INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D27/95

Profits tax – purchase and sale of property at a profit – whether profit assessable to profits tax.

Panel: Kenneth Kwok Hing Wai QC (chairman), Anthony N C Griffiths and Eric Lo King Chiu.

Dates of hearing: 2 and 3 March 1995.
Date of decision: 8 June 1995.

The taxpayer purchased a property and sold the same soon thereafter at a profit. The assessor assessed the profit to profits tax and the taxpayer appealed to the Board of Review. At the hearing the taxpayer gave evidence.

Held:

The taxpayer had not discharged the onus of proof.

Appeal dismissed.

Cases referred to:

Marson v Morton [1986] STC 463
Simmons v IRC [1980] 1 WLR 1196
Simmons v IRC [1980] 53 TC 461
All Best Wishes Limited v CIR [1992] 3 HKTC 750

Iris Ng Yuk Chun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal against the determination dated 6 October 1994 by Mr Anthony Au Yeung, Commissioner of Inland Revenue, rejecting the Taxpayer's objection but revising the profits tax assessment for the year of assessment 1991/92 dated 31 January 1994 showing assessable profits of $624,812 with tax payable thereon of $93,721 by reducing them to assessable profits of $589,812 with tax payable thereon of $88,471.

Name of the Taxpayer in this appeal

2. In the papers sent to us before the hearing, the name of Taxpayer was 'Mr X trading as X'. This was how the Commissioner referred to the Taxpayer in his letter to the Taxpayer dated 6 October 1994, enclosing his determination. At the outset of the hearing, we told the parties that as the issue in this appeal was whether the one-off purchase and sale of a residential unit by the Taxpayer amounted to an adventure in the nature of a trade, the above description of the Taxpayer was not only inappropriate but wrong. After having heard both parties, neither of which had any objection, we corrected the title of this appeal by deleting the words 'trading as X' from the name of the Taxpayer.

The Facts:

3.1 The Taxpayer, born in 1953 (now age 41), is and has at all material times been an officer of a government department.

3.2 From 1984 to mid 1990, the Taxpayer was stationed at Centre A and resided in a departmental quarter on Island K.

3.3 In mid 1990, the Taxpayer was transferred to Centre B and has since been residing with his wife, son, father-in-law, and a domestic helper at a departmental quarter in District Y, with a floor area of approximately 1,500 square feet. He has been paying 'rent' at 7.5% of his monthly salary.

3.4 The Taxpayer's wife has also been working in the same government department and her rank is an officer. She is in Division R.

3.5 The Taxpayer's son was aged 5 in September 1991. The son attended a kindergarten on Island K, and after moving to District Y, attended Kindergarten H on Hong Kong Island.

3.6 By a provisional agreement dated 28 February 1991, the Taxpayer agreed to purchase Property N ('the subject property'), which was then under construction, at the price of $1,057,000. The floor area of the subject property is 664 square feet.

3.7 The formal agreement for the purchase by the Taxpayer of the subject property is dated 4 March 1991.

3.8 The Taxpayer's purchase of the subject property was financed by a loan of $951,300 advanced by Bank L, on or about 13 March 1991. The loan was secured by an equitable mortgage dated 11 March 1991. A legal mortgage dated 29 July 1991 was also executed by the Taxpayer.

3.9 The Taxpayer's purchase of the subject property was completed by the assignment dated 29 July 1991.

3.10 The Taxpayer collected the keys to the subject property in July 1991 and discovered some damage which was subsequently repaired by or on behalf of the developer by mid August 1991. The Taxpayer spent $20,000 on floor polishing and painting which lasted about a month.

3.11 By a provisional agreement which was signed on or about 8 October 1991, the Taxpayer agreed to sell the subject property at the price of $1,820,000. The provisional agreement was made about a week or longer after the Taxpayer had put up the subject property for sale through estate agents. The formal agreement is dated 25 October 1991, and the assignment by the Taxpayer is dated 18 December 1991. The consideration stated in the assignment is $1,855,000.

3.12 Before us, the Taxpayer produced a copy undated notice from School T, Primary Section ('School P') notifying the Taxpayer's son to attend an interview on 30 November 1991 at School P's premises in District Z; a copy receipt from School P dated 23 May 1992 for school and sundry fees for September 1992; and a copy provisional agreement dated 6 October 1992 made by the Taxpayer and his wife to purchase Property O at the price of $1,968,000. The floor area of Property O is 591 square feet.

3.13 The Taxpayer's purchase of Property O was financed by a mortgage loan of $1,370,000 repayable by monthly instalments of around $13,000 over a period of fifteen years. This property was let out to a tenant in about February 1993 for a term of two years at a monthly rental of $8,200, inclusive of rates. This property remains in the co-ownership of the Taxpayer and his wife.

