

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D17/98

Profits tax – real property – intention at the time of purchase – whether liable for profits tax – section 68(4) of the Inland Revenue Ordinance.

Panel: Robert Wei Wen Nam SC (chairman), Jiang Zhaodong and William E Mocatta.

Date of hearing: 21 January 1998.

Date of decision: 24 April 1998.

In November 1992 the taxpayers (husband and wife) purchased a unit in an uncompleted industrial/commercial building. In early 1994 and before the said purchase was completed, the taxpayers acted as confirmors and sold the unit to a sub-purchaser.

The taxpayers claimed that they originally planned to purchase the unit for the use of their own business. Then they went to China to conduct their business and suffered loss. They were forced to sell the unit to cover losses. The balance of proceeds was used to purchase another property for self-residence.

Held:

1. Intention is a question of fact. The stated 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.
2. The taxpayers never used the unit at all. They never took possession but sold it as confirmors before the purchase was completed. The taxpayer's stated intention of holding the unit as a long-term investment cannot prevail unless the sub-sale is satisfactorily explained away. Since it has not been satisfactorily explained away, the taxpayers have failed to discharge their onus of proving that they had a long-term investment intention towards the unit and that the assessment under appeal is excessive or incorrect.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd (In Liquidation) and Others v CIR 53 TC 461

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All Best Wishes Ltd v CIR 3 HKTC 750

Yim Kwok Cheong 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 against the profits tax assessment raised on them for the year of assessment 1993/94. They claim that the profit derived from the sale of a property was a capital gain not chargeable to tax.

Extension of time

2. The Taxpayer were 22 days late in filing their notice of appeal. The First Taxpayer, the husband, who appeared for the Taxpayers, stated that the delay was because they had to seek help in gathering information for the appeal. Mr Yim, the Commissioner's representative offered no opposition. The Board granted the necessary extension of time to enable the Taxpayers to prosecute this appeal.

Facts not in dispute

3. By an agreement for sale and purchase dated 11 November 1992, the Taxpayers purchased from the developer a unit in an uncompleted industrial/commercial building in District A (the Property) at a consideration of \$1,864,000.

4. By an agreement for sub-sale and sub-purchase dated 14 February 1994, before the purchase of the Property was completed, the Taxpayers sold the Property at a consideration of \$2,746,000. The Taxpayers acted as confirmors to the assignment of the Property to the sub-purchaser on 28 February 1994.

5. The net profit derived from the sale of the Property was \$849,440, calculated as follows:

	\$
Sale proceeds	2,746,000
<u>Less: Purchase cost</u>	<u>1,864,000</u>
	882,000
<u>Less: Expenses including legal fee and brokerage</u>	<u>32,560</u>
Net profit	<u>849,440</u>

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6. The assessor considered the purchase and sale of the Property by the Taxpayers amounted to an adventure in the nature of trade. She raised the following profits tax assessment for the year of assessment 1993/94 on the Taxpayers:

Assessable profits	<u>\$849,440</u>
Tax payable thereon	<u>\$127,416</u>

7. The Taxpayers lodged an objection against the assessment on the ground that the profit on the sale of the Property was a capital gain. The grounds of objection may be found in the representations of the Taxpayers dated for 31 March 1995 and may be stated as follows:

7.1 He wanted to use the Property all along as a factory. In 1993 he borrowed money in China to start a small business of making electronic spare parts. At first business was quite good. But at the end of the year, clients would take away goods without payment. He pressed them for payment but to no avail and they disappeared causing him losses to the amount of RMB520,000. He had to wind up his business. He was dealt a heavy blow mentally. His wife had quarrels with him frequently over that. Finally they had no alternative but to sell the factory premises on 5 February 1994. He used the proceeds to purchase Property B for self-residence on 29 April 1994. He is still paying the instalments.

8. The Taxpayers' residence in Property B is located in District C. The Taxpayers obtained a mortgage loan of \$2,928,000 to finance the purchase of the residence. The loan was repayable by 216 monthly instalments of \$26,511.79 each.

9 (a) By a letter dated 27 March 1996, the assessor requested the Taxpayers to state among other things the particulars, including business registration number, of the business intended to be carried on in the Property, and explain why it was considered that the Property was suitable for use by the intended business. The Taxpayers replied that no company registration had been obtained in Hong Kong as the business was carried on in China.

(b) By the same letter, the Taxpayers were requested to elaborate in detail how the loss/failure of the business in China led to the disposal of the Property; if part of the sale proceeds was transferred to the business in China, state the exact amount; and also advise the mode of transfer and the exact date on which the amount was transferred to the business in China with documentary evidence such as remittance advices. The Taxpayers replied that because of the loss of the business in China, the greater part of the proceeds of sale of the Property was transmitted to China to cover (such loss) and that part (of the proceeds) was used to finance the purchase of the residence in Property B.

10. (a) On 12 July 1993 the Taxpayers purchased the following two uncompleted industrial units (No 7 and No 5) in District D:

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Unit	Agreement for sale and purchase	Assignment	Consideration
No 7	12-7-1993	27-1-1995	2,035,000
No 5	12-7-1993	27-1-1995	2,436,000

- (b) The Taxpayers sold Unit No 7 on 25 March 1995 at the consideration of \$2,128,770.
- (c) The Taxpayers entered into a tenancy agreement dated 2 July 1995 to let out Unit No 5 for a term of two years from 10 July 1995 at a monthly rental of \$13,800.

Determination

11. On 28 April 1997, the Commissioner of Inland Revenue determined the objection against the Taxpayers and confirmed the profits tax assessment for the year of assessment 1993/94.

