

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D2/89

Interpretation – foreign cases – evidential matters – whether applicable.

Profits tax – sale of flat – whether profits were trading gains or realization of capital – evidential factors: taxpayer's dealing history and short holding period – s 14 of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), Eric Lo King Chiu and Frank Pong Fai.

Date of hearing: 21 February 1989.

Date of decision: 6 April 1989.

The taxpayers (a father and his daughter) purchased a flat in August 1978 for \$121,000 and sold it twelve months later for \$300,000.

The rental return from the flat was an unattractive 4.73% per year. The father had been involved in at least seven property transactions over the previous few years, either solely or with others. He also held shares in a family company which was an admitted property trader.

The taxpayers did not borrow funds to finance their purchase of the flat. They made no improvements to the flat. During the period they owned the flat, they increased the rent payable by the tenant.

The IRD assessed the taxpayers to profits tax on their profits from the resale of the flat. The taxpayers appealed and claimed that the profits represented capital gains.

Held:

The gains were of a trading nature and were therefore taxable.

- (a) The Board was entitled to take into account the father's participation in other property transactions. This factor, coupled with the short period during which the flat was held by the taxpayers, gave rise to a strong presumption in favour of trading.
- (b) There is no objection to reliance on UK cases concerning UK taxing provisions where those cases were concerned purely with matters of evidence.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Appeal dismissed.

Cases referred to:

D61/87, IRBRD, vol 3, 31
Armstrong v CED (Hong Kong) [1937] AC 885
Burrell v Davies (1948) 38 TC 307
CIR v Glynn (CA) Civ App No 51 of 1988
CIR v Livingston (1926) 11 TC 538
Marson v Morton [1986] STC 470

Tse Yue Keung for the Commissioner of Inland Revenue.
Lau Kam Cheuk of S Y Leung & Co for the taxpayer.

Decision:

This is an appeal by a father and daughter ('the Taxpayers') against an assessment to tax on the profits they derived on the sale of a residential flat ('the property') in the year of assessment 1979/80.

1. Background

The following primary facts are not disputed:

- 1.1 The property was acquired in the joint names of the Taxpayers on 2 August 1978, subject to the existing tenancy, for \$121,000 and sold, also subject to the tenancy, on 9 August 1979 for \$300,000.
- 1.2 On application under the Landlord & Tenant (Consolidation) Ordinance (Cap 7), the Taxpayers obtained an increase in the rent from \$425 to \$498 per calendar month. In the result, the total rent received throughout the period of ownership was \$5,725, representing a return of 4.73%.
- 1.3 The father was at all material times a shareholder, with his wife, a son and another daughter, in a company called X Limited.
- 1.4 This property transaction was the only one in which the daughter had been involved whereas the father had admittedly been involved in several property transactions prior to 2 August 1978, namely:

<u>Date of Purchase-Sale</u>	<u>Buyer</u>	<u>Location</u>	<u>Gross Profit on disposal</u>
----------------------------------	--------------	-----------------	-------------------------------------

INLAND REVENUE BOARD OF REVIEW DECISIONS

16-10-1976 14-2-1977	in conjunction with Mr A	A flat in Hong Kong	5,000
25-3-1977 11-8-1977	father alone	A flat in Hong Kong	14,500
20-6-1977 30-9-1977	father alone	A flat in Hong Kong	3,000
20-12-1976 30-11-1977	X Limited in conjunction with others	A building in Hong Kong	315,000
20-3-1978 20-3-1978	X Limited in conjunction with others	A building in Hong Kong	200,000
20-9-1977 26-6-1978	father alone	A building in Hong Kong	1,080,000
25-10-1977 31-7-1979	in conjunction with Mr A	A building in Hong Kong	1,310,000

We note that, although this last property was purchased before August 1978, it was not disposed of before that date.

