

**Case No. D16/12**

**Profits tax** – profits arising from sale of property – whether the Appellant acquired the property with the intention of disposing the same at profit – whether the Appellant used the property as his residence – section 14(1) of the Inland Revenue Ordinance (‘the IRO’).

Panel: Cissy K S Lam (chairman), Miu Liong Nelson and Catherine Yip Miu Chun.

Date of hearing: 23 March 2012.

Date of decision: 13 July 2012.

The Appellant owned an estate agent company. Between 2004 and 2008, he purchased and sold 10 different properties in different buildings in the same street, which was adjacent to the one where his company’s office located. The buildings were all old in a busy area. A notice of assessment was issued to him raising profits tax in relation to the profits made on selling 4 of those properties. The Appellant raised objection with respect to the assessment for one of those properties (‘the Property’). In various questionnaires and letters to the Inland Revenue Department, he explained the reasons for buying the Property in October 2006 to be either (i) for waiting for the acquisition by a developer; or (ii) the area was quiet. When asked why he sold the Property in June 2008, he explained the reason to be either (i) many parts of the building where the Property situated was used for commercial purposes, and the public liability insurance of the building might not cover any damage by the commercial signboards; (ii) he would like to move to a bigger house to live with his girlfriend; (iii) renovation works would be carried out at the building opposite to the Property, which would generate noise and create danger. At all material times, the Appellant’s girlfriend lived in a 2,000 square feet apartment, where the Property was 1,000 square feet. The property that the Appellant alleged to have moved into after selling the Property was 535 square feet. Between October 2006 and October 2008, the Property had zero electricity consumption. On rejection of his objection, the Appellant appealed.

**Held:**

1. In order to consider whether the profits of selling the Property was chargeable with profits tax, one has to determine whether the Property was a sale of a capital asset or a sale in the nature of trade within the meaning of the IRO. The critical issue is whether the intention of the Appellant when acquiring the Property was to dispose of it at a profit, or to acquire it as a permanent investment (Simmons v IRC [1980] 53 TC 461 at 491 applied).

2. The first reason that the Appellant gave in buying the Property falls squarely within the intention of disposing it at a profit. This is a clear concession of an intention to trade. The concession is generally, even if not always, decisive of the intention (Lee Yee Shing v CIR [2008] 3 HKLRD 51 at 72 applied). This reason is also consistent with the objective facts that the buildings in that area were waiting to be redeveloped, and this must be something that the Appellant was familiar with operating an estate agency.
3. Given this clear intention to trade, the alleged reasons for selling the Property are not relevant considerations. These reasons were also rejected as the true or dominant reasons for selling the Property.
4. Similarly, whether the Appellant did occupy the Property is not relevant. Using the Property as a home is not the test, and even if proved, it did not per se turn the Property into a capital investment. In any event, the Appellant's allegation that he lived in the Property was rejected. It would be impossible for there to be zero electricity consumption if he ever lived there.
5. This is a suitable case to award costs of \$5,000 against the Appellant.

**Appeal dismissed and costs order in the amount of \$5,000 imposed.**

Cases referred to:

Simmons v IRC [1980] 53 TC 461

Lee Yee Shing v CIR [2008] 3 HKLRD 51

Taxpayer represented by his staff Mr G.

Chan Tsui Fung and Leung Wing Chi for the Commissioner of Inland Revenue.

**Decision:**

1. The Appellant objected to the profits tax assessment for the year of assessment 2008/09 raised on him in respect of the disposal of a property ('Property A') in a residential building ('Building A') in Area C. The Appellant's case was that Property A was his home and per se it was a capital investment whereby profits arising from its sale was not chargeable to tax under section 14(1) of the Inland Revenue Ordinance, Chapter 112 ('the IRO'). By determination dated 27 July 2011 ('the Determination') the Deputy Commissioner of Inland Revenue ('Deputy Commissioner') rejected his claim. The Appellant now appeals to us.

