u>Less: Purchase price</u>	<u>1,300,000</u>
	400,000
<u>Less: Expenses per paragraph 5 above</u>	<u>252,671</u>
	147,329
Add: Premium	<u>85,000</u>
Revised assessable profit	<u>232,329</u>
Tax payable thereon	<u>34,849</u>

### Property 2

10. Property 2 is a flat of Private Housing Estate B at District C. It is relevant to the profits tax assessment for the year of assessment 1993/94.

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11. On 24 November 1993, the Taxpayers signed a provisional agreement to purchase Property 2 at a price of \$2,728,000. The formal purchase agreement was signed on 10 December 1993.

12. At the time of purchase, the construction of Property 2 was not yet completed. The occupation permit was issued on 20 December 1993. The letter of consent to assign was issued on 28 March 1994.

13. On 27 January 1994, the Taxpayers signed a provisional agreement to sell Property 2 at a price of \$3,480,000. The formal sub-sale agreement was signed on 7 February 1994. The sale was completed on 2 May 1994 when the assignment was executed with the Taxpayers acting as confirmors.

14. In response to the assessor's inquiry regarding Property 2, the Taxpayers wrote as follows:

'We learned one month after purchase that the ground floor of the block where Property 2 was situated would be used as the bus terminal for the Citybus (all night services would also be provided) and a bus stop for CMB. These developments affected our property as it was right on top of them and it was located at a low floor and close to the roadside. It might be noisier and there was going to be nuisance from evening and throughout the night. So we considered to change to a unit in other blocks. Later at the end of the year, our fortune teller pointed out our property was facing the exit and entrance of a carpark. That did not augur well according to him and would have an effect on the safety of the family. So we would like to sell it before the lunar year and find another good one after the new year.

After the new year, we searched for quite some time. The price was increasing. We paid the deposit and the agent could not help us to send it to the owner. At last we paid the market price and finally got another flat in Phase X. It was 22 March 1994. But it was very expensive and cost \$4,203,000. But it was on a good floor. For if it was on too high a floor, we might be faced with a graveyard. If on too low a floor, we might see the park. Since it was surrounded by the Phase X development, it must be quieter. So we purchased it despite the fact that it was more expensive.'

15. The Taxpayers provided the assessor with a computation of profit arising from the sale of Property 2. The computation shows a net profit of \$597,965.

16. The assessor was of the view that the purchase and sale of Property 2 by the Taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax. On 22 January 1996, after the Taxpayers had failed to submit a profits tax return for the year of assessment 1993/94 within the stipulated time, the assessor raised on them the following profits tax assessments for the year of assessment 1993/94:



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Estimated assessable profit \$597,965

Tax payable thereon \$89,694

17. On 26 March 1996, the Taxpayers' representative objected against the assessment for the year of assessment 1993/94 mentioned in paragraph 16 above on the ground that the profit arising from the sale of Property 2 was a capital gain. The representative claimed that the Taxpayers were forced to sell the property because of the noise and fung shui problems mentioned in their letter quoted in paragraph 14 above.

18. By a letter dated 18 May 1996, the assessor asked the Taxpayers' representative to supply further information and documentary evidence to support the Taxpayers' objection to the assessment for the year of assessment 1993/94. No reply was received by the assessor from the representative.

### **Property 3**

19. Property 3 is another flat of Private Housing Estate B at District C. It is relevant to the profits tax assessment for the year of assessment 1994/95.

20. On 28 November 1993, the Taxpayers signed a provisional agreement to purchase Property 3 at a price of \$2,580,000. The formal purchase agreement was signed on 21 December 1993.

21. At the time of purchase, the construction of Property 3 was not yet completed. The occupation permit was issued on 2 February 1994. The letter of consent to assign was issued on 28 March 1994.

22. On 15 May 1994, the Taxpayers signed a provisional agreement to sell Property 3 at a price of \$3,258,000. The formal sub-sale agreement was signed on 19 May 1994. The sale was completed on 25 May 1994 when the assignment was executed with the Taxpayers acting as confirmors.

