

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D24/98

Profits tax – whether property acquired for the purpose of long term investment.

Panel: Terence Tai Chun To (chairman), Herman Fung Man Hei and Herbert Wong Wan Cham.

Dates of hearing: 8 December 1997 and 23 January 1998.

Date of decision: 8 May 1998.

The taxpayer is a private company incorporated in Hong Kong. Its directors were at all material times Mr and Mrs A.

Mr and Mrs A first resided at Property H owned by the taxpayer. The taxpayer sold Property H and Mr A and Mrs B moved to Property D. Property D was also owned by the taxpayer but was leased to Mr A's then employer, Company B, which in turn provided it to Mr and Mrs A as their quarters. The taxpayer sold Property D in early April 1990 with completion in July 1990.

In mid-April 1990, the taxpayer used part of the proceeds of sale from Property H to purchase the Subject Property which was still under construction at the time and would not be completed until September 1991.

In June 1990, Mr A left the employment of Company B and Mr and Mrs A moved to Property F in July 1990 rented by Mr A for a term of 24 months.

The taxpayer sold the Subject Property in September 1990. The Subject Property was left vacant during the period of ownership by the taxpayer.

The taxpayer purchased Property G on 20 September 1990 and provided it to Mr and Mrs A as quarters.

The taxpayer company objected to the profits tax assessment for the year of assessment 1992/93 on the ground that the Subject Property was acquired for the purpose of long term investment, that it was acquired for the purpose of providing accommodation for Mr and Mrs A and as protection against inflation.

Held:

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1. Under section 68(4) of the Inland Revenue Ordinance, the burden of proving that the assessment appealed against is incorrect falls on the taxpayer. It is for the taxpayer to put facts before the Board to show that the assessments were wrong.
2. The Board found it puzzling that the taxpayer having sold property H on account of fears generated by the June 4 incident in Beijing in 1989 would purchase the Subject Property almost immediately after for the purpose of hedging against inflation. The fears generated by the June 4 incident would have far outweighed the worry caused by inflation. Equally puzzling was when the taxpayer claimed that its directors needed a residence after the sale of Property H, it chose to purchase a unit estimated to be completed by September 1991, more than a year after vacating Property H.
3. The Board found it difficult to infer from the hand-written measurements on the sales brochure of the Subject Property that the taxpayer had the intention to use the Subject property for the residence of its directors. The mere declarations of intention of Mr and Mrs A were, by their self-serving value, of limited value.
4. The taxpayer evinced every intention of staying on in Property F where they did stay on in until the end of November 1991. The two-year tenancy of Property F was more consistent with the taxpayer's intention to use Property F rather than the Subject Property as the residence for its directors. The two-year tenancy was one year beyond the expected completion date of the Subject Property and if the taxpayer had no intention to stay at Property F for two full years, it would have entered into a shorter tenancy or at least have inserted a break clause in the tenancy agreement.
5. The Board rejected the reasons put forward by the taxpayer for finding the Subject Property unsuitable for its directors, namely, that there were communication barriers; that if one wanted shops catering for expatriates in the vicinity and expatriates living in the neighbourhood, one would have taken greater care to ensure that his requirements were met before committing oneself to set up residence in the area; and that poor environment and traffic congestion could have caused the taxpayer to give up the Subject Property.
6. It was unrealistic to infer from the taxpayer's instruction to an agent to let out or sell the Subject Property that the taxpayer had a settled intention to hold the Subject Property for long term investment.
7. The taxpayer's acquisition of Property G, even though it might not be a trading stock of the taxpayer, was far from being sufficient to lead to the conclusion that the taxpayer had an intention to hold the Subject Property for long term investment.

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8. The Revenue should have dealt with the taxpayer's objection within a reasonable time of the receipt of the notice of objection. However, there was no justification for the puerile accusation made by the taxpayer that the Revenue had deliberately engaged in a strategy to prolong the case so as to make it difficult for the taxpayer to locate witnesses or obtain evidence.
9. The taxpayer had failed to discharge the burden of proving that the Subject Property was acquired for the purpose of long term investment.

Appeal dismissed.

Ma Wai Fong for the Commissioner of Inland Revenue.
Taxpayer represented by its directors.

Decision:

The Taxpayer company (the Company) appeals against the determination of the Commissioner of Inland Revenue dated 8 May 1997 assessing the Company to profits tax upon its disposal of a property.