**Intention to trade**

2. It is well established that in appeals of this kind, namely, whether the transaction was the sale of a capital asset or a sale in the nature of trade within the meaning of the IRO, the one critical issue before the Board is what was the intention of the Appellant at the time he purchased the property. ‘Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’ [see the oft-quoted dictum of Lord Wilberforce in Simmons v IRC [1980] 53 TC 461 at page 491].

3. Using the property as a home is not the test. It is but one of the objective facts to gauge the Appellant’s intention (see the badges of trade summarised by McHugh NPJ in Lee Yee Shing v CIR [2008] 3 HKLRD 51 at pages 72 to 74). If a person purchases a property with an intention to resell for profit, that is an intention to trade whether or not he occupies the property in the meantime.

**The Land Registry records and the correspondence**

4. As shown by the Land Registry Records, between 2004 and 2008 the Appellant has purchased and sold a number of different properties all situated in the same street (‘Street A’) as Building A, particulars of which are as follows:

Property	Purchase (i) Purchase Date (ii) Purchase Price	Resale (i) Resale Date (ii) Resale Price
Property 1 in Building B	(i) 30-7-2004 (ii) \$3,000,000	(i) 18-7-2005 (ii) \$4,180,000
Property 2 in Building B	(i) 31-08-2005 (ii) \$2,530,000	(i) 22-6-2007 (ii) \$3,200,000
Property 3 in Building C	(i) 16-1-2006 (ii) \$1,600,000	(i) 28-4-2006 (ii) \$2,500,000
Property A in Building A	(i) 3-10-2006 (ii) \$2,000,000	(i) 6-6-2008 (ii) \$5,000,000
Property 5 in Building D	(i) 27-7-2007 (ii) \$2,750,000	(i) 21-12-2007 (ii) \$3,230,000
Property 6 in Building A	(i) 13-10-2007 (ii) \$2,300,000	(i) 10-6-2008 (ii) \$4,480,000
Property 7 in Building B	(i) 5-6-2008 (ii) \$2,800,000	(i) 25-5-2009 (ii) \$3,100,000
Property 8 in Building B	(i) 23-6-2008 (ii) \$3,280,000	(i) 20-10-2008 (ii) \$3,983,000

(2012-13) VOLUME 27 INLAND REVENUE BOARD OF REVIEW DECISIONS

Property	Purchase (i) Purchase Date (ii) Purchase Price	Resale (i) Resale Date (ii) Resale Price
Property 9 in Building D	(i) 23-6-2008 (ii) \$3,250,000	(i) 30-7-2008 (ii) \$3,998,000
Property 10 in Building B	(i) 16-9-2008 (ii) \$2,300,000	

5. The Appellant's girlfriend Ms D also resided at one of the flats in Building A ('Ms D's Property').

6. The Inland Revenue Department ('IRD') first took issue with the Appellant's tax liability in relation to the sale and purchase of Property 3. By letter of 25 February 2008, the IRD required the Appellant to submit a questionnaire in respect of each property sold by him since 1 April 2001. The completed form was purportedly dated 18 February 2008 but received by the IRD on 3 March 2008 ('the 3 March 2008 Questionnaire') in which the Appellant gave particulars of the sale and purchase of Properties 1, 2, 3 and 5. The Appellant claimed, inter alia, that:

- (1) Properties 1 and 3 were occupied as self residence.
- (2) Property 2 was not occupied as self residence and was rented out.
- (3) Property 5 was not occupied as self residence and was not rented out.