Grounds of appeal

12. The notice of appeal dated 23 June 1997 merely enclosed some documents which the Taxpayers said were requested by the assessor by a letter dated 20 December 1996. The grounds of appeal are contained in a supplementary notice of appeal dated 15 July 1997 and are to the following effect:

‘I (the First Taxpayer) originally planned to purchase the Property for my own use and long-term investment. But later due to the losses suffered by my business in China, I sold the Property. The difference between cost of purchase and selling price was used to cover the losses sustained in business. So I did not have any surplus for that year. Therefore I object to the payment of profits tax for that year.’

Hearing and parties

13. At the hearing of this of appeal, the First Taxpayer appeared for the Taxpayers, while Mr YIM Kwok-cheong, assessor, appeared as the Commissioner’s representative. The First Taxpayer gave evidence for the Taxpayers. No other witness was called.

Evidence

14. The First Taxpayer’s evidence is to the following effect.

In chief

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14.1 On 5 November 1992, he purchased the Property. It was industrial/commercial property. They planned to use it themselves for business purposes. Then they went to China to engage in the business of electronic watch manufacture. They supplied their customers with watches. After delivery of two or three batches of watches, customers disappeared. Could not be reached by telephone, nor could they be found at their addresses. They suffered RMB 500,000. They went to China every now and then. He suffered losses and was forced to sell the Property to cover losses. The balance of proceeds was used to purchase Property B for self-residence. Originally the Property was for long-term investment, but, as a result of the losses in China, he had to sell to cover the losses.

14.2 Right now his wife was in hospital. Intestinal problems. She had cancer and had to be operated on on 23 this month. Could not sleep at night. That was why she was not here today. Got doctor's certificate to prove that. Two Children, 14 and 15 years old, both sons.

14.3 The Property was originally for long-term investment. It was conveniently located.

In cross-examination

14.4 He purchased the Property for his own use. As to why he did not buy a completed unit, that was because the Property was conveniently located. He did not inspect completed properties in the same area.

14.5 The business of electronic watch manufacture was carried on in Province E, China. As the business was closed down, some documents could not be found. [The First Taxpayer identified two photocopy documents 39 and 40 on the Appeal Bundle as a contract for sale, and photocopy documents 44 and 45 on the Appeal Bundle as four invoices.] They photocopied for him. There were no other invoices for similar transactions. The manager in China had sent these copy invoices to him. The First Taxpayer had asked him by telephone to get the documents. [Here Miss Hui the interpreter stated that the four invoices on documents 44 and 45 were illegible in so many places that they were untranslatable.]

14.6 From the sale of a property in Centre F, he obtained funds to the amount of \$418,051 to finance the purchase of the Property. He purchased the two industrial units No 5 and No 7 in District D in July 1993 and sold the Property in February 1994.

14.7 They made watch bodies. Buyers of watch bodies sold them in Province G, China, while they made the watch bodies in Province E. Their business was to make and sell them in China.

14.8 Regarding the purchase of the Property, he had in mind taking watch orders in Hong Kong.

In answer to questions from a member of the Board

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14.9 He needed funds to cover losses sustained in China. He had borrowed money from others. He could produce evidence from China. He had to take care of the two children. He could not go. As for receipts, he let a Mr H take care of that. Sometimes he took cash to China. He would try his best to locate Mr H.

Findings and reasons

15. The question for this appeal is what was the intention of the Taxpayers at the time of the acquisition of the Property. 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.) If the intention was to dispose of it at a profit, the Property was a trading asset, and the profit arising from the subsequent sale is a trading profit and is subject to profits tax. On the other hand, if the Property was acquired as a permanent or long-term investment, the profit arising from the subsequent sale is a capital gain and is not subject to profits tax.

16. The assessment in question was raised by the assessor on the basis that the Property was acquired by the Taxpayers with a trading intention, that the Property was a trading asset and that the profit on its sale was subject to profits tax.

17. Under section 68(4) of the Inland Revenue Ordinance, the onus is on the Taxpayers to prove that the assessment is excessive or incorrect, and for that purpose to prove that the Property was acquired with the intention of holding it as a permanent or long-term investment.

18. Intention is a question of fact. The stated intention of the Taxpayers 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.)

19. The Taxpayers' case is that they purchased the Property for long-term investment, that is, for use by themselves for business purposes. That is a stated intention and has to be tested against the surrounding circumstances, and more particularly against the following:

19. The Taxpayers never used the Property at all. They held it for slightly more than one year. They never took up possession but sold it as confirmors before the purchase was completed.

19.2 Their explanation was this. In 1993 they borrowed money in China and started a small business. At the end of the year, customers disappeared without paying for the goods supplied to them, causing the Taxpayers losses to the amount of RMB500,000. The Taxpayers were forced to sell the Property to cover the losses.

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19.3 The Taxpayers were unable to prove their explanation. In particular, there is no or no sufficient evidence of the following:

- (a) Loans obtained in China for the business The Taxpayers gave no particulars of the 'loans', nor any financial statements or accounts to show the indebtedness which required repayment.
- (b) Repayment of loans or debts There is no evidence to show that any part of the proceeds of sale of the Property was transferred to the business in China. In particular, no remittance advices or receipts were produced.
- (c) Loss caused by customer's default in payment The First Taxpayer produced four photocopy invoices (Documents 44 and 45). Because of their illegibility (see paragraph 14.5 above), the Board is unable to give any weight to the photocopy invoices as evidence of any loss incurred in consequence of a customer's failure to pay for goods supplied.

19.4 The First Taxpayer's stated intention of holding the Property as a long-term investment cannot prevail unless the sub-sale is satisfactorily explained away. Since it has not been satisfactorily explained away, the Taxpayers have failed to discharge their onus of proving that they had a long-term investment intention towards the Property and that the assessment under appeal is excessive or incorrect.

Decision

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