The agreed facts of the case are as follows:

- (1) The Company has objected against the profits tax assessment for the year of assessment 1992/93 raised on it.
- (2) The Company was incorporated as a private company in Hong Kong on 13 February 1987. At all relevant times, the Company's authorized and paid up capital were \$10,000 and \$2 respectively.
- (3) At all relevant times, the directors of the Company were Mr A and his wife, Mrs A.
- (4) Between 1 April 1987 to 31 March 1995 Mr A was employed as follows:

Employer	Capacity	Period
Company B	Senior Consultant	1 April 1987 to 9 June 1990
Company C	Senior Engineer	11 June 1990 to 31 March 1995

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(5) By a provisional agreement dated 6 April 1990, the Company agreed to sell the property described as Property D at a consideration of \$2,060,000. The sale was completed by an assignment dated 6 July 1990.

(6) During the period from 1 December 1987 to 9 June 1990, Property D was let to Company B by the Company and Company B provided it to Mr A as his quarters.

(7) By a provisional order dated 12 April 1990, the Company purchased the property described as the Subject Property at a consideration of \$1,006,700. The formal agreement for sale and purchase was made on 18 April 1990. At the time of acquisition, the Subject Property was under construction.

(8) On 25 April 1990, the Company obtained an equitable mortgage loan of \$900,000 from a financial company to finance the purchase of the Subject Property.

(9) A tenancy agreement dated 16 June 1990 was made between Company E as landlord and Mr A as tenant in respect of the property described as Property F. The tenancy was for a term of 24 months commencing from 1 July 1990 at the monthly rent of \$14,000.

(10) On 21 June 1991, the Subject Property was assigned to the Company by an assignment.

(11) By a provisional agreement dated 3 September 1991, the Company agreed to sell the Subject Property at a consideration of \$2,100,000. The formal agreement for sale and purchase was made on 16 September 1991. The sale was completed by an assignment dated 30 September 1991.

(12) The Subject Property was left vacant during the period of ownership.

(13) By a provisional agreement for sale and purchase dated 20 September 1991, the Company purchased the property described as Property G at a consideration of \$3,200,000.

(14) The Company provided Property G as director's quarters for Mr and Mrs A rent free during the period from 21 November 1991 to 30 June 1992.

(15) A tenancy agreement dated 1 July 1992 was made between the Company as landlord and Mr A as tenant in respect of Property G. The tenancy was for a term of 24 months commencing from 1 July 1992 at the monthly rent of \$23,500. The rent paid by Mr A to the Company was refunded by Company C since July 1992.

(16) Place of residence of Mr and Mrs A is as follows:

Property	Period
Property D	December 1987 to June 1990
Property F	July 1990 to November 1991

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Property G

since November 1991

Proceedings

(17) At the hearing of this appeal on the 8 December 1997, both Mr A and Mrs A, directors of the Company, gave evidence. They also took turns to address the Board on behalf of the Company.

(18) At the close of hearing on 8 December 1997, the Board adjourned for deliberation.

(19) On 9 December 1997, the Company sent to the Board by fax further written submissions.

(20) The Revenue raised objection to the admission of the Company's further submission.

(21) At a re-convened hearing on 23 January 1998, the Board decided that since it had not come to any final decision, it decided to hear further submissions by the Company.

(22) At the re-convened hearing, Mr and Mrs A elaborated on the Company's written submissions faxed to the Board earlier.

(23) The Company wanted to adduce evidence by forensic experts with a view to establishing the authenticity of the hand-written measurements appearing on a sales brochure which the Company considered to be relevant to its case. We granted an adjournment for two months, as required by the Company, to enable the Company to obtain such evidence.

(24) On the 18 March 1998, the Company informed the Board that despite all its efforts, the Company was not able to obtain any forensic evidence which could help its case.

(25) At the same time, the Company made further submissions which did not contain any new point of significance.

(26) We do not find it necessary to conduct a further hearing.

The main thrust of the Company's case is this:

(27) Owing to political uncertainty emerging after the June 4 incident in Beijing in 1989, the Company sold Property H then occupied by Mr and Mrs A.