23. The assessor was of the view that the purchase and sale of Property 3 by the Taxpayers was a trading adventure and that the profit arising therefrom was assessable to profits tax. On 14 November 1996, the assessor raised on the Taxpayers the following profits tax assessment for the year of assessment 1994/95 to assess the profit arising from the sale of Property 3:

Estimated assessable profit \$614,000

Tax payable thereon \$92,100

24. The Taxpayers' representative objected against the profits tax assessment for the year of assessment 1994/95 in the following terms:

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‘We are instructed by the Taxpayers to object to the assessment on the ground that they did not have any business during the said year of assessment.’

### Property 4

25. Property 4 is also a flat of Private Housing Estate B at District C. On 22 March 1994, the Taxpayers signed a provisional agreement to purchase Property 4 at a price of \$4,203,000. The formal purchase agreement was signed on 15 April 1994.

26. The occupation permit of Property 4 was issued on 2 February 1994. The letter of consent to assign was issued on 28 March 1994.

27. On 25 May 1994, the Taxpayers obtained a bank loan of \$2,700,000 to finance the purchase of Property 4. The loan was to be repaid by a 180 monthly repayments of \$27,386 each. The first repayment was to be made on 24 June 1994.

28. On 25 May 1994, the purchase of Property 4 was completed when the title to it to was assigned to the Taxpayers.

29. Between 25 September 1994 and 17 January 1996, the Taxpayers let out Property 4. The rent received was \$62,258 for the period from 25 September 1994 to 31 March 1995 and \$95,483 for the period from 1 April 1995 to 17 January 1996.

30. On 1 August 1996, the Taxpayers sold Property 4 at the price of \$3,630,000. The sale was completed on 17 August 1996 when the assignment was executed.

31. In response to the assessor’s inquiries regarding the electricity consumption of Property 4, China Light and Power Co, Ltd informed that the account was in the name of the First Taxpayer for the period from 24 February 1994 to 22 August 1996. The electricity consumption for the periods before 23 September 1994 and after 29 February 1996 are as follows:

<b>Period</b>	<b>Units consumed</b>	<b>Charges \$</b>
24-2-1994 to 21-7-1994	2	7.74
22-7-1994 to 22-8-1994	6	7.74
23-8-1994 to 22-9-1994	26	20.12
1-3-1996 to 19-3-1996	0	7.74
20-3-1996 to 19-4-1996	0	7.74
20-4-1996 to 17-5-1996	0	7.74

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18-5-1996 to 14-6-1996	1	7.74
15-6-1996 to 18-7-1996	82	63.47
19-7-1996 to 16-8-1996	1	7.74
17-8-1996 to 22-8-1996	1	3.87

### **Request for further information**

32. By a letter dated 27 January 1997, the assessor asked the Taxpayers' representative to supply further information and documentary evidence to support the Taxpayers' objections. She also requested the representative to give a reply to the assessor's letter dated 18 May 1996 (see paragraph 18 above). Despite repeated requests, no reply was received from the representative.

### **Employment income**

33. Details of the Taxpayers' employment income for the years of assessments from 1990/91 to 1995/96 are as follows:

<b>Year</b>	<b>First Taxpayer \$</b>	<b>Second Taxpayer \$</b>	<b>Total \$</b>
1990/91	176,400	nil	176,400
1991/92	195,300	nil	195,300
1992/93	96,543	nil	96,543
1993/94	140,584	38,900	179,484
1994/95	230,132	68,862	298,994
1995/96	182,000	68,000	250,000

### **Determination**

34. By his determination dated 30 April 1997, the Commissioner of Inland Revenue determined against the Taxpayers' objections, confirmed the assessments for the years of assessment 1993/94 and 1994/95 and revised the additional assessment for the year of assessment 1993/94 as per paragraph 9 above. The Taxpayers now appeal against the determination.

### **Grounds of appeal**

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35. The Taxpayers' grounds of appeal are to the following effect.

35.1 Property 1 The land was agricultural land. The Taxpayers purchased it on 5 March 1992 at the price of \$1,435,000. They in fact paid that price. It was 'town house' and premium had to be paid on completion. The Taxpayers' share of the premium was \$85,000, which they paid. Profit should be computed as shown in paragraph 5 above. The Taxpayers have no objection to a demand note (for tax) being imposed against the transactions relating to Property 1.

