

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D28/01

**Profits tax** – acquisition and sale of property – intention at time of purchase – burden of proof on purchaser to establish that property purchased for long term investment – adventure and concern in nature of trade – ‘totality of evidence’ approach – badges of trade – section 2(1) of the Inland Revenue Ordinance (‘IRO’).

Panel: Ronny Wong Fook Hum SC (chairman), Man Mo Leung and Ng Yin Nam.

Date of hearing: 8 March 2001.

Date of decision: 10 May 2001.

By memorandum of purchase dated 11 May 1996, Property 4 was purchased by Mrs A at Housing Estate J for the sum of \$5,422,300. On 15 May 1996, Ms B, the daughter of Mrs A, was inserted as an additional purchaser of Property 4. The certificate of compliance for the property was issued on 27 March 1997 after which, on 30 April 1997, Mrs A and Ms B sold Property 4 for the sum of \$10,000,000.

#### **Held:**

1. It was for the taxpayer to prove that the acquisition of the properties was for long term investment. A bare assertion was not decisive and must be viewed in the light of the conduct of the parties and the surrounding circumstances (Lionel Simmons Properties Ltd (in liquidation) v Commissioner of Inland Revenue 53 TC 461 and All Best Wishes Limited v CIR 3 HKTC 750 followed).
2. The totality of the evidence presented by the witnesses would be taken into account rather than any particular fact in isolation.
3. Looking at the six badges of trade (subject matter, length of period of ownership, frequency or number of similar transactions by the same person, supplementary work on or in connection with the property, motive and circumstances responsible for the realisation of property), the Board was satisfied that Ms B should be assessed in respect of the profits made.

**Appeal allowed in part.**

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Cases referred to:

Lionel Simmons Properties Ltd v The Commissioner of Inland Revenue [1980]  
53 TC 461  
All Best Wishes Limited v CIR 3 HKTC 750  
D124/99, IRBRD, vol 15, 1  
Pickford v Quirke 13 TC 251  
Marson v Morton [1986] STC 463

Fung Ka Leung for the Commissioner of Inland Revenue.  
Taxpayers represented by their representative.

### **Decision:**

### **Background**

1. The first named Taxpayer (‘ Mrs A ’ ) is the mother of three children:
  - (a) a daughter, the second named Taxpayer (‘ Ms B ’ ), born in October 1968;
  - (b) a son Mr C born in December 1971;
  - (c) another son Mr D born in October 1973.
2. On 19 December 1983, Mrs A and her husband acquired as joint tenants a flat at Housing Estate E (‘ Property 1 ’ ). Property 1 had been the family home ever since.
3. Ms B worked as an estate agent with Company F between 1 April 1995 and 31 December 1995. In Company F’s employer’s return for the year ended 31 March 1996, a flat at Housing Estate G (‘ Property 2 ’ ) was given as Ms B’s residential address.
4. Property 2 was the residence of Mr H. Mr H is the boy-friend of Ms B.
5. By an agreement dated 23 February 1996, Mr H and Ms B purchased a flat at Housing Estate I for \$9,050,000 (‘ Property 3 ’ ).
6. On 6 May 1996, the developer of a complex known as Housing Estate J invited interested purchasers to submit applications for a total of 128 units. Each person (be it individual or corporation) was allowed not more than one application which must be accompanied by a cashier order of \$650,000. Successful applicant must execute the provisional and the formal agreements in

## INLAND REVENUE BOARD OF REVIEW DECISIONS

his own name. No transfer or alteration of the ownership was permitted prior to occupation of the relevant unit.

7. Mrs A, Ms B and Mr H each submitted one application. Mrs A's application drew sequence number 255 for the selection of the available units. Ms B and Mr H respectively drew sequence numbers 2117 and 3444.

8. By a memorandum for purchase dated 11 May 1996, Mrs A purchased a flat at Housing Estate J ( ' Property 4 ' ) with a saleable area of 971 square feet for \$5,422,300. Apart from the sum of \$650,000 submitted with her initial application, Mrs A had to pay \$434,460 on 29 May 1996 and \$4,337,840 on 14 June 1996.

9. On 15 May 1996, Ms B was inserted as an additional purchaser for Property 4.

10. By a letter dated 5 June 1996 and addressed to Mr H, Ms B and Mrs A, Bank K extended to them an instalment loan of \$3,790,000 repayable by 360 monthly instalments of \$31,179.4 each. The first of such instalment fell due on 13 July 1996.

11. On 31 October 1996, Ms B submitted her tax return for the year of assessment 1995/96. The return was sent to her at Property 2 which she reported as her residential address. According to this return, her income for the year was \$76,440. She claimed deduction of interest paid in respect of a loan of \$1,800,000 extended by Bank K in respect of a flat at Housing Estate L.

