

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D15/00

**Profits Tax** – real property – whether the gains arising from the disposition of a property was liable for profits tax – sections 2(1), 14 and 68(4) of the Inland Revenue Ordinance.

Panel: Anna Chow Suk Han (chairman), Berry Hsu Fong Chung and Vernon F Moore.

Date of hearing: 22 March 2000.

Date of decision: 23 May 2000.

The taxpayer had three properties during the period from 1991 to 1996. The assessor was of the view that the gains made by the taxpayer from the sale of Property 1 and Property 3 were trading profits chargeable to profits tax.

The taxpayer's decision to sell Property 1 and to buy Property 2, where he lived until he left Hong Kong in 1996, was to realise his investment strategy of buying a suitable flat to live in. Whilst he was living in Property 2 he decided to revise his investment strategy. He purchased Property 3 for long term investment purposes and to have available a smaller flat than Property 2 which as he became older and retired from working, he could live in and rent out the larger flat for income. Both Property 1 and Property 3 were sold prior to the issuance of the occupation permits and had never been put to the intended use.

#### **Held :**

1. Despite the expressed intention, the properties were sold prior to the issuance of the occupation permits and had never been put to the intended use. This is a strong indicator of an intention to trade on the part of the taxpayer.
2. Had the taxpayer not intended to acquire Property 1 as his residence, he probably would not have looked for another property so soon after he purchased Property 1. Notwithstanding the short period of ownership of Property 1 and because of the hectic circumstances under which Property 1 was acquired, the Board accepted that Property 1 was intended to be used by the taxpayer as his residence.
3. As for Property 3, the Board was not persuaded that the taxpayer had the same intention for it as he did for Property 1. Self-serving statements are of limited value. They need to be tested against the surrounding facts and the whole of the evidence.

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Moreover, the Board was not convinced that the reasons for the sale of Property 3 were genuine. The taxpayer had failed to discharge the burden placed upon him to prove that Property 3 was acquired for self use or renting out purposes.

### **Appeal allowed in part.**

Case referred to:

All Best Wishes Limited v CIR 3 HKTC 750

Chow Chee Leung for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

#### **The appeal**

1. This is an appeal by the Taxpayer against the determination by the Commissioner of Inland Revenue of 29 June 1999, in respect of the profits tax assessment raised on him for the years of assessment 1992/93 and 1994/95, relating to the profits derived from the sale of two properties in Private Housing Estate A in District B.

#### **The background facts**

2. The Taxpayer is a qualified civil engineer. He came to Hong Kong from Country C in 1967 when he obtained a post in a department of the Hong Kong Government. He remained working for the Hong Kong Government on contract basis until he retired in 1988. Upon his retirement, in September 1988 he secured a part-time employment with Company D and in January 1990 he secured a further part time employment with Company E. He retired from both companies prior to leaving Hong Kong in October 1996, at the age of 69.

3. Prior to retirement from the Hong Kong Government, the Taxpayer was living in the Government's rental quarters in District F. After retirement, he moved out from the rental quarter to a rented flat in District G.

4. During the period from 1991 to 1996, the Taxpayer had the following property transactions in Hong Kong:

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<b>Location</b>	<b>Purchase</b>	<b>Sale</b>
	(a) Date of agreement	(a) Date of agreement
	(b) Date of assignment	(b) Date of assignment
	(c) Purchase price	(c) Selling price
<b>Property 1</b>		
Private Housing	(a) 2-9-1991	(a) 16-5-1992
Estate A,	(b) Not applicable	(b) 22-12-1992
District B	(c) \$1,812,600	(c) \$2,660,000
(Gross area 798 square feet)		
<b>Property 2</b>		
Private Housing	(a) 11-10-1991	(a) 12-6-1996
Estate A,	(b) 31-12-1992	(b) 31-7-1996
District B	(c) \$2,434,600	(c) \$5,450,000
(Gross area 931 square feet)		
<b>Property 3</b>		
Private Housing	(a) 13-5-1993	(a) 2-2-1994
Estate A,	(b) Not applicable	(b) 24-5-1994
District B	(c) \$2,058,238	(c) \$3,550,000
(Gross area 728 square feet)		

5. The assessor was of the view that the gains made by the Taxpayer from the sale of both Property 1 and Property 3 were trading profits chargeable to profits tax and raised on the Taxpayer the following profits tax assessments:

**Year of assessment 1992/93 – Property 1**

	\$
Estimated assessable profits	<u>840,000</u>
Tax payable thereon	<u>126,000</u>

**Year of assessment 1994/95 – Property 3**

	\$
Net profit	1,234,464

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<u>Add:</u> Legal fees overstated (\$40,793 - \$16,805)	23,988
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Assessable profits	<u>1,258,452</u>
Tax payable thereon	<u>188,767</u>