35.2 Property 2 The Taxpayers have been renting a flat in Private Housing Estate B since early 1993. They had always wanted very much to own a house instead of renting one in Private Housing Estate B. It was very surprising when they found that Property 2 was facing the graveyard and it would be very noisy downstairs. Being Chinese, the Taxpayers felt very uncomfortable when facing a graveyard and they hated noise. They did not pay attention when signing the provisional agreement as the construction work was not yet completed. Then they were forced to sell the flat within a very short time. In fact, the price of property soared in early 1994. If they were property gamblers, why did they sell so urgently. They sold because they did not like the flat. Consequently, they bought Property 4 in March 1994. During that period they lived in another flat in the same private housing estate with an area of 1,000 square feet at a very cheap rental of \$9,000 per month. Both Property 2 and Property 4 were only 700 square feet, that is why they did not move into Property 4. It will be very unfair if they have to pay tax on this property.

35.3 Property 3 The Taxpayers have no objection against tax being imposed on the purchase and sale this property for they did not have any intention to keep (it) for long-term investment.

### **Hearing and parties**

36. At the hearing of this appeal, the First Taxpayer represented the Taxpayers, while Miss Tsui Siu-fong, assessor, appeared for the Commissioner of Inland Revenue. The Second Taxpayer was absent. The Taxpayers' representative was in attendance. The First Taxpayer gave evidence for the Taxpayers. No other witness was called.

37. Before he gave evidence, the First Taxpayer applied for leave to contest the issue of liability to profits tax in respect of Property 1. The Board turned down the application, but allowed the Taxpayers to contest the issue of quantum on the grounds stated in the notice of appeal (see paragraph 35.1 above).

38. In the course of the hearing, the First Taxpayer stated in evidence that the amount of premium the Taxpayers had paid on Property 1 was \$83,200 instead of \$85,000. Having regard to the evidence, Miss Tsui conceded that the Taxpayers incurred a premium of \$83,200 on Property 1 and were entitled to a deduction of that sum.

### **Evidence**

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39. The evidence of the First Taxpayer was to the following effect.

### **In chief**

39.1 He has all along lived in a rented house.

39.2 In March 1992, he bought a village house through estate agents. It was an unconstructed site. They paid to the agents: a provisional deposit of \$20,000; ten days later, \$80,000; 3 April 1992, \$295,000; on that day, also \$14,350 being 1% of purchase price, that is, the commission.

39.3 On 19 July 1993, the purchase was completed. For completion he borrowed \$910,000 from the bank. He also paid the balance of \$130,000, their share of the premium \$83,200, stamp duty \$26,100 and solicitors' costs.

39.4 Upon taking possession of Property 1, he intended to move in. They inspected the place and found it inconvenient. At the end of 1992 they had a second child. The Second Taxpayer was worried that in case the child should get sick, she might have problems as she did not have a driving licence. They decided not to move in and they sold it, intending to get another one. They sold the flat on 18 November 1993 and purchased Property 2 on 24 November 1993.

39.5 He truly paid \$1,435,000. [The First Taxpayer referred to Exhibits A, B and C which the he had produced at the hearing and which will be dealt with under Findings and Reasons below.]

39.6 The First Taxpayer then referred to the assignment of Property 1 dated 20 September 1993 showing that the purchase price paid by the Taxpayers was \$1,300,000 (see paragraph 8 above). When he signed the document, he did not read the provisions in it. Someone at the solicitors' firm said, 'You sign here-sign here.' The First Taxpayer then signed his name. When the Taxpayers asked why was it that they had put down \$1,300,000, they said, 'Some had made a gain of more than some hundred thousand dollars out of it, so anyway you just sign.' That was how they explained it. When he signed it, he did not read through the document.

39.7 He actually paid \$1,435,000, referring to page 10 of the Appeal Bundle. There could only be sale and purchase of farmland upon payment of premium. It would be illegal before payment of premium.

39.8 The Taxpayers sold Property 1 on 18 November 1993 and bought Property 2 on 24 November 1993. One month later, he realized that there was going to be a bus terminal and a car park opposite Property 2. He confirmed the truth of their representations set out in paragraph 14 above. That was why he sold it.

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39.9 They sold Property 2 on 22 January 1994. After the sale came the Chinese New Year. Market was booming. On 22 March they bought Property 4. They used joint names of himself and his wife, intention being self-use. He could charge up to \$10,000 per month rent by letting Property 4, while he only paid \$9,000 per month for the rented flat. Like everybody else, he wanted to own a house while living in a rented flat. Later he sold Property 4 because he could not afford to pay the instalments.

