

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D25/04

Personal assessment – deduction for losses – disposal of properties – intention at the time of acquisition – whether the properties are capital assets or trading assets – sections 14(1), 2(1), 42(2) & 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Colin Cohen (chairman), Krishnan Arjunan and Malcolm John Merry.

Date of hearing: 21 May 2004.

Date of decision: 7 July 2004.

The taxpayer was a property speculator, having purchased and sold sixteen properties in his own name since 1993. In 1994/95, he had also purchased a property jointly with two other persons and sold the same in his capacity of confirmor. During the year of assessment 2000/01, four of his properties, namely Properties B, C, D and E suffered losses. In the Deputy Commissioner's determination in respect of his personal assessment for 2000/01, the taxpayer's claims for deduction for trading losses sustained in respect of one or more of his four properties were disallowed.

The issue before the Board was whether losses sustained by the taxpayer in respect of one or more of the said properties should be allowed as deduction in calculating the taxpayer's total income under personal assessment for the year of assessment 2000/01.

It was contended by the taxpayer that he had intended from 1993 onwards to make a quick profit from his various property holdings. In respect of Property B, it was his intention at the beginning to try to make a quick profit but due to falling property market in 1994, he was not able to sell but to rent out the property hoping that the property price would rise. As to Properties C, D and E, the taxpayer contended that he was not able to sell the said Properties in 1997 because he could not obtain a satisfactory price, and he had no alternative but to hold them for two years until 1999 when he decided to dispose them when the various leases came to an end.

Held:

1. It is accepted and well-established that in determining whether a property is a trading stock or a capital asset, one has to ascertain the intention towards the property at the time of acquisition and the objective facts and circumstances surrounding the purchase and resale of property. The intention must be genuinely

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held, realistic and realizable (Lionel Simmons Properties Limited v CIR; D11/80 and All Best Wishes Limited v CIR followed).

2. Looking not only at the taxpayer's dealings in respect of Properties B, C, D and E, but also at his transactions with regard to his other properties; the Board accepted the taxpayer's evidence that it was always his intention to make a quick profit and because of the unusual circumstances that took place, he was unable to effect sales at an earlier date in order to obtain a return of profit as he had expected. The Board accepted that the Properties B, C, D and E were purchased as his trading assets and that intention was genuinely held.
3. Accordingly, such losses sustained by the taxpayer in respect of Properties B, C, D and E properties were allowed as deduction in calculating the taxpayer's total income under personal assessment for the year of assessment 2000/01.

Appeal allowed.

Cases referred to:

Lionel Simmons Properties Ltd (in liquidation) and Others v CIR [53 TC 461]
All Best Wishes Limited v CIR 3 HKTC 75
D11/80, IRBRD, vol 1, 374

Lee Yun Hung for the Commissioner of Inland Revenue.
Aaron Wong of Messrs Aaron Wong & Co CPA for the taxpayer.

Decision:

Introduction

1. This is an appeal by Mr X ('the Taxpayer') in respect of the determination of the Deputy Commissioner of Inland Revenue dated the 28 January 2004 in respect of a personal assessment for the year of assessment 2000/01 under charge number 6-1886166-01-2, dated 27 February 2002, showing net chargeable income of \$1,656,343 with tax payable thereon of \$122,539 reduced to net chargeable income of \$1,078,060 with tax payable thereon of \$37,667.
2. The issue to be decided by this Board is whether losses sustained by the Taxpayer in respect of one or more of the following four properties should be allowed as deduction in

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calculating the Taxpayer's total income under personal assessment for the year of assessment 2000/01:

Property B : Address 1
 Property C : Address 2
 Property D : Address 3
 Property E : Address 4

3. Therefore, the Board has to determine whether Properties B, C, D and E were the Taxpayer's capital assets or trading stock.