6. At the relevant time, the Taxpayer also had property transactions in Country C and Country H.

### **The law**

7. Section 14 of the Inland Revenue Ordinance (IRO):

*‘ Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) ... ’*

8. Section 2(1) of IRO provides that ‘ trade ’ :

*‘ includes every trade and manufacture, and every adventure and concern in the nature of trade ’ .*

9. Section 68(4) of IRO:

*‘ The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant ’ .*

### **The Taxpayer’s case**

10. After the Taxpayer retired from service with the Hong Kong Government, he was living in a rented flat in District G. As he was concerned about the rising rent and the ageing condition of the rented flat, he decided to purchase a flat in Private Housing Estate A. He went through the balloting and selection process and when it came to his turn in the selection, he selected Property 1 which was apparently the best available of those which were left. The Taxpayer explained that the selection process was a hectic one and that a person would hardly know what he had bought until afterwards. He claimed that Property 1 (798 square feet) was smaller than he had wanted. It could not accommodate the furniture he stored at a Government department. It was facing towards the commercial centres and had no sea view. All in all, he was not happy with it as it was not suitable for his requirements. At the same time, he was pressurized by the Government department to

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remove his furniture from its store.

11. Subsequently the Taxpayer took the opportunity to inspect other towers under construction in Phase 2 of Private Housing Estate A which was previously not accessible due to construction works. He especially liked Tower 9 and flats looking southeast over an outlying island, which, he believed, would be suitable for him to live in and possibly renting out in the future. He therefore contacted an estate agent and arranged to purchase a right to a number fairly high in the ballot and eventually secured Property 2. It was a larger flat (931 square feet) and had excellent views. The Taxpayer claimed that it would suit his standard of living and would relieve the furniture problem.

12. Consequently the Taxpayer decided to sell Property 1, the proceeds of which would help to finance Property 2. The Taxpayer moved into Property 2 in March 1993 and lived there continuously until he sold it in July 1996 prior to his leaving Hong Kong.

13. The Taxpayer summarized his reasons for selling Property 1 and buying Property 2 as follows:

- (1) The Taxpayer's decision to sell Property 1 and to buy Property 2 was to realize his investment strategy of buying a suitable flat to live in.
- (2) Property 1 did not conform with that strategy as a place that would be suitable to live in, because of the following reasons, that is:
  - a) it did not have a good view, as it faced towards the commercial centres, with no sea view,
  - b) it was too small to contain the Taxpayer's furniture and effects, and
  - c) also too small for the standard of living the Taxpayer envisaged, especially if he had guests staying.

Property 2, however, conformed in all respects with his intentions to locate a suitable place to live in.

- (3) The proceeds of sale of Property 1 would help the Taxpayer to finance Property 2.

14. The Taxpayer claimed that while he was living in Property 2, he decided to revise his investment strategy as follows:

- (a) to purchase a property in Phase 3 of Private Housing Estate A for long term

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investment purposes which could be rented out on completion, and

- (b) to have available a smaller flat than Property 2 which as he became older and retired from working, he could live in and rent out the larger flat for income.

As his ballot was again in the middle range, he was able to buy Property 3 on 13 May 1993. It was a flat facing north and had a good garden view. It was still under construction at the time of purchase.

15. The Taxpayer claimed that in the second half of 1993, he became concerned about his employment prospects due to a lull in the construction industry which was also affected by the political differences between the UK and the PRC. He too was influenced by the negative reporting on the PRC's legal, political and financial systems, the implementation of the justice system and what would happen to Hong Kong after 1997. Because of these concerns and uncertainties, the Taxpayer decided to sell his assets and leave Hong Kong. He decided to sell Property 3 in the near future as he feared that it would be increasingly difficult to sell properties as July 1997 approached, especially the less favourable ones and to sell Property 2 in the middle of 1996 at the latest.

### **The Respondent's (the Revenue's) case**

16. It was the Respondent's submission that the Taxpayer's stated intention towards Property 1 and Property 3, that is, to purchase them as capital assets, was inconsistent with the objective facts. There was no evidence that he would keep the two properties for letting or as his residence.

17. The Respondent argued that after the Taxpayer purchased Property 1 on 27 August 1991 and Property 2 in October 1991, the balance in his bank account in October 1991 came down only to \$765,515. The Taxpayer then proceeded to purchase a property in Country H (Property 4) on 29 April 1991 for 295,000 in Country H's currency. Property 1 was sold before it was put to use and the sale proceeds was used to settle the purchase price of Property 4. This fact demonstrated that the Taxpayer did not have the intention to hold Property 1 as his capital asset. The quick sale of Property 1 was consistent with a trading venture.

18. The Respondent further argued that it was the Taxpayer's own case that since he obtained a low ballot number he would only have the choice of inferior apartments. Thus the sale of Property 1 because of its unfavourable features cannot be a genuine reason for the sale.