### **In cross-examination**

39.10 The copy cheques and copy receipts regarding Property 1 were given to him by the estate agent Mr D when he made payments to them. He gave them the cheques at their offices. As for the cheque for \$295,000 dated 3 April 1992 and made payable to the agents, they refused to issue a receipt and only signed below the cheque. It was intended as part-payment of the purchase price in accordance with the agreement (referring to an undated and unsigned copy agreement at page 4 of Exhibit A). The agreement was unsigned. He was told that they could not sign agreement before paying premium.

39.11 He was referred to another copy agreement at page 2 of Exhibit A, dated 5 March 1992 and purportedly signed by the Taxpayers as purchasers and Mr D as the estate agent while the space for vendor's signature was blank. He state that they agreed to sign because, if they refused, the Taxpayers would not have purchased it. So they signed and he paid \$20,000. As for the receipts, Mr D issued receipts for the first and second payments but refused to do so regarding the payment of \$295,000 and only gave him a photocopy of the cheque with their signature underneath.

39.12 As to why out of the three copy agreements which he had produced, that is, pages 2 and 4 of Exhibit A and page 3 of the Appeal Bundle, only the one at page 2 of Exhibit A was signed, they first gave him page 3 of the Appeal Bundle, which was unsigned. The First Taxpayer objected. They then gave him page 2 of Exhibit A.

39.13 He received the copy agreements at page 3 of the Appeal Bundle and page 2 of Exhibit A on 5 March 1992. He received the copy agreement at page 4 of Exhibit A on 14 March 1992 when he paid the \$80,000.

39.14 The original of page 2 of Exhibit A was kept by the agent. He only had a copy and he made copies of that.

39.15 He completed the purchase in July 1993. They told him that the vendor was Company E. The vendor's name was not in the agreement.

39.16 He agreed that the bank loan of \$910,000 was 70 percent of the purchase price. That was how it was calculated.

39.17 He has lived in a flat in Private Housing Estate F since April/May 1996. Before that, he lived in a flat in Private Housing Estate B. The flat in Private Housing Estate B had

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an area of 970 square feet, while the one in Private Housing Estate F is 700 square feet. Both were rented by the First Taxpayer.

39.18 The tenancy for the flat in Private Housing Estate B ran from 31 March 1993 to 28 February 1995. The landlord took the premises back in mid-1995 for self-use.

39.19 The floor areas of Properties 2, 3 and 4 were respectively 745, 720 and 760 square feet.

39.20 When he was buying, he could not afford an area of 900 square feet. If he rented, he could do so at a reasonable rent. When he purchased a flat, he considered its size.

39.21 There were three bus routes, that is, Nos 590, 592 and 595 passing Property 2 at the time when he purchased it.

39.22 From Property 2, he could see the graveyard. From Property 4, one would not see it.

### **In re-examination**

39.23 He sold Property 1. Ten days later he bought Property 2. On 27 January 1994 he sold Property 2. On 22 March 1994 he bought Property 4. They were for self-residence. If he did not like one, he would purchase another. All properties were bought in joint names. They needed to pay instalments together, so they used joint names, because they needed property for self-use. It was not trading in a large number of transactions.

39.24 He agreed that he should pay tax on Property 3.

39.25 He lost a lot of money over Property 4, due to bank loans.

### **Findings and Reasons**

#### **Property 1**

40. At the start of this hearing, the First Taxpayer applied for leave to raise the issue of liability. The Board refused the application but allowed him to contest the issue of quantum (see paragraph 37 above). In the course of his evidence, he stated in effect that the Taxpayers had intended to move into Property 1 but decided not to because they found it inconvenient. So they sold Property 1 and instead purchased Property 2 (see paragraph 39.4 above). By those statements the First Taxpayers sought to raise the issue of whether the Taxpayers were liable to pay profits tax at all, an issue which he was not allowed to raise. The evidence must therefore be disregarded. Further, in any event, the evidence can have little credibility, considering the fact that liability was never raised as a ground of objection before the Commissioner, nor as a ground of appeal in the notice of appeal.