2. TAXPAYER'S SUBMISSIONS

- 2.1 Neither of the Taxpayers nor any other person appeared to give evidence and no additional documentary evidence was submitted, save as mentioned below.
- 2.2 The Taxpayers' representative ('the representative') argued that the Taxpayers had paid property tax for the years 1978/79 and 1980, that the purchase price was paid for in full without recourse to any mortgage, that the Taxpayers had made no improvements in order to make the property more marketable, and that the sale of the property was induced by an approach made by a large public property development corporation and not by any solicitation by the Taxpayers. In this last regard, the representative produced a Land Office search which showed that the property was one of four flats bought by the large property developer as indicative of the probability that it was the developer that made the approach. We do not, however, consider that any such inference can be drawn from the search.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 2.3 He went on to suggest that the yield of 4.2% (based on the rent at the time of purchase) was not low. However, he produced no useful documentary evidence to support this contention. He did refer the Board to an extract from the annual return of a public company (a property investment company) for the year ended 31 December 1985 where the earnings per share for the year 1984 were shown at 4.2 ¢, that is, 4.2% on the par value of the shares. However we were given no indication of the then market value of that company's shares and could not therefore draw any inference. In any event, as the information was not even reasonably contemporaneous with 1978, we felt it was not at all helpful. Nor was the representative's reference to the latest interest rates for Japanese yen, German marks and Swiss francs of any value.
- 2.4 The representative took exception to the statement in the Commissioner's determination to the effect that no return had been filed by the Taxpayers. However, we considered that the Commissioner's remark was not material (in this particular case at any rate) in determining whether the profits from the sale of the property were by way of a non-taxable capital gain or a taxable trading profit and therefore we have ignored it.
- 2.5 The representative further stated that his clients had bought the property for rental income but, as already mentioned, neither of them appeared before the Board. We must therefore treat this statement as a bare submission by the representative.
- 2.6 The representative submitted that the Board should ignore other property transactions in which the father had been involved and should view this particular transaction in isolation.
- 2.7 The representative asserted that the obligation was upon the Inland Revenue to issue a return following notification in November 1979 to the property tax section of the Inland Revenue of the sale. We assume that his argument was to the effect that such failure amounted to estoppel: we were not, however, referred to any statutory provision or supporting case-law.
- 2.8 We were referred to D61/87, IRBRD, vol 3, 31 in which the profits on sale of holdings of Letters B were held, in the particular circumstances of that case, not to be taxable. The facts of that case are so different from the present case that the reference to it has no merit.
- 2.9 The representative made further submissions which in our view were concerned purely with administrative detail and had no bearing on the legal issues of this case.

3. THE REVENUE'S SUBMISSIONS

INLAND REVENUE BOARD OF REVIEW DECISIONS

3.1 The Commissioner's representative, Mr Tse Yue Keung, referred to the following passage in the report of CIR v Livingston (1926) 11 TC 538:

‘Where there are one or more isolated transactions which are alleged to constitute the carrying on of a trade, it is necessary to determine, by reviewing all the facts of the case, whether they are ‘in the nature of trade’ ... or whether they are merely a conversion of capital in one form into capital of another kind. The test is whether the operations involved in the transaction are of the same character, and carried on in the same way, as those which characterise what is admittedly trading in the line of business in question.’

3.2 He then referred us to the following six badges of trade set out at paragraph B3.212 of Simon's Taxes. However, he first acknowledged that no single factor is in any way necessarily decisive and that ‘whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case’ (Sir Nicholas Browne-Wilkinson VC in Marson v Morton [1986] STC 463, 470.

- 3.3
- (a) The subject matter of the realisation: Immovable property, said Mr Tse, is capable of being both bought for trading or for investment. In the instant case, the property was subject to rent control and hence the unattractive income rendered it an unlikely long-term asset. Mr Tse however produced no evidence to show that at the material time 4.27% was particularly unattractive.
 - (b) The length of the period of ownership: Here, the period was only just over one year and ‘a quick resale leads one to scrutinize the evidence that it was not envisaged from the first very carefully’ (Cross J in Turner v Last (1965) 42 TC 517, 523. In the present case, no corroborative evidence was available to enable any such scrutiny to be made.
 - (c) The frequency or number of similar transactions by the same person: In such cases, a presumption of trading arises. The dictum of Harman J In Burrell v Davies (1948) 38 TC at 307, 312 and 313 is authority for the proposition that the prior similar activities of one or more of a group of persons involved in a single transaction has a ‘very strong bearing’ on whether the single transaction is a trade, even when the remaining members of that group had no prior similar activities. That is to say, the passive partners are infected by the history of the active partners.