(28) With a view to providing accommodation for Mr and Mrs A and to protecting against inflation, the Company used part of the proceeds of sale from Property H to purchase the Subject Property in mid April 1990, which was still under construction and would not be ready for occupation until September 1991.

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(29) Shortly after the purchase of the Subject Property, Mr A entered into a 2-year tenancy agreement with Company E in respect of Property F commencing from 1 July 1990 for the residence of Mr and Mrs A.

(30) When the Company was given notice of completion of the Subject Property in mid June 1991, Mr and Mrs A gave the landlord of Property F notice to terminate the tenancy agreement at the end of September 1991. On this occasion, the landlord asked for compensation.

(31) The Company took possession of the Subject Property at the end of June 1991 and immediately discovered that the Subject Property was not suitable for the residence of its directors for reasons such as communication barrier (management circulars in the Subject Property only in Chinese), no shops catering for expatriates in the vicinity, poor environment and traffic congestion.

(32) At about the same time, Mr and Mrs A had another meeting with the landlord of Property F. In the course of the meeting, the landlord offered to sell Property F at \$3,050,000. Although, according to Mr and Mrs A, they were not interested, they did not reject the offer straightway. Instead, Mr and Mrs A promised to give the landlord a definite answer upon their return from their impending trip overseas.

(33) One week before Mr and Mrs A left for the trip in early July 1991, they reconsidered their position and conceded that it would not be a bad idea after all to stay on in Property F.

(34) So they decided to let out the Subject Property and gave instructions to agents to act accordingly.

(35) Upon their return to Hong Kong in September 1991, Mr and Mrs A discovered that there was no enquiry for renting the Subject Property. They decided to and did dispose of the Subject Property in September 1991.

Reasons for Determination

(36) As stated earlier, the Company disposed of Property H on account of fears generated by the June 4 incident in Beijing in 1989. One would have thought that as a logical consequence, the Company would have found it prudent to stay away from investment in property. But almost immediately after the sale of Property H, the Company committed itself to purchase the Subject Property. It was puzzling that having successfully extricated itself from the worrying property market affected as it was by the June 4 incident, the Company should purchase another property purportedly for the purpose of hedging against inflation. The fears generated by the June 4 incident would have far outweighed the worry caused by inflation.

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(37) The Company also claimed that its directors needed a new residence after the sale of Property H. Instead of getting a completed unit ready for immediate occupation, the Company chose to purchase a unit estimated to be completed by September 1991, that is, more than a year after vacating Property H. This was equally puzzling.

(38) In order to show that the Company intended to use the Subject Property for the residence of its directors, Mr and Mrs A placed considerable importance on the hand-written measurements appearing on the sales brochure so much so that they went through the trouble to find forensic experts worldwide for the purpose of establishing their authenticity as mentioned earlier. The Company's contention was that Mr or Mrs A had made measurements of the living and dining area as well as the master bedroom of the Subject Property for the purpose of finding out if their existing furniture could fit in, thereby demonstrating their intention to live there.

(39) The Revenue had raised queries about the hand-written measurements on the brochure. In raising queries, the Revenue was merely testing the reliability of the Company's story. The Revenue's action incurred the wrath of Mr and Mrs A. We think Mr and Mrs A were over sensitive as they apparently misconstrued the Revenue's intention and misled themselves into thinking that the Revenue was accusing them of fabricating evidence. We certainly did not detect such accusation nor did we find any evidence tending to show that Mr and Mrs A were fabricating evidence.

(40) Despite all its efforts, the Company was not able to obtain forensic evidence which, it hoped, would assist its case. We find it difficult to infer from the hand-written measurements that the Company had the intention to use the Subject Property for the residence of its directors. The mere declarations of intention of Mr and Mrs A were, by their self-serving nature, of limited value.

(41) The Company claimed that pending the completion of the Subject Property, it rented Property F for the residence of its directors.

(42) Being fully aware of the expected completion date of the Subject Property to be in September 1991, it was surprising that the Company chose to enter into a tenancy agreement for two years, expiring on 30 June 1992, about one whole year beyond the completion date of the Subject Property. If the Company had no intention to stay at Property F for two full years, it would have entered into a shorter term of tenancy or at least it should have inserted a break clause in the tenancy agreement.

(43) The 2-year tenancy was more consistent with the Company's intention to use Property F rather than the Subject Property as the residence for its directors.

(44) In fact, the Company evinced every intention of staying on in Property F.