7. Although Property A was purchased before Property 5, the Appellant did not mention Property A in this questionnaire.

8. In a letter dated 11 September 2008, the IRD raised further queries in relation to the sale and purchase of Property 3. The Appellant replied to these queries by letter undated but received by the IRD on 24 October 2008 ('the 24 October 2008 letter'). Of particular relevance is that when asked to particularize all the properties that he had occupied as his residence since 1 April 2005, the Appellant gave a list of seven properties: see paragraph E(1) of the 24 October 2008 letter:

Property 1  
Property 3  
Property A  
Property 5  
Property 8  
Property 9  
Present address: Property 7

(2012-13) VOLUME 27 INLAND REVENUE BOARD OF REVIEW DECISIONS

9. Following the 24 October 2008 letter, the IRD by letter of 20 November 2008 asked for further information in relation to Properties 1, 3 and A. In his reply by letter purportedly dated 21 November 2008 but received by the IRD on 16 February 2009 ('the 16 February 2009 letter'), the Appellant claimed, inter alia, that

- (1) He used the sale proceeds from the sale of Property 1 to buy Property 3.
- (2) He used the sale proceeds from the sale of Property 3 to buy Property A.
- (3) He used the sale proceeds from the sale of Property A to buy Property 10.
- (4) The reason he moved out of Property A ('Selling Reason 1') was that Building A was supposed to be a residential building, yet many parts were used for commercial purposes. The Appellant raised this issue at the meeting of the incorporated owners, but the incorporated owners and the management company took no step to deal with it. There were signboards overhanging from the side of the building. Should any signboard fall down and injure someone all the owners would be liable and it would not be viable to cover such liability by a public liability insurance because the building was supposed to be residential only. So the Appellant considered it unsound to live in the building and he decided to sell Property A. See the Appellant's answer in Chinese at paragraph 1C(IV) of the 16 February 2009 letter: '本人查核這大廈是純住宅的單位，但這大廈有很多在做商業，本人在業主立案法團的大會上討論，某人自稱為大廈法團的主席（大廈分為6座，應有6個主席），並聯同管理公司並沒有反對或採取行動而令這些商業單位的業主經營。並掛招牌在路上，本人亦知道若招牌 [跌] 下來擊傷途人，發生意外，第三者保險不會賠償的（因該大廈並不是商業大廈，是純住宅），問題最後好可能要各業主平均分擔賠償。所以本人覺得這大廈不安全。決定出售'.
- (5) The reason the Appellant purchased Property A ('Buying Reason 1') was that he originally thought that he could wait for its acquisition by a developer – See the Appellant's answer in Chinese at paragraph 2C of the 16 February 2009 letter: '本以為可以買下來等待發展商收購'.

10. The Appellant filed his tax return for the year of assessment 2008/09 on 15 May 2009. He reported zero income and did not report any profits from the sale of his properties.

11. The IRD issued another request dated 28 August 2009 for the Appellant to submit a questionnaire in respect of each property sold by him since 1 April 2003. The completed form was received by the IRD on 30 September 2009 ('the 30 September 2009 Questionnaire') in which the Appellant gave particulars of the sale and purchase of

(2012-13) VOLUME 27 INLAND REVENUE BOARD OF REVIEW DECISIONS

Properties A, 6, 8 and 9. The Appellant claimed, inter alia, that

- (1) Property A was occupied as self residence.
- (2) Properties 6, 8 and 9 were not occupied as self residence and were not rented out.
- (3) He sold Property A to move to a different residence, namely Ms D's Property.
- (4) The reason for moving ('Selling Reason 2') was that he wanted to move to a bigger house to live with his girlfriend – see original answer in Chinese '想搬一間比較大的單位和女友一起住'.

12. The net profits he made from the sale of Properties A, 6, 8 and 9 as reported in the 30 September 2009 Questionnaire and the tax payable thereon were as follows:

	<u>Net profits</u>
Property A	\$2,926,200
Property 6	\$2,127,580
Property 8	\$ 541,050
Property 9	\$ 630,875
Total:	\$6,225,705
15% profits tax:	\$ 933,855

13. Notice of assessment of profits tax in the sum of \$933,855 was issued against him on 4 December 2009.

14. By fax of 5 January 2010, the Appellant objected to this assessment on the ground that Property A was occupied as self-residence and should not be treated as for commercial use to levy tax ('反對... 自住物業當作商業用途徵稅').