In January 1980, X Limited wrote (in a letter signed by the father) to the Inland Revenue to the effect that since 1973/74 that company had been in the business of dealing in the purchase and sale of properties, and this

INLAND REVENUE BOARD OF REVIEW DECISIONS

was confirmed in its 1977/78 tax return. The said letter and accounts and returns of X Limited were produced to the Board. In addition, the father had registered himself and a Mr B as carrying on the business of property dealing since May 1976.

The father's admitted property dealing activities should be taken into account when considering the circumstances of the case before the Board.

- (d) Supplementary work on or in connection with the property realised; Mr Tse argued that this badge had little significance in Hong Kong where immovable property is readily marketable. Indeed, since there has been no suggestion of any money having been expended on any of the properties listed in 1.4 above, it can be fairly assumed that no supplementary work was done on them – and yet, they were all sold at a profit and mostly within a fairly short period.
- (e) The circumstances that were responsible for the realisation; No evidence has been adduced to support the Taxpayers' statement that it was the large property developer which approached the Taxpayers.
- (f) Motive; There is no evidence to support the bare assertion by the Taxpayers that the motive behind the purchase was to obtain rental income.

3.4 Section 25 deals with the Taxpayers' representative's comments concerning property tax – it is up to the Taxpayers to claim reduction of any profits tax to the extent of any property tax paid.

3.5 That no mortgage was obtained is of neutral significance.

3.6 The fact that the Taxpayers sought an increase in rent was an understandable attempt to increase the return pending a sale; by itself, it was not a significant factor in rebuttal of trading.

4. CONCLUSIONS

4.1 The onus of proving, to our satisfaction on the balance of probabilities, that the assessment is excessive or incorrect lies squarely with the Taxpayers (s 68(4)). This point does not seem to have been fully appreciated by the representative. For example, in correspondence with IRD the Taxpayers' tax representatives said that the sale proceeds from the property were applied in another investment. However, as no evidence was forthcoming to support this statement, we rejected it.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 4.2 Contrary to the representative's submission (2.6 above), we have no hesitation in deciding that we are perfectly entitled to take into account the father's involvement in property transactions. It seems to us that the strictures of Lord Manghan in the Privy Council decision of Armstrong v Estate Duty Commissioner [1937] AC 885, referred to in the recent decision of the Court of Appeal in Glynn v CIR, Civil Appeal No 51 of 1988), concerning the impropriety of relying on UK decisions concerning UK taxing provisions for guidance as to the interpretation of similar provisions in colonial statutes has no application to Harman J's dictum because that is concerned purely with an evidentiary principle. Accordingly, we look upon Harman J's dictum as binding authority in Hong Kong and we are therefore obliged to take into account the father's other property transactions, which we shall now proceed to do.
- 4.3 Of the properties listed in paragraph 1.4 and on our reading of X Limited's accounts, the 3rd, 4th and 5th transactions were admittedly property dealings. As to the remainder, although there was insufficient evidence to form a categorical conclusion for each of the five transactions concerned, nevertheless, when they are viewed collectively in the light of the two last mentioned dealings, the father's admitted dealing propensity and the short periods for which most of the properties were held, there is in our view a strong presumption that they too were by way of trading.
- 4.4 With the above remarks in mind, we agree with all of those arguments so ably and fairly advanced by Mr Tse which we have set out at paragraph 3 (except as qualified by us in 3.3(a)) and hereby find as a matter of fact that the Taxpayers were carrying on a trade in relation to the property.

We therefore dismiss this appeal.