Agreed facts

4. There was much common ground between the parties in respect of the Taxpayer's appeal. It was accepted that the Taxpayer was a property speculator and had purchased and sold the following properties in his own name since 1993:

	Purchase		Sale	
	Agreement date [Assignment date]	Purchase price	Agreement date [Assignment date]	Selling price
Address 5 ['Property 1']	1-8-1992 [24-7-1993]	\$1,538,000	13-11-1993 [27-11-1993]	\$1,500,000
Address 6 ['Property 2']	2-8-1992 [24-7-1993]	\$1,346,000	10-10-1993 [15-12-1993]	\$1,338,000
Address 7 ['Property 3']	7-4-1993	\$2,450,100	14-12-1993 [27-4-1994] Note 1	\$3,180,000
Address 8 ['Property 4']	27-4-1993 [25-5-1993]	\$2,350,000	3-5-1995 [31-5-1995]	\$3,250,000
Address 9 ['Property 5']	1-5-1993 [12-5-1994]	\$3,760,700	15-5-1994 [1-6-1994]	\$5,900,000
Address 10 ['Property 6']	13-5-1994 [25-5-1994]	\$3,204,200	25-10-1994 [21-11-1994]	\$4,350,000
Address 11 ['Property 7']	23-5-1993 [12-5-1994]	\$3,182,700	25-5-1994 [15-6-1994]	\$4,250,000

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Address 12 [‘Property 8’]	3-7-1993 [28-2-1995]	\$8,646,000	23-5-1995 [26-7-1995]	\$8,430,000
Address 13 [‘Property 9’]	7-1-1994 [20-2-1995]	\$3,288,330	27-8-1996 [10-10-1996]	\$3,160,000
Address 1 [‘Property B’]	(2-7-1994) 7-7-1994 [31-5-1995]	\$4,364,400	(20-5-2000) 2-6-2000 [20-6-2000]	\$3,120,000
Address 14 [‘Property 10’]	29-10-1994	\$9,518,000	28-12-1994 [2-5-1995] Note 1	\$8,900,000
Address 4 [‘Property E’]	(12-12-1995) 21-12-1995 [12-1-1996]	\$3,070,000	(28-11-2000) 12-12-2000 [31-1-2001]	\$2,680,000
Address 2 [‘Property C’]	(31-1-1996) 3-2-1996 [5-3-1996]	\$3,594,690	(12-7-2000) 26-7-2000 [11-8-2000]	\$2,250,000
Address 3 [‘Property D’]	3-2-1996 [22-2-1996]	\$600,000	(15-10-2000) 23-10-2000 [15-11-2000]	\$380,000
Address 15 [‘Property A’]	(11-5-1996) 15-5-1996 [7-5-1997]	\$5,885,600	(7-11-1999) 23-11-1999 [20-12-1999]	\$4,850,000
Address 16 [‘Property F’]	4-12-1996 [4-1-1997]	\$1,405,000		
Note 1 : The Taxpayer acted as a confirmor in the transaction.				
Note 2 : The dates in () refer to the dates of provisional agreements.				

5. The Taxpayer also purchased the following property jointly with two other persons and sold the property in his capacity of confirmor:

	Purchase		Sale	
	Agreement	Purchase	Assignment	Selling

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	date	price	date	price
Address 17 [‘Property 11’]	4-1-1994	\$9,674,830	16-1-1995	\$7,930,000

6. Properties 1 to 11 were accepted by the Commissioner of Inland Revenue (‘the Commissioner’) to be the Taxpayer’s trading stock although Taxpayer did not initially claim that the properties were his trading stock.

7. Property A was initially considered by the Commissioner not to be a trading asset, however, after considering representations made by the Taxpayer, the Commissioner has conceded that Property A was purchased as a trading asset.

The evidence

8. The Taxpayer gave evidence before us. He was previously employed as a civil servant and before he retired from the Government, he had reached the rank of Senior Land Executive to the Chief Land Executive. In his evidence, he drew our attention to various property transactions that he had previously been involved in and made it perfectly clear that he had intended from 1993 onwards to make a quick profit from his various property holdings. Under cross-examination, he explained that he was investing with a group of friends and his objective was to make money in the short term. He gave evidence in respect of each of the particular properties which were the subject matter of his appeal.

Property B

9. In respect of the purchase of Property B, the Taxpayer had been successful by way of ballot and so was able to acquire an uncompleted flat of 816 square feet in a private residential estate (‘the Estate’) in approximately July 1994. He told us that when he went to attend at the site of the Estate, numerous estate agents were waiting outside and many of them were asking him to place the flat on the market with them for a quick re-sale. He recollected being handed various name cards. However, he told us that he believed that the price of the flat was going to increase. At the time, his intention was to re-sell the property at a profit after the value had gone up. He indicated that he continuously received phone calls from various estate agents asking for details of the flat and the price. However, he accepted that there was no appointment of an estate agent.