12. On 6 November 1996, Mr H and Ms B sold Property 3 for \$10,600,000. On the same day, they purchased another flat at Housing Estate I ( ' Property 5 ' ) for \$9,800,000.

13. By an agreement dated 7 March 1997, Mr H and Ms B purchased the third flat at Housing Estate I ( ' Property 6 ' ) for \$13,200,000.

14. The certificate of compliance in respect of Property 4 was granted on 27 March 1997. By a provisional agreement dated 30 April 1997, Mrs A and Ms B sold Property 4 for \$10,000,000. The issue before us relates to their tax liability pertaining to the gains arising from the purchase and sale of this flat.

15. On 13 January 1998, Mr C left Hong Kong to further his studies in Country M.

16. Mr H and Ms B sold Property 5 on 18 May 1998 for \$10,100,000. They sold Property 6 on 14 October 2000 for \$7,200,000,

**Sworn testimony before us**

## INLAND REVENUE BOARD OF REVIEW DECISIONS

17. Mrs A, Ms B and a Mr N gave sworn testimony before us.
18. According to Mrs A:
  - (a) Her husband had retired by 1996 and Mr D was then studying in a university in Hong Kong. She came across the site of Housing Estate J when she visited Mr D and became interested in acquiring a unit in Housing Estate J as her family home. She was most concerned with the position of Mr C who did not then have the benefit of a university education. She thought the move to Housing Estate J might enhance Mr C's station of life.
  - (b) She discussed the move with her family when she was afforded priority in her application. The family considered the move from their Property 1 with three bedrooms and one toilet to Property 4 with three bedrooms and two toilets. The whole family supported the move.
  - (c) She was then approached by many estate agents for the sale of Property 1. She was under the impression that Property 1 would fetch \$5,000,000 on sale.
  - (d) She did not succeed in getting the unit in Housing Estate J that she earmarked for her purchase. Although Property 4 was priced at \$5,422,300, about \$400,000 more than what she thought was the price for her Property 1, she decided to chance it after obtaining Ms B's assurance that she could bear the difference.
  - (e) Ms B was added in as an additional purchaser as she was not in a position to obtain finance from the bank. Ms B paid the initial deposits and the monthly mortgage repayments.
  - (f) In late 1996 or early 1997, Mr C expressed the wish to further his studies abroad. It was then estimated that his studies would last not less than five years. Ms B also indicated her desire to move out of Property 1. Ms B moved into Property 2 in early 1997.
  - (g) She gave Mr C partial support of about \$10,000 per month for the furtherance of his studies in Country M.
  - (h) After discussing the situation with her friends in Housing Estate E, she decided to stay. Property 4 was therefore sold immediately after securing possession at the offered price of \$10,000,000. The net proceeds of sale were all retained by Ms B although she made use of part of such proceeds when she was diagnosed in having breast cancer in August 2000.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

19. According to Ms B:

- (a) She began working as an estate agent in 1991. Despite her occupation as an estate agent, she has never been assessed profits tax for gains made through dealings in properties. She successfully resisted assessments made against her in respect of Properties 3 and 5.
- (b) She used Property 2 as her correspondence address. Although she stayed in that flat on an occasional basis before 1997, she did not reside in that flat until Mr H requested her to do so in early 1997.
- (c) Mr H paid all the initial deposits totalling \$1,950,000 in respect of the three applications for units in Housing Estate J. If successful, Mr H would use his unit in Housing Estate J as his residence and she would use her unit for rental purpose. She denied any interest in the application by Mrs A.
- (d) Her average earnings in 1996 was about \$10,000 per month. As her boyfriend, Mr H gave her financial support. She has no knowledge as to the state of finance of Mr H. Mr H also lent his name in order to secure the loan of \$3,790,000 from Bank K.
- (e) Had she intended to speculate in the property market, she would have opted for units in completed buildings and would not have selected units in Housing Estate J for that purpose. As a result of restrictions imposed by the developer of Housing Estate J, a speculator could not reap his profit through a confirmor sale. She also laid emphasis on the fact that no limited company was used in the acquisition of Property 4.
- (f) She received the net proceeds of about \$6,000,000 obtained on sale of Property 4. After repaying her outlay of about \$2,000,000, she placed the balance in fixed deposits on behalf of Mrs A. She explained that Mrs A had never handled sums of this magnitude and she was helping her in managing these funds.

20. Mr N is an estate agent. According to Mr N:

- (a) In 1997, units in Housing Estate E could easily be disposed off within a week or two.
- (b) A speculator would try to maximize the returns on his outlay and to minimise the risks involved. Flexibility is the key. A limited company would normally be

## INLAND REVENUE BOARD OF REVIEW DECISIONS

utilised for that purpose. Furthermore, the speculator would await completion of the building before venturing into the market.