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41. The amount of premium having been agreed at \$83,200 (see paragraph 38 above), the remaining issue between the parties is the amount of the purchase price of Property 1. The First Taxpayer's evidence is that the purchase price was \$1,435,000, which the Taxpayers paid, while the Revenue maintain that it was only \$1,300,000, relying on a deed of assignment dated 20 September 1993 by which the Taxpayers were assigned the title to Property 1. According to the deed, the purchase price of Property 1 paid by the Taxpayers and received by Company E (which was selling as confirmor) was \$1,300,000, while the purchase price paid by Company E and received by a vendor was \$1,180,000. The First Taxpayer stated that he signed the assignment without reading the contents. He was told to sign by someone at the solicitors' firm handling the execution of the assignment. He noticed that the purchase price stated in the assignment was \$1,300,000 and queried about it. He was told that someone had made a profit out of it, 'so anyway you just sign' (see paragraph 39.6 above). The implication of the evidence is this: the First Taxpayer had no intention to understate the purchase price but, at the solicitors' firm, someone who knew that the assignment understated the purchase price rushed the First Taxpayer into signing it. The story borders on the bizarre, and requires the support of clear and strong evidence before it can be accepted.

42. At the objection stage, the Taxpayer did not submit any documentary evidence to prove their claim despite the assessor's request (see paragraph 32 above). Under the cover of their notice of appeal they provided for the first time what purported to be a copy provisional agreement (the first copy agreement) for the sale and purchase of Property 1 at the price of \$1,435,000 together with some copy cheques and copy receipts. At the hearing, the First Taxpayer produced further documents, including what purported to be two more copy provisional agreements (the second and third copy agreements) for the sale and purchase of Property 1 at the price of \$1,435,000.

43. The three copy agreements have one thing in common: neither the vendor's name nor his signature appears in the agreement; all the spaces for his name or signature are left blank. There is thus no documentary evidence to show that Company E was a party to the \$1,435,000 agreement.

44. Both the first and second copy agreements are dated 5 March 1992, while the third copy agreement is undated. The Taxpayers' names and signatures as well as those of Mr D the estate agent appear in the second copy agreement but not in the first or third. Otherwise the first and second copy agreements are identical. Why did the Taxpayers not submit the second copy agreement, instead of the first copy agreement, with their notice of appeal? Indeed, why did they not submit it at the objection stage? As Miss Tsui pointed out, the belated submission of the second copy agreement raises a doubt as to whether the second copy agreement was signed by the Taxpayers and Mr D on 5 March 1992, the date of the purported agreement.

45. All the receipted payments and the bank loan of \$910,000 do not add up to a purchase price of \$1,435,000. As for the purported payment of \$295,000, there is not even a copy receipt for it. What is laid before the Board is a copy document showing a purported cheque for the amount of \$295,000 dated 3 April 1992, drawn by the Second Taxpayer and



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made payable to Mr D together with an unidentified signature placed underneath and separately from the cheque. There is no indication in the copy document as to the nature of the purported payment. Further, the figure of \$295,000 does not appear in the first or the second copy agreement. It appears in the third copy agreement which amends the first and second copy agreements, but the third copy agreement is not signed by any of the three parties. Moreover, there is no statement of account from the solicitors on the basis that the purchase price was \$1,435,000. On the other hand, the stamp duty of \$26,100 paid on the property is confirmatory of the purchase price of \$1,300,000 calculated at 2% plus \$100 being stamp duty payable on the deed of assignment.

46. Viewing the evidence as a whole, we accept Miss Tsui's submission that there is no satisfactory or concrete evidence that the Taxpayers purchased Property 1 at a price of \$1,435,000. The Taxpayers have therefore failed to discharge their onus of proof in this regard. On the other hand, there is clear evidence, and we find, that they purchased it at a price of \$1,300,000. We therefore direct that the additional profits tax assessment for the year of assessment 1993/94 be revised as follows:

	\$	\$
Selling price		1,700,000
<u>Less: Purchase price</u>		<u>1,300,000</u>
		400,000
<u>Less: Premium</u>	83,200	
Other expenses	<u>167,671</u>	<u>250,871</u>
Assessable profits		<u>149,129</u>
Tax payable thereon		<u>22,369</u>

### Property 2

47. The question of whether the profit which the Taxpayers derived from the sale of Property 2 is subject to profits tax turns on the intention of the Taxpayers at the time of acquiring it. 'Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?' (See Lionel Simmons Properties Ltd (in liquidation) and Others v CIR 53 TC 461 at 491.) The Taxpayers' case is that their intention at the time of the acquisition of Property 2 was to hold it as a permanent investment, that is, for the purpose of self-residence, and that they were forced by circumstances to sell it. The onus is on the Taxpayers to prove their case. (See section 68(4) of the Inland Revenue Ordinance.) As to the evidence of intention, 'the stated intention of the taxpayer cannot be decisive... 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

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that actions speak louder than words.’ (See All Best Wishes Ltd v CIR 3 HKTC 750 at 771.)

