INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D28/02

Profits tax – sale of property – whether the profits derived from the sale of the houses were capital in nature – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance ('IRO') – onus of proof on the appellant – unsustainable appeal – order to pay costs.

Panel: Kenneth Kwok Hing Wai SC (chairman), Edward Cheung Wing Yui and Wong Kwai Huen.

Date of hearing: 21 June 2002.
Date of decision: 12 July 2002.

The appellant is an indigenous villager of a village. In 1957, the appellant inherited several pieces of land. The appellant appointed a limited company as his lawful attorney to construct two three-storey small houses on the land and on divers dates, the attorney, on behalf of the appellant, sold the houses. The appellant objected to the profits tax from the sale of the houses and claimed that the profits he derived from the sale were capital in nature and should not be chargeable to profits tax and the profits tax assessments are excessive.

Held:

1. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the appellant.

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.

3. Whether the appellant intended to build two houses for him and his children to live is a question of fact. Neither he nor any of his children attended the hearing of the appeal to tell the Board about the appellant's alleged intention. There is simply no evidence on the appellant's intention. There is no evidence on the appellant's financial ability to fund the building costs of the houses. Such evidence is clearly relevant to the question whether the stated intention is on the evidence, genuinely held, realistic or realizable (Marson v Morton [1986] 1 WLR 1343; Simmons v IRC [1980] 1 WLR 1196; and All Best Wishes Limited v CIR [1992] 3 HKTC 750 followed).

4. The appellant has not discharged the onus under section 68(4) of the IRO of proving that any of the assessments appealed against is excessive or incorrect. The Board is of the opinion that this appeal is obviously unsustainable and pursuant to section 68(9) of the IRO, the Board orders the appellant to pay the sum of $5,000 as costs of the Board.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

Marson v Morton [1986] 1 WLR 1343
Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR (1992) 3 HKTC 750

Chow Chee Leung for the Commissioner of Inland Revenue.
Leung Wo Ping of Messrs Charles Chan, Ip & Fung CPA Limited for the taxpayer.

Decision:

1. This is an appeal against the determination of the Commissioner of Inland Revenue dated 26 February 2002 whereby:

(a) Profits tax assessment for the year of assessment 1998/99 under charge number 3-1995929-99-3, dated 14 November 2000, showing assessable profits of $2,520,297 with tax payable thereon of $378,044 was confirmed.

(b) Profits tax assessment for the year of assessment 1999/2000 under charge number 3-1476855-00-A, dated 14 November 2000, showing assessable profits of $1,113,933 with tax payable thereon of $167,089 was confirmed.

The agreed facts

2. The following facts are agreed and we find them as facts.

3. The Appellant has objected to the profits tax assessments for the years of assessment 1998/99 and 1999/2000 raised on him. The Appellant claimed that the profits he derived from the sale of certain properties were capital in nature and should not be chargeable to profits tax.

4. The Appellant is an indigenous villager of a village in District A, New Territories. In 1957, the Appellant inherited several pieces of land including the Old Lot.

5. (a) By an agreement and conditions of exchange dated 23 February 1995 ('the Agreement'), the Appellant surrendered the Old Lot to the government and was granted the New Lot in exchange. The Agreement contained, among other things, a special condition which provided that the Appellant should develop the New Lot by the erection thereon of two small houses to be completed and made fit for occupation before the expiration of 36 months from the date of the Agreement.

(b) On 17 March 1995, the district land officer, District B ('DLO') issued three certificates of exemption which would exempt the small houses to be erected on the New Lot from certain provisions and regulations of the Buildings Ordinance (Chapter 123) in respect of site formation works, building works and drainage works.

6. By a power of attorney dated 6 July 1995, the Appellant appointed a limited company to be his attorney ('the Attorney') as his lawful attorney to act for him in all matters relating to the New Lot.

7. (a) The Appellant constructed two three-storey small houses known as Block A and Block B (collectively referred to as 'the Houses') on the New Lot.

(b) On 20 November 1998, DLO, after inspecting the Houses, issued to the Appellant a certificate of compliance.