15. Pursuant to his objection the Appellant was asked to supply further information for consideration. By letter purportedly dated 27 January 2010 but received by the IRD on 5 February 2010 ('the 5 February 2010 letter') the Appellant represented by his girlfriend Ms D replied as follows:

- (1) Since 1 April 2006 the Appellant had lived in the following addresses:
  - i. 1 April 2006 to July 2006 he lived in Country E.

(2012-13) VOLUME 27 INLAND REVENUE BOARD OF REVIEW DECISIONS

- ii. August 2006 to December 2006 he lived at Ms D's Property with Ms D.
  - iii. January 2007 to May 2008 he lived at Property A alone.
  - iv. June 2008 to July 2009 he lived at Ms D's Property with Ms D.
  - v. August 2009 to the date of the letter he lived at Property 10 alone.
- (2) Reason for buying Property A ('Buying Reason 2') – at that time the area was quiet ('當時環境清靜').
- (3) Reason for selling Property A ('Selling Reason 3') – Renovation works would be carried out at Building B which was opposite Property A and such works would generate noise and create danger ('單位對面的 .... 進行大廈維修工程，將會構成噪音及危險').
- (4) The proceeds of sale of Property A were used to purchase Property 10 which had a gross floor area of 535 square feet and a saleable area of 460 square feet.

**The Witness Mr F**

16. The Appellant did not attend the hearing before this Board. He was represented by his staff Mr G and Mr F. Mr F gave evidence for the Appellant and argued the case on his behalf.

17. Mr G and Mr F were employees of the estate agent company, 'Estate Agent H'. At all relevant time the Appellant was its sole shareholder and was one of its two directors. Prior to its incorporation, the Appellant was a partner of an estate agent business of the same name.

18. Estate Agent H operated on a small scale. It has only one office staffed by two to three employees. The office was situated in the street adjacent to Street A.

19. Mr F joined Estate Agent H as a clerk in 2005. He obtained his estate agent's license in June/July 2006 and has since been promoted to the position of manager. He told us that he was like a personal assistant to the Appellant and Ms D. He took care of all their affairs personal or business. He sometimes had to work with the Appellant and Ms D at their home or respective homes. All the correspondence with the IRD were drafted by him and approved by the Appellant. He claimed he had full knowledge of the circumstances relating to the sale and purchase of all the properties.

**Buying Reason 1 was a clear statement of an intention to trade Property A**

20. The Appellant gave his first reasons for buying and selling Property A in the 16 February 2009 letter. What he was saying there was that he bought Property A with the intention of selling it to a developer (that is Buying Reason 1) but because of the problems with the signboards and the commercial activities carried on in Building A, he had to sell before his intention for acquisition by a developer could be realised (that is Selling Reason 1). Mr F agreed that Buying Reason 1 was one of the reasons the Appellant purchased Property A. To buy with the intention of selling to a developer falls squarely within the test of Lord Wilberforce in Simmons quoted above. This is a clear concession of an intention to trade.

21. True that the intention to trade to which Lord Wilberforce referred is not subjective but objective in the sense that the stated intention of a taxpayer is not conclusive but has to be tested against all the objective facts. But if a taxpayer concedes the intention to resell for profit in a case where the IRD claims that a profit is assessable to tax, the concession is generally, even if not always, decisive of intention (see McHugh NPJ in Lee Yee Shing at page 72, paragraph 59).