48. We derived much assistance from Miss Tsui’s comprehensive submissions. In particular, we agree with the following points:

48.1 Property 2 was purchased on 24 November 1993 and sold on 27 January 1994. It was owned for a period of only two months. The Taxpayers sold it as confirmors and they never took possession of the property.

48.2 Within five days after they had purchased Property 2, the Taxpayers purchased Property 3 on 28 November 1993. The two properties are comparable in terms of size, value, and time of completion of construction and the letter of consent to assign was issued on the same day. The Taxpayers accepted liability to profits tax on Property 3. In other words, they accepted that Property 3 was their trading stock.

48.3 The Taxpayers have been residing at rented premises for five years. During that period, they had owned Property 1, Property 2, Property 3 and then Property 4. However, they did not move to any of those properties but sold them off one after the other within relatively short periods.

48.4 According to the First Taxpayer, Property 4 was intended to replace Property 2 and was acquired for self-residence (see paragraphs 39.9 and 39.23 above). But the Taxpayers never moved into Property 4. On the contrary, they left it vacant for five months after taking possession. When they first put it to use, they let it out. Before selling it in August 1996, they again had left it vacant for seven months. In the meantime, the Taxpayers were paying rent for their then residence.

48.5 The Taxpayers gave two reasons for selling Property 2: the noise problem and the fung shui problem. As regards fung shui, they alleged completely different problems at different stages: the car park exit and entrance problem in their representations to the assessor and the graveyard problem in the notice of appeal (see paragraphs 14 and 35.2 above). It was never explained why the graveyard issue was not mentioned in their correspondence with the assessor.

48.6 The occupation permit of Property 2 was issued within one month after the purchase. In other words, the construction was substantially completed at the time of purchase. By that time, the Taxpayers had been residing at Private Housing Estate B for some time. They had ample opportunities of assessing the surroundings of the property before they made the purchase. The First Taxpayer in his evidence stated that he was aware of the size of the flat and that the property faced the road on which the buses ran. It is only his bare assertion that the Taxpayers did not learn about the alleged bus terminal and bus stop problems until one month after the purchase.

48.7 Property 3 and Property 4 did not have any noise or fung shui problems alleged by the Taxpayers in respect of Property 2. One would have expected them to occupy

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Property 3 or Property 4 as their residence. But they did not do so. The Taxpayers' reason for not moving into Property 4, that is, that it was of a smaller size than their then rented residence, is unconvincing. The Taxpayers knew and had considered the size of Property 4 (which was similar in size to Property 2) when they purchased it (see paragraphs 35.2 and 39.19 and 35.20 above).

49. The quick sale of Property 2 is indicative of an intention to trade unless the Taxpayers can explain it away by satisfactory evidence. Their explanation gave two reasons for the quick sale: bad fung shui and bus noise. The First Taxpayer's shift of ground over the nature of the fung shui problem has not only destroyed the credibility of the fung shui story but has also cast a serious doubt on the credibility of the noise story. Further, looking at the surrounding circumstances, including those mentioned in paragraph 48 above, we find that the Taxpayers' actions in purchasing and selling Properties 1, 2 and 3 within short periods of time are consistent with an intention to trade rather than with a self-residence or long-term-investment intention. In our view, the Taxpayers have failed to discharge their onus to prove that the Profit from the sale of Property 2 is a capital gain not liable to profits tax. Further, we find that in selling Property 2 the Taxpayers carried out their intention to trade which they had formed at the time of the purchase. The Profit is therefore subject to profit tax.

### **Property 3**

50. The Taxpayers have conceded liability to profits tax on Property 3.

### **Decision**

51. (1) The profits tax assessment for the year of assessment 1993/94 and the profits tax assessment for the year of assessment 1994/95 are hereby confirmed.
- (2) The additional profits tax assessment for the year of assessment 1993/94 is to be revised as shown in paragraph 46 above.
- (3) Subject to the above, this appeal is dismissed.