### **The applicable principles**

21. In order for a tax liability to arise, a profit must be derived in Hong Kong from a trade, profession or business carried on in Hong Kong. Section 2(1) of the IRO defines ‘trade’ to include every ‘*adventure and concern in the nature of trade*’. The facts of each case must be looked at to see whether a gain was made in the operation of business in carrying out a scheme for profit-making.

22. In Lionel Simmons Properties Ltd v The Commissioner of Inland Revenue [1980] 53 TC 461 at 491, Lord Wiberforce pointed out that trading requires an intention to trade and the question to be asked is whether this intention existed at the time of the acquisition of the asset. We therefore have to ascertain the intention of Mrs A and Ms B on 11 and 15 May 1996. We have to be satisfied that their intention was to purchase Property 4 as their family home and such intention is on the evidence ‘genuinely held, realistic and realisable’.

23. As pointed out by Mortimer J (as he then was) in All Best Wishes Limited v CIR 3 HKTC 750:

*‘ 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.’*

24. Mr O for the Taxpayers drew our attention to the decision of this Board in D124/99, IRBRD, vol 15, 1. It is regrettable that the headnote of that case is inaccurate. The issue in that case was the taxability of gains arising from dealings with Property II. Substantial down payment was one factor which the Board took into consideration. The Board further accepted the evidence of the taxpayer that he renovated Property II and it was then that he received advice from a *fung shui* expert that the flat was most unsuitable for his wife, carrying with it a high risk of miscarriage. It was on the totality of such evidence that the Board held that the taxpayer had properly discharged his onus. Every case depends on its own facts and it is dangerous to isolate one factor and elevate the same into a proposition of law.

### **Our decision**

25. We would consider this case by applying the six well known badges of trade.

26. Subject matter: Mr O placed considerable reliance on the evidence of Ms B and Mr N to the effect that units in Housing Estate J were unsuitable for speculative purposes. We have

## INLAND REVENUE BOARD OF REVIEW DECISIONS

serious reservations on the veracity of such evidence. The suitability of a unit for speculative purposes depends on a variety of factors. The location of the units and the developer involved are but some of the relevant factors. The developer of Housing Estate J obviously anticipated heavy demand for their units and tried their best to dampen speculation. The demand remained high. There were at least 3444 (the sequence number allotted to Mr H) applicants for the 128 units offered. In the light of such heavy demand, it would be naive to believe that units in Housing Estate J did not attract the attention of local speculators.

27. The length of period of ownership: Property 4 was disposed of immediately after the grant of the certificate of compliance.

28. The frequency or number of similar transactions by the same person: Mr O cited Pickford v Quirke 13 TC 251 in support of his proposition that 'It is well settled that one transaction of buying and selling does not make a man a trader.' Mr O has obviously failed to consider the leading case of Marson v Morton [1986] STC 463. Sir Browne-Wilkinson VC stated at page 470j that 'Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.' Mrs A has no history of property dealings. Ms B was involved in other property deals before and after the purchase of Property 4. It must however be emphasised that she has never been taxed for any profits she made in her property deals.

29. Supplementary work on or in connection with the property realised: No step was taken to dispose of Property 1. No renovation work was done to Property 4 prior to its disposal.

30. Motive and the circumstances that were responsible for the realisation: It is the case of the Taxpayers that Mrs A was the sole beneficial owner of Property 4. She had Mr C's interest in mind when she made the purchase. She decided to dispose of the same when Mr C expressed his desire to further his studies in Country M. We have difficulty accepting this case when considering the overall circumstances of the purchase. Three applications for units in Housing Estate J were submitted on the same day. Mr H financed all the applications. Ms B was in no position at all to pay the monthly mortgage instalments. Mr H supported the purchase of Property 4 throughout. Little is known about the financial state of Mr H. The sale of Property 4 followed shortly after the purchase by Ms B and Mr H of their Property 6. Mrs A did not receive a cent from the net proceeds of sale. No documentary evidence has been furnished to demonstrate that she derived any benefit from the proceeds of sale. We find this surprising in view of her affection towards Mr C. There is no evidence to suggest that she used any part of the proceeds of sale to support Mr C's education in Country M. For these reasons, we are not persuaded that the Taxpayers have discharged the burden in proving the principal averment of their case, namely, that Mrs A was the true beneficial owner of Property 4. On a balance of probabilities, we take the view that Ms B was the true beneficial owner. Ms B did not put forward any other case on the basis of her beneficial interest.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

31. On our review of the six badges of trade in the light of the facts of this case, we are satisfied that Ms B should be assessed in respect of the profits made. We allow Mrs A's appeal and direct that the assessment on Ms B be revised in the light of our findings.