8. On divers dates, the Attorney, on behalf of the Appellant, sold the Houses with details as follows:

	Date of agreement	**Date of assignment**	**Consideration** $
G/F, Block A	20-1-1999	27-2-1999	1,750,000
1/F, Block A	5-5-1999	5-5-1999	1,350,000
2/F, Block A	23-12-1998	22-1-1999	1,550,000
G/F, Block B	20-1-1999	27-2-1999	1,750,000
1/F, Block B	8-12-1998	22-2-1999	1,500,000
2/F, Block B	16-3-1999	17-4-1999	1,545,000
			9,445,000

9. The Appellant provided the assessor with the following computation of profits arising from the sale of the Houses:

			$	$
Selling price [paragraph 8]				9,445,000
Less:	Value of land		4,000,000	
	Cost of construction		1,604,900	
	Legal fee		41,670	
	Agency commission		63,500	
	Survey fee		30,000	
	Administrative fee		20,700	
	Demolition cost		50,000	5,810,770
Profits				3,634,230

The Appellant did not offer the profits for assessment.

10. The assessor was of the view that the construction and disposal of the Houses by the Appellant amounted to an adventure in the nature of trade. She raised on the Appellant the following profits tax assessments for the years of assessment 1998/99 and 1999/2000:

	1998/99	**1999/2000**
	$	$
Assessable profits	2,520,297 [Note 1]	1,113,933 [Note 2]
Tax payable thereon	378,004	167,089

Note 1:

				$
G/F and 2/F, Block A	($1,750,000 + $1,550,000) / $9,445,000	× $3,634,230	=	1,269,768
G/F and 1/F, Block B	($1,750,000 + $1,500,000) / $9,445,000	× $3,634,230	=	1,250,529
				2,520,297

Note 2:

				$
1/F, Block A	$1,350,000 / $9,445,000	× $3,634,230	=	519,451
2/F, Block B	$1,545,000 / $9,445,000	× $3,634,230	=	594,482
				1,113,933

11. Messrs Charles Chan, Ip & Fung CPA Limited, on behalf of the Appellant, objected to the above assessments on the ground that the gains on disposal of the Houses were capital in nature and should be non-taxable. Messrs Charles Chan, Ip & Fung CPA Limited put forward the following contentions:

(a) In 1994, the Appellant decided to redevelop the two old houses on the Old Lot for his family use.

(b) At that time, the Appellant was living in Country C.

(c) It was later discovered that the Old Lot had a doubled 'lot number' problem. To resolve the problem, the Appellant agreed to surrender the Old Lot in exchange for the New Lot.

(d) The redevelopment project had taken much longer time than expected. In late 1997, the Appellant and his family decided not to move back to Hong Kong. The Houses were therefore subsequently disposed of.

(e) The Appellant originally intended to redevelop the Houses for his own use and the gain was therefore capital in nature.

12. In reply to the assessor's enquiries, Messrs Charles Chan, Ip & Fung CPA Limited provided the following information:

(a) The Appellant had a son and four daughters, Daughter1, Daughter2, Daughter3, Daughter4 and Son5.

(b) The Appellant and his family went to Country C in the early sixties.

(c) The Appellant and his wife came to Hong Kong twice a year and stayed for about three months per visit. They usually stayed at the Appellant's other property at District A, New Territories ('the Residence').

(d) The Appellant's children visited Hong Kong once every two to three years. His elder children sometimes stayed at hotels when they came to Hong Kong.

(e) The age and occupation of the Appellant's five children as at 1997 were:

	Age	**Occupation**
Daughter1	39	Waitress
Daughter2	31	Student
Daughter3	30	Secretary

Daughter4	27	Student
Son5	21	Student

(f) Daughter1 was married in 1986 while Daughter3 was married in 1995.

(g) Daughter2, Daughter4 and Son5 lived with the Appellant before they moved out in 1999.

(h) At all relevant times, Daughter1 and Daughter3 lived with their own families.

13. Messrs Charles Chan, Ip & Fung CPA Limited also asserted that:

(a) The Appellant intended to occupy G/F of Blocks A and B with his wife and Son5. The remaining floors would be occupied by his four daughters and their respective families.

(b) The two old houses on the Old Lot were in a dilapidated state. They were left vacant and demolished in 1996.

(c) The Appellant appointed a building constructor on 25 April 1997. The construction works then commenced in May 1997 and were completed in September 1998.

(d) There had been much family discussion about the relocation plan including the likelihood of closing the family's takeaway outlet in Country C.

(e) There had been some reservations but no strong objection was voiced to the relocation plan.

(f) The relocation plan was subsequently deferred because of:

(i) the birth of Daughter3's daughter in June 1997; and

(ii) uncertainties after the changeover of sovereignty of Hong Kong.

14. The assessor had since ascertained that the Residence was a three-storey small house. The Appellant occupied G/F and let out 1/F and 2/F for rental income.