3.14 The Taxpayer's purchase and sale of the subject property came to the assessor's notice and the assessor made enquiries with the Taxpayer. By letter dated 18 July 1993, the Taxpayer replied alleging that the subject property was self-occupied from acquisition to sale, and enclosed a copy of the electricity bill in respect of the subject property dated 21 October 1991 showing consumption of 1 unit of electricity in support of his allegation of self-occupation.

3.15 The assessor took the view that the acquisition and sale of the subject property amounted to an adventure in the nature of trade and on 16 August 1993 issued a profits tax return for the year of assessment 1991/92 to the Taxpayer for completion.

3.16 The Taxpayer submitted the return declaring that there was no assessable profit and attached a letter dated 8 September 1993 contending that the subject property was sold in exchange for Property O because his place of work and his son's school were both located on Hong Kong Island. The Taxpayer also provided an account for the acquisition and sale of the subject property showing a gain of $589,812.

3.17 The Taxpayer did not mention anything about an activity centre for ex-mentally ill persons in his two letters dated 18 July 1993 and 8 September 1993. Nor did he cite any blocking of view of his 2/F flat as a reason for sale in either letter.

3.18 The assessor maintained his view that the subject property was acquired as trading stock. There was no dispute between the assessor and the Taxpayer on the amount of expenses. The assessor did not accept the assertion made by the Taxpayer that the sale price of the subject property was $1,820,000, but took the sale price as $1,855,000. Thus, on 31 January 1994, the assessor raised on the Taxpayer the profits tax assessment for the year of assessment 1991/92 with an assessable profits of $624,812 [having added the sum of $35,000 (which was the difference between $1,855,000 and $1,820,000) to the figure of $589,812 furnished by the Taxpayer] and tax payable thereon of $93,721.

3.19 By a notice dated 2 February 1994, the Taxpayer objected to the assessment; contending that as he had used the whole of the proceeds of sale of the subject property to purchase Property O, there was no 'profits'; claiming that the subject property was sold because of the close proximity of an escalator and a government department which blocked (the view of) the subject property; and further contending that as he had applied under the housing loan scheme and as his son was studying as School P. he had to acquire his own property (on Hong Kong Island). The complaint in relation to the government department was blockage of view, not the presence of an activity centre for ex-mentally ill patients.

3.20 The assessor has since raising the assessment conceded that the sale price of the subject property was $1,820,000 and proposed to revise the assessment by reducing the assessable profits to $589,812 and tax payable thereon to $88,471.

3.21 By the determination dated 6 October 1994, the Commissioner rejected the Taxpayer's objection but revised the profits tax assessment for the year of assessment 1991/92 dated 31 January 1994 showing assessable profits of $624,812 with tax payable thereon of $93,721 by reducing them to assessable profits of $589,812 with tax payable thereon of $88,471.

3.22 The Taxpayer appealed from the determination.

3.23 Apart from the purchase and sale of the subject property and the purchase of Property O, the Taxpayer has not bought or sold any other landed property.

Relevant provisions

4.1 Section 68(4) of the Inland Revenue Ordinance (the IRO), Chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Taxpayer.

4.2 Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

The Issue

5. The issue is whether the Taxpayer has discharged his onus of proving that the assessment on the gain arising from the sale of the subject property is incorrect in that it is not assessable to profits tax in accordance with section 14(1) on the ground that the subject property was acquired as a capital asset.

Authorities

6. We do not find it necessary to refer to all the relevant authorities on whether there was an adventure in the nature of trade. Each case depends on its own facts.

7. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] STC 463 at pages 470-471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and [1980] 53 TC 461 at pages 491-492; and the statement of the law by Orr L J at pages 488 and 489 of the report in Tax Cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

8. In All Best Wishes Limited v CIR [1992] 3 HKTC 750 at page 770 and page 771, Mortimer J, as he then was, was reported to have said:

> *'Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.'*
>
> (at page 770).
>
> *'The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.*
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> *I am unable to accept that submission quite in its entirely. I am, of course, bound by the decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? The intention of the taxpayer, at the time of acquisition, and at the time when he is holding the asset is undoubtedly of very great weight. And if the intention is on the evidence, genuinely held, realistic and realisable, and if all the circumstances show that at the time of the acquisition of the asset, the taxpayer was investing in it, then I agree. But as it is a question of fact, no single test can produce the answer. In particular, the stated intention of the taxpayer cannot be decisive and the actual intention can only be determined upon the whole of the evidence. Indeed, decisions upon a person's intention are commonplace in the law. It is probably the most litigated issue of all. 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. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.'* (at page 771).