(45) Towards the end of June 1991, it had a meeting with the landlord of Property F who offered to sell the property to the Company for \$3,050,000. The Company kept an open mind about the offer. Finally, just before Mr and Mrs A made their overseas trip in

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early July 1991, it decided that, having considered all factors, it would stay on in Property F which it did until the end of November 1991.

(46) The Company gave three main reasons for finding the Subject Property unsuitable for its directors.

(47) Firstly, there were communication barriers because circulars issued by the management of the Subject Property were all in Chinese and Mr A did not understand Chinese. But Mrs A was Chinese and had a perfect understanding of the Chinese language. We do not believe that Mr and Mrs A would have any difficulty with the management circulars.

(48) Secondly, the Company stated that there were no shops catering for expatriates in the vicinity and indeed there were not many expatriates living in the neighbourhood. We would comment here that there are not many residential areas which have shops catering for all the special tastes of individuals. If one would require shops capable of satisfying one's special tastes, or want to choose one's own neighbours, one would have taken greater care to ensure that his requirements were met before committing oneself to set up residence in the area.

(49) Thirdly, shortly before acquiring the Subject Property, the Company already realised that it would not be as convenient as Property H nor would the environment of the Subject Property be as good. The Company admitted that because of political uncertainty, a compromise had to be made in respect of the standard of the residential requirements of its directors. Poor environment and traffic congestion could hardly have caused the Company to give up the Subject Property.

(50) It was the Company's case that having decided to give up the Subject Property as a residence for its directors, it decided to let it out. Its directors left the keys of the Subject Property to an agent with instruction to let it out at \$10,000 a month inclusive of rates but exclusive of management fees as the directors were taking a short trip overseas. No clear evidence was adduced as to what effort had been made to let out the Subject Property.

(51) The Company claimed that, upon the return of its directors, the Company discovered that there had been no enquiry for rental.

(52) On its own admission, the Company decided to let market forces determine whether it should let or whether it should sell the Subject Property.

(53) The Company gave instructions to its agent to let at \$10,000 or to sell at \$2,100,000. These instructions were equivocal and it was unrealistic to infer from such instructions that the Company had a settled intention to hold the Subject Property for long term investment.

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(54) Eventually, the Company agreed to sell the Subject Property on 3 September 1991 for \$2,100,000 with completion scheduled to take place on 5 October 1991.

(55) Prior to the completion of the sale of the Subject Property, the Company entered into an agreement to buy Property G for the purpose of providing a residence for its directors. It was part of the Company's case that the acquisition of Property G was consistent with its contention that the Company was not engaged in trading activities. It might well be that Property G did not turn out to be a trading stock of the Company but that was far from being sufficient to lead us to the conclusion that the Company had an intention to hold the Subject Property for long term investment.

(56) There remains for us to comment on the part of the Revenue in handling the Company's objection.

(57) The Ombudsman found and the Revenue admitted that there was delay on the part of the Revenue in dealing with the Company's objection. The Revenue should have dealt with the Company's objection within a reasonable time of the receipt of the notice of objection. The Revenue took three years to deliver its determination which cannot, in the absence of any special circumstances, be considered reasonable. We can understand the intensity of feeling of Mr and Mrs A provoked by such delay.

(58) The Revenue might have been culpable for causing inordinate delay, but it was unfair for the Company to accuse the Revenue of deliberately engaging in a strategy to prolong the case so as to make it difficult for the Company to locate witnesses or obtain evidence, which could only have been a figment of imagination of the Company's directors. There was absolutely no justification for such puerile accusation.

(59) In 1994, when the Company was making representations to the Revenue in respect of the Revenue's assessment for the year of assessment 1992/93, the Company had every opportunity to locate both the landlord of Property F and the letting agent of the Subject Property and procure their evidence in support of its case, but for reasons best known to itself, the Company did not make any attempt to do so.

(60) Under section 68(4) of the Inland Revenue Ordinance, the burden of proving that the assessment appealed against is incorrect falls on the Company. It is for the Company to put facts before us to show that the assessments were wrong.

(61) Having regard to all the circumstances of this case, we are not satisfied that the Company has discharged its onus in proving that the Subject Property was acquired for the purpose of long term investment. The appeal is accordingly dismissed and the determination of the Commissioner confirmed.