The appeal notice

15. The objection failed. By letter dated 25 March 2002, Messrs Charles Chan, Ip & Fung CPA Limited gave notice of appeal in its own name:

‘ Dear Sir

Re: [Name of the Appellant]

Appeal against Ag. Deputy Commissioner of Inland Revenue’s determination dated 26 February 2002

Pursuant to Section 66(1) of the Inland Revenue Ordinance, we hereby lodge an appeal against the Ag. Deputy Commissioner of Inland Revenue’s written determination dated 26 February 2002 issued to our captioned client. This appeal is made on the following grounds:

(1) The gain on disposal of the properties situated at [Block A and Block B] is capital-in-nature and should not be chargeable to Profits Tax.

(2) The Profits Tax assessments for the years of assessment 1998/99 and 1999/2000 are excessive.

A copy of Ag. Deputy Commissioner of Inland Revenue’s written determination dated 26 February 2002 together with a copy of the reasons therefor and of the statement of facts are enclosed for your reference.

Yours faithfully
For and on behalf of
Charles Chan, Ip & Fung CPA Ltd.
Authorised signatory’

The appeal hearing

16. The appeal came before us on 21 June 2002.

17. The Appellant was absent. So were his five children.

18. Mr Leung Wo-ping of Messrs Charles Chan, Ip & Fung CPA Limited represented the Appellant. Ms Chow Chee-leung represented the Respondent.

19. Mr Leung Wo-ping called a vice-chairman of a rural committee as a ‘witness’ and told us that the ‘witness’ would give evidence on the reasons why New Territories people went abroad, evidence on life abroad, and evidence on ancestral houses. The Chairman questioned Mr Leung Wo-ping on the relevance of such evidence to this appeal where the issue was the intention

of the Appellant. Mr Leung Wo-ping did not address us on relevance and did not ask the 'witness' any question.

20. Mr Leung Wo-ping called a surveyor. In response to a question from the Chairman, Ms Chow Chee-leung agreed the following fact and Mr Leung Wo-ping said he had no question for the surveyor:

> ' [The New Lot] was granted to the Appellant on 13 February 1995 by means of in-situ exchange upon the surrender of [the Old Lot] to facilitate the redevelopment application of the old lot to 3-storey NTEHs. Both lots are situated on the same piece of land with an area of 100.34 square metres about.'

21. No witness was called by Ms Chow Chee-leung.

22. After Mr Leung Wo-ping had confirmed that he had nothing further to say on behalf of the Appellant, we invited him to address us on costs. After his submission on costs, we told the parties that we were not calling on the Respondent and that we would give our decision in writing which we now do.

Our decision

23. Section 68(4) of the IRO provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Appellant.

24. As Halkyard, VanderWolk, and Chow advised in Hong Kong Tax Law, Cases and Materials, 3rd edition, page 318:

> *' In ... a Board ... hearing, the onus is on the appellant of proving that the assessment appealed against is excessive or incorrect; s. 68(4) ... This issue cannot be stressed enough, especially in trade versus investment cases, where silence virtually guarantees defeat'* .

25. 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.

26. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] 1 WLR 1343 at pages 1347 to 1349 and [1986] STC 463 at pages 470 to 471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and (1980) 53 Tax Cases 461 at pages 491 to 492; and the statement of the law by Orr LJ 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).

27. We also remind ourselves of what Mortimer J, as he then was, said in All Best Wishes Limited v CIR (1992) 3 HKTC 750 at page 770 and page 771:

> *' 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.*
>
> *I am unable to accept that submission quite in its entirety. 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)

28. Whether the Appellant intended to build two houses for him and his children to live in is a question of fact. Neither he nor any of his children attended the hearing of the appeal to tell us about the Appellant's alleged intention. There is simply no evidence on the Appellant's intention. The appeal is doomed to failure and fails. It is also a great waste of the time and resources of the Board of Review.

29. Another reason why this appeal must fail and does fail is that there is no evidence on the Appellant's financial ability to fund the building costs of the Houses. Such evidence is clearly

relevant to the question whether the stated intention (upon which there is no evidence) is on the evidence, genuinely held, realistic or realisable.

Disposition

30. The Appellant has not discharged the onus under section 68(4) of the IRO of proving that any of the assessments appealed against is excessive or incorrect. We confirm the assessments as confirmed by the Commissioner.

Costs

31. We are of the opinion that this appeal is obviously unsustainable. Pursuant to section 68(9) of the IRO, we order the Appellant to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.