22. Moreover the objective facts here do support this conceded intention. Building A was a fairly old building in a prime area in Area C. Mr F told us that the buildings along Street A, including Buildings A and B, were fairly old buildings and it was the common intent and expectation of the majority of the owners there to sell to a big developer. As an estate agent specialising in properties of that area, he, and no doubt the Appellant as his employer, must be familiar with the redevelopment potential of buildings in that area. Indeed Mr F told us that Building A was so acquired in mid-2011 and each unit was paid a price of around \$14 million. Mr F told us this to argue that if the Appellant was a speculator he would not have sold Property A in 2008 for \$5 million. We do not agree with this argument. The Appellant might not be selling at \$14 million, but \$5 million was already more than double his purchase price. He had used the sale proceeds to buy other properties and made further profits. In any event, the argument failed to understand the one important issue in the present appeal. We are not concerned with the Appellant's reason for selling Property A. We are concerned with his reason for buying. The Appellant might not have held on long enough to sell to the developer, but his intention at the time he purchased Property A was to do so. To buy with a view of selling to a developer at a profit was clearly an intention to trade.

23. Given the clear intention to trade at the time Property A was purchased, the alleged reasons for sale and whether the Appellant did use Property A as his home are not relevant considerations unless they show a change of intention from trading to investing. We see no such change of intention. Indeed we are not satisfied that the Appellant had ever occupied Property A as his home or that the alleged reasons for selling Property A were the true or dominant reasons.



**Use of Property A allegedly as the Appellant's home**

24. The Appellant gave inconsistent accounts of where he lived.
- (1) According to the 3 March 2008 Questionnaire Properties 1 and 3 were occupied as self residence but Property 5 was not.
  - (2) In the 24 October 2008 letter, the Appellant gave a list of seven properties as his residence since 1 April 2005, which included Properties 1, 3, A, 5, 8, 9 and 7.
  - (3) In the 30 September 2009 Questionnaire the Appellant claimed that Property A was occupied as self residence but Properties 6, 8 and 9 were not and after he sold Property A he lived with Ms D at Ms D's Property.
  - (4) Finally in the 5 February 2010 letter he claimed that he had lived in Country E, then at Ms D's Property with Ms D, then at Property A alone, then at Ms D's Property with Ms D and then at Property 10 alone.
  - (5) All along the Appellant use the office address of Estate Agent G as his corresponding address with the IRD.

25. Information obtained from the CLP Power Hong Kong Limited for the period from 6 October 2006 to 16 October 2008 (a total of 11 months) in respect of Property A showed very low meter readings with 6 out of the 11 months showing zero consumption.

26. Mr F sought to explain this by saying that the Appellant spent most of his time with Ms D at her home which was in the same building and only went back to Property A to sleep. Be that as it may, this was not sufficient to explain the zero electricity consumption. Moreover Mr F's assertion was contrary to what was stated in the Appellant's statement of grounds of appeal where the Appellant alleged that he would carry out his daily activities at Property A and spent the night with Ms D at her home.

27. Mr F was asked whether the Appellant kept any refrigerator or water boiler/warmer in Property A. He said the Appellant did not. When the Appellant purchased Property A, he simply took over all the fittings and furniture from the previous owner. He did not carry out any decoration or buy any new furniture and did not use any electrical appliances in Property A. Such a scenario is hardly plausible if the Appellant had genuinely occupied Property A as his home. We are not satisfied that the Appellant ever lived in Property A as alleged.

**Selling Reason 1**

28. This reason was concerned with the problems about the signboards. As shown in the photo attached to the Appellant's statement of the grounds of appeal, there is a

prominent signboard right outside the entrance to Building A. We do not think anyone can fail to notice that signboard. Mr F sought to argue that the Appellant did not notice the signboards overhanging Building A until the end of 2007. We cannot accept that. Nor can we accept that the Appellant was unaware of the commercial activities carried on inside the building.