Evidence

9.1 The Taxpayer produced a copy of an undated notification under the home purchase scheme. He gave oral evidence himself but called no other witness.

9.2 The Commissioner produced a certified copy of the land office record in respect of the subject property; a copy of the first two pages of the sale brochure of the subject property; and a copy of pages 3, 30 and 31 of the 1992-93 Annual Report of the Hong Kong Council of Social Services; and a copy of newspaper cuttings extracted from three different newspapers in December 1992 and January 1993. The Commissioner did not adduce any oral evidence.

Our Decision

10. After having carefully considered the grounds of appeal, the evidence adduced by the Taxpayer, and the submission made by the Taxpayer, we did not think it was necessary to call on Miss G for the Commissioner. We told the parties that we would give our decision in writing in the usual way. This we now do.

11. Our task is to decide on the materials before us whether the Taxpayer has discharged his onus of proving that the assessment on the gain arising from the sale of the subject property is incorrect in that the subject property was acquired as a capital asset.

12.1 That the transaction in question was a one-off transaction by the time of sale is a pointer which indicates there might not here be trade but something else. However, the lack of repetition is not by itself conclusive and a one-off transaction is in law capable of being an adventure in the nature of trade.

12.2 That the transaction in question is not related to the occupation of the Taxpayer is another pointer in favour of the Taxpayer. Again, this factor is not conclusive. In Hong Kong, people from different walks of life take part in trading in or speculation of landed properties.

12.3 The nature of the subject matter, that is a residential flat, is neutral. It can be turned to advantage by realisation when the market goes up. It can also be bought for long-term investment, for self-occupation, or for rental income. Significantly, it is **not** the Taxpayer's case that rental income from the subject property was a factor in his decision to acquire the subject property.

12.4 The Taxpayer relied on his equitable mortgage of the subject property. We are not persuaded that this was an unusual way of trading in landed property.

12.5 The fact that the source of finance was substantially borrowed does not assist the Taxpayer.

12.6 The work done by the Taxpayer on floor polishing and painting is neutral and does not necessarily point to trade. The improvement could have been done because the Taxpayer wished to reside there.

12.7 The Taxpayer's case is that he purchased the subject property for the purpose of self-occupation in the event he had to surrender his quarters in District Y. The Taxpayer does not impress us as a credible witness. His evidence on this point is unconvincing and we reject it. The provisional agreement is dated 28 February 1991 and the formal agreement is dated 4 March 1991. The assignment is dated 29 July 1991. Between February 1991 and July 1991, the Taxpayer's place of work had been Centre B, his wife had been in Division R, and his son, aged 5 had been attending Kindergarten H. The location of the subject property could not have commended itself to the Taxpayer as his residence. The size of the subject property is less than ½ of that in District Y quarters. The subject property could not accommodate the Taxpayer's father-in-law who was living with the Taxpayer in District Y quarters during the period of acquisition. The Taxpayer's son would have to share a room with the domestic helper if the Taxpayer were to reside in the subject property. The subject property was by no means near any centre or primary school which the Taxpayer was content to send his son to – the nearest centre being Centre C, which was about 25 minutes away by public transport and a government primary school was about 15 minutes away by public transport. Furthermore, the Taxpayer conceded that should he be transferred and should he wish to surrender District Y quarters, he would still be entitled to alternative quarters. Lastly, the fact that he alleged in his letter dated 18 July 1993 that the subject property was self-occupied from acquisition to sale when he had in fact been residing at District Y quarters throughout that period is no credit to his veracity.

13. Since we have rejected the Taxpayer's claim that he acquired the subject property as a capital asset, the question whether he subsequently changed his mind and decided to sell what had been acquired as a capital asset does not arise. Be that as it may, we find the reasons given by him on appeal wholly unconvincing and reject them. He has been shifting his case – see paragraphs 3.14, 3.16, 3.17, 3.19 above and his evidence before us that the presence of an activity centre for ex-mentally ill patients was a reason for sale. The Taxpayer contracted to sell the subject property within three months of completion of his purchase (and within eight months of contracting to purchase the subject property) and made a handsome profit.

14. On our findings, the profits accrued on sale of the subject property. It is immaterial how the Taxpayer allegedly applied the proceeds of sale or the profits, particularly when the purchase of Property O did not take place until the following year of assessment.

Appeal dismissed:

15. We have carefully considered the grounds of appeal, the evidence adduced by the Taxpayer, and all the pointers towards investment. Taking all the relevant factors into consideration, we have no doubt that the Taxpayer has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment appealed against.