10. After the purchase of Property B, the property price in Hong Kong was adjusting downwards. He was not able to sell the property because the market was flat. He said that in his conversations with various estate agents, no one was willing to offer a price at that time, hence he could not profit from a quick re-sale. He told us that he felt that later the property market would go up by at least ten percent (10%). However, subsequent to his purchase, the property market in Hong Kong kept going down.

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11. His evidence was that Property B was not sold after the purchase, not because he did not want to sell, but because the price for that kind of property had been flat. However, he drew to our attention that in October 1994, he decided to replenish his property holdings by purchasing a luxury flat (Property 10). Again, he advised us that soon after that purchase, market sentiment had become pessimistic especially at the luxury end of the property market. He took the view that he had made a wrong decision to hold further stocks. He was tired of the penalty interest and related costs of obtaining bank borrowings and decided to dispose of Property B.

12. When asked about his letting of Property B in 1994, he stated that because the property market had fallen, he felt he should rent out the property hoping that the property price would rise.

13. We accept the Taxpayer's evidence. In our view, it is clear having regard to his evidence and having regard to his other property transactions that it was his intention at the beginning to try to make a quick profit but due to unusual and difficult circumstances, namely the fall in the property market.

Properties C, D and E

14. The Taxpayer told us that around November 1995, he felt this was a suitable time to purchase further properties. Therefore, he purchased Property C which was a completed flat of 644 square feet and Property D (a car parking space). He also purchased a further Property E at the Estate. He gave evidence that these were all located at popular residential estates which, in his opinion, had better marketability. Again, he gave evidence that after each purchase, he was asked by many estate agents whether or not he was interested in selling. Under cross-examination, he was asked as to why he let Properties C and E and he answered this by indicating that since the property market subsequently turned flat and prices were not increasing, he wished to maximize any returns by waiting a little longer.

15. He drew our attention to the various changes that took place in 1997 and in particular, property asking prices had increased very quickly. However, when he tried to sell, he could not obtain a satisfactory price. He was of the view that he had no alternative but to hold Properties B, C, D and E due the fact that the property price had already reached its peak. He drew our attention to the economic turmoil that took place in late 1997 and the dramatic fall in property values. However, he was of the view that the property prices would bottom out sooner or later. Having waited for two years after 1997, he decided that the price would go down again and therefore, in 1999, he decided to dispose of Properties A, B, C, D and E when the various leases came to an end. Those properties on hand were sold to estate agents one after the other after vacant possession had been obtained.

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16. We accept the Taxpayer's evidence that it was always his intention to make a quick profit and that because of the unusual events that took place, he was unable to effect sales at an earlier date in order to obtain a return of profit as he had expected.

Our analysis

17. Section 14 of the Inland Revenue Ordinance ('IRO') is the charging provision for profits tax. The section reads as follows:

'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) as ascertained in accordance with this Part.'

18. Section 2 of IRO contains a definition of trade which reads as follows:

'"trade" includes every trade and manufacture, and every adventure and concern in the nature of trade.'

19. Section 42(2) of IRO provides as follows:

'(2) There shall be deducted from the total income of an individual for any year of assessment –

.....

(b) the amount of the individual's loss or share of loss for that year of assessment computed in accordance with Part IV.'

20. We remind ourselves as to the provisions of section 68(4) which puts the burden of proof on the Taxpayer as follows:

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

21. We refer to Lionel Simmons Properties Ltd (in liquidation) and Others v CIR [53 TC 461], All Best Wishes Limited v CIR 3 HKTC 75 and Board Decision D11/80, IRBRD, vol 1, 374. However, it is accepted and well established that in determining whether a property is a trading stock or a capital asset, one has to ascertain the intention towards the property at the time of acquisition. A stated intention we accept is of limited probative value, one must have regard to

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the objective facts and circumstances surrounding the purchase and re-sale of the property. The intention must be genuinely held, realistic and realizable.

22. In order to ascertain such an intention, we take the view that we are entitled to look not only at the Taxpayer's dealings in respect of Properties B, C, D and E but we are also able to look at his transactions with regard to Properties 1 to 11 and Property A. In our view, one cannot look at Properties B, C, D and E in isolation.

23. Therefore, we have no difficulty in accepting the Taxpayer's evidence that it was always his intention to speculate and that the properties he purchased were his trading assets and that intention was genuinely held.

Conclusion

24. We conclude therefore that the appeal should be allowed.