29. There might, however, be some truth in Mr F's contention that the Appellant was only aware of the issue of liability that might arise from the existence of the signboards in late 2007. Issues of liability are not generally in the forefront of an owner or occupier's mind. Mr F claimed that it was he who in 2007 found out that it was not viable to cover such liability by a public liability insurance because Building A was supposed to be residential only. We do not discount the possibility that this issue of liability was brought to the Appellant's attention by Mr F and it was something the Appellant had considered when he decided to sell Property A, in addition to the very handsome profits to be made upon the sale. But how important was this consideration we do not know. Mr F was not in a position to tell us exactly what was in the Appellant's mind. In any event we reiterate that this reason for selling Property A, even if true, does not in any way disturb the Appellant's concession that his original intention was to wait for the acquisition by a developer.

### **Selling Reasons 2 and 3**

30. The Appellant has not explained why Selling Reasons 2 and 3 were not proffered in the 16 February 2009 letter. When asked why three different reasons for sale were given in three different documents, Mr F said that because they were asked three times to give reasons for the sale of Property A, they thought the IRD were not satisfied with their previous answers. We do not understand the logics of this explanation. If the reasons were true, they would be the answer no matter how many times one was asked. We were not impressed with Mr F as a witness. Many of his answers in cross-examination were quite untenable.

31. Selling Reason 2 was that the Appellant wanted to move to a bigger house to live with his girlfriend. As discussed above we are not satisfied that the Appellant ever lived in Property A as alleged. For the same reason, Selling Reason 2 is likewise dubious.

32. Further it is not clear where the Appellant lived after he sold Property A – whether he lived with Ms D at her property or whether he lived alone at Property 10. The proceeds of sale of Property A was applied towards the purchase of Property 10. The size of Ms D's Property was 2,000 square feet. The size of Property A was 1,000 square feet with 2 rooms whereas the size of Property 10 was only 535 square feet. These figures simply do not tally with Selling Reason 2.

33. Selling Reason 3 was that the Appellant was worried about the noise and danger created by renovation works at Building B. But almost immediately after he sold Property A (the provisional sale and purchase agreement of which was dated 25 April 2008), he bought three properties in Building B, namely Properties 7 and 8 in June 2008 and

Property 10 in September 2008. This removes all logics in Selling Reason 3.

34. Moreover from the minutes of meeting of the Incorporated Owners of Building B dated 18 January 2008, the Incorporated Owners of Building B had invited tenders for the renovation works back in April 2006. At the material times the Appellant owned Property 2 which was in Building B and which he bought in August 2005 and sold in June 2007. Mr F contended that the Appellant was nonetheless oblivious to the impending renovation works at Building B when he purchased Property A in October 2006. We do not find such a contention convincing.

### **Conclusion**

35. In summary:

- (1) The Appellant himself in the 16 February 2009 letter has given a clear statement of his intention to trade Property A, namely to sell to a developer. Given that Building A was a fairly old building in a prime area of Area C, we have no doubt that this intention was the predominant reason the Appellant purchased Property A.
- (2) Given this clear intention to trade, the alleged reasons for sale and whether the Appellant did occupy Property A as his home are not relevant considerations.
- (3) Using Property A as a home is not the test and even if proved did not per se turn the property into a capital investment.
- (4) In any event we are not satisfied that the Appellant had ever lived in Property A as alleged and we are not satisfied that the alleged reasons for selling Property A were the true or dominant reasons for selling Property A.

36. In the circumstances we find that the Appellant purchased Property A with the intention of disposing of it at a profit. The Appellant did not intend to hold Property A as a permanent investment. The sale and purchase of Property A amounted to the carrying on of a trade and Property A was not a capital investment.

37. Further or alternatively, section 68(4) of the IRO places on the Appellant the onus of proving that the assessment appealed against is excessive or incorrect. The Appellant has fallen far short of this onus of proof. The Profits Tax Assessment for the year of assessment 2008/09 is hereby confirmed.

38. Under section 68(9) of the IRO this Board may order the Appellant to pay as costs of this Board a sum not exceeding \$5,000. We think this is a suitable case to award costs against the Appellant in the sum of \$5,000 and we so order. This sum shall be added to the tax charged and recovered therewith.