19. As to Property 3, the Respondent contended that the Taxpayer was already holding Property 2 as his residence and two other properties in Country H when he purchased Property 3. He sold it before the occupation permit was issued and never let it out as intended. Thus, this factor shows he never had the intention to hold Property 3 for letting or as his residence. As to the

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Taxpayer's reasons for the sale of Property 3, the Respondent argued that there was no evidence that the problems of possible loss of employment and the unfavourable political climate only surfaced after the purchase of Property 3 and not before. The Respondent asserted that the Taxpayer already had plans to settle in Country H when he purchased Property 3, because he was then also holding two properties in Country H.

20. Finally, the Respondent argued that:

'Investment could be long term or short term. The Taxpayer could change his investment plan for a number of reasons. However, the purchasing of a property and selling it as and when the opportunity comes is not inconsistent with trading. If, at the outset, there is intention for a quick sale for profit, it is the very essence of trading. It is my submission that the quick sale of Property 1 and Property 3 could be part of the Taxpayer's investment strategy and the sale is consistent with trading venture.'

### **Our decision**

21. In All Best Wishes Limited v Commissioner of Inland Revenue 3 HKTC 750, Mortimer J stated:

*'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.'*

22. It is the Taxpayer's case that both Property 1 and Property 3 were purchased with an intention to hold them as long term investment, for self-use or renting out. Despite the expressed intention, the properties were however sold prior to the issuance of the occupation permits and had never been put to the intended use. This is a strong indicator of an intention to trade on the part of the Taxpayer. It is our task to ascertain the actual intention of the Taxpayer at the time when he acquired the properties in question.

23. Property 1 was acquired by the Taxpayer through balloting and selection process. Private Housing Estate A was and still is a popular development favoured by many home buyers. We are prepared to accept the Taxpayer's evidence that he had to make a quick decision at the selection and ended in purchasing Property 1 despite its shortcomings. We are also convinced that he intended to acquire it as his residence. Had he not intended to acquire Property 1 as his residence, he probably would not have looked for another property so soon after he purchased Property 1. Notwithstanding the short period of ownership of Property 1 and because of the hectic circumstances under which Property 1 was acquired, we accept that Property 1 was intended to be used by the Taxpayer as his residence and it was replaced by Property 2, a more suitable apartment, where the Taxpayer lived until he left Hong Kong in 1996.

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24. As to Property 3, we are not persuaded that the Taxpayer had the same intention for it as he did for Property 1. Self-serving statements are of limited value. They need to be tested against the surrounding facts and the whole of the evidence. The Taxpayer completed the purchase of Property 2 on 31 December 1992 and moved into the property in March 1993. He entered into an agreement to purchase Property 3 on 13 May 1993. There was no time frame for his retirement. It is inconceivable that the Taxpayer should already acquire Property 3, a smaller flat, to replace Property 2 for the purpose of his eventual retirement while he had hardly settled in Property 2.

25. The area of Property 3 was only 728 square feet, some 60 square feet smaller than Property 1 and 203 square feet smaller than Property 2. The Taxpayer chose Property 2 as his residence, because of its seaview and Property 3 does not have a seaview. Instead Property 3 faced towards other buildings in the development although the Taxpayer claimed that it had a nice garden view. We find it inconsistent that on the one hand, the Taxpayer rejected Property 1 as his residence because of its inadequacies in size and view and on the other hand, he purchased Property 3 which evidently could not meet his requirements referred to in paragraph 13 above.

26. Moreover, we are not convinced that the reasons for the sale of Property 3 were genuine. The Taxpayer claimed that in the second half of 1993 shortly after he purchased Property 3, he was advised by his superior in Company D that he might be laid off as the existing contracts were near to completion with no new ones in sight. This was a mere assertion on the part of the Taxpayer. The fact was that the Taxpayer continued working for Company D until he left Hong Kong in 1996.

27. The Taxpayer produced the financial review for year ended 31 December 1993 by the chairman of Company I. Quoting from the chairman's statement:

‘ In my 1992 statement, I advised that the group faced a most challenging year in 1993 and indeed this has proved to be the case. However, there are clear signs that our markets in a number of areas in South East Asia, are improving.’

‘ Hong Kong and Macau operations this year have produced much better results than originally anticipated and we see strength in these markets for some time to come.’

We do not accept that the chairman's outlook for the company was as bad as the Taxpayer would like us to believe.

28. The Taxpayer also claimed that he was concerned about the political differences between the UK and the PRC and the uncertainties facing Hong Kong after 1997. As most people are aware, these concerns and uncertainties had been haunting Hong Kong for a long time, indeed, long before the Taxpayer's acquisition of Property 3 in 1993. Besides, there is no evidence to show that there were any specific incidents after May 1993 which might have caused the



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Taxpayer's change of mind about the future of Hong Kong, resulting in his decision to leave Hong Kong and to sell Property 3 soonest possible.

29. For the reasons aforesaid, we find that the Taxpayer has failed to discharge the burden placed upon him to prove that Property 3 was acquired for self use or renting out purposes.

30. Accordingly, we allow the appeal in relation to Property 1 and dismiss the appeal in relation to Property 3.