

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D31/00

Profits tax – acquisition and sale of property – intention of purchaser at time of acquisition – burden of proof on purchaser – whether tax chargeable on the profits of sale – section 68(4) of Inland Revenue Ordinance.

Panel: Robert Wei Wen Nam SC (chairman), Kenneth Ku Shu Kay and Sydney Leong Siu Wing.

Dates of hearing: 2, 9 and 14 February 2000.

Date of decision: 30 June 2000.

The taxpayers rented the subject property up to June 1996. At that time, the landlord gave priority to the taxpayers to purchase the said property for \$5,600,000. The taxpayers stated that it was their very strong intention to purchase the property for their daughter to live in after she had finished her studies in USA. They pleaded that there was no intention to speculate.

Held:

1. It was for the taxpayers 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 (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. Upon considering the evidence as a whole, the Board doubted the assertion made by the taxpayers as to their intention at the material time. The nature of the taxpayers' communications with the estate agent were inconsistent with a long term investment intention.
3. Further, the taxpayers had a mere hope of their daughter residing at the subject property which never developed into the required intention to displace the intention of trading. If such an intention was realised, the property would then have been a capital asset as opposed to a trading asset.

Appeal dismissed.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Cases referred to:

Simmons v IRC [1980] 1 WLR 1196
All Best Wishes Limited v CIR 3 HKTC 750
D11/80, IRBRD, vol 1, 374

Fung Ka Leung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Nature of appeal

1. The Taxpayers are husband and wife and are hereinafter referred to as Mr A and Ms B respectively. They are appealing against the profits tax assessment for year of assessment 1996/97 raised on them as revised by the Commissioner of Inland Revenue in her determination dated 30 September 1999. They claim that the profit derived from the sale of a flat in Building C in District D in Hong Kong Island (the subject property) should not be assessable to tax.

Agreed facts

2. Before and up to 15 June 1996, the Taxpayers and their son resided in the subject property which was rented by Mr A. The rent was imbursemented by Mr A's employer, a university in Hong Kong (the employer) under a private tenancy allowance scheme (the PTA Scheme). The subject property has a gross floor area of 968 square feet with three bedrooms. From 16 June 1996 onwards, the Taxpayers moved their residence to a flat in another district in Hong Kong Island, the rent of which was also met by a private tenancy allowance received by Mr A from the employer.

3. (a) In January 1996, the landlord of the subject property informed the Taxpayers that he was not going to renew the lease because he wanted to sell the property. The landlord gave the Taxpayers priority in acquiring it. A verbal agreement to purchase the property was reached in February 1996.
- (b) By an agreement dated 9 April 1996, the Taxpayers purchased the subject property from the landlord at a consideration of \$5,600,000
- (c) To finance the purchase, the Taxpayers took out a bank loan of \$3,500,000 repayable by 120 equal monthly instalments of \$44,336 each. On 22 June 1996, the subject property was assigned to the Taxpayers.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (d) By a provisional agreement dated 20 November 1996, the Taxpayers sold the subject property at a consideration of \$7,430,000. On 6 January 1997, the sale was completed.

4. In answering a questionnaire from the Inland Revenue Department, Mr A provided the following reasons for the acquisition and disposal of the subject property:

Intended/actual usage:

- ‘ The flat was purchased for the use of our daughter. At the time of the purchase, our daughter was towards her final year of her graduate studies in the United States and she expressed a very strong wish of returning and working in Hong Kong. At the same time, the landlord of the flat told us (the sitting tenants of the flat) that he intended to sell the flat and offered to sell it to us.’

Reasons for selling:

- ‘ Despite our daughter’ s great effort in job search in Hong Kong, her attempt was in vain. Then my daughter has had several job offers in the United States and she decided to stay rather than returning to Hong Kong. We could not afford to leave the flat vacant so we sold the flat instead.’

5. The assessor was of the view that the purchase and resale of the subject property amounted to an adventure in the nature of trade. A profits tax return was thus issued to the Taxpayers for completion.

6. Mr A completed the tax return and declared that there were no profits assessable to profits tax. In a letter attached to the tax return, the Taxpayers set out the circumstances leading to the acquisition and disposal of the subject property as follows:

- 6.1 At the time of purchase, their daughter was in her final year of study in America and she was actively looking for jobs in Hong Kong. She thought that there was a favourable job market for foreign-trained students in Hong Kong.
- 6.2 They felt that the subject property would be ideal for their daughter because it was located near to major financial institutions and law firms from which she sought employment.
- 6.3 Their daughter’ s effort to find a job in Hong Kong was in vain because of her inability to speak mandarin and the fact that Hong Kong employers preferred applicants to first obtain work experience in America before returning to Hong

INLAND REVENUE BOARD OF REVIEW DECISIONS

Kong

- 6.4 In December 1996, their daughter received many offers for interview with reputable firms in the United States. She found that the average salary in Hong Kong was much lower than that in the United States for similar jobs. So, she determined that she would be unable to find employment in Hong Kong or even if she was able to obtain a job, her salary would not be able to support her lifestyle. By then, the Taxpayers considered that the subject property would no longer serve their initial intent and they began thinking of selling it.
- 6.5 They had considered staying in the subject property themselves. However, it was not practical to do so because they were not allowed to use the private tenancy allowance to purchase the subject property. If they stayed in a flat owned by them, the employer would only pay an allowance equal to half of the allowance under the PTA Scheme. Therefore, they decided to sell it.
- 6.6 They submitted a copy of a certificate which shows that their daughter graduated from a university in America in May 1997.

7. The assessor did not accept the Taxpayers' contentions and raised on them the following 1996/97 profits tax assessment:

Estimated assessable profits	<u>\$1,567,000</u>
Tax payable thereon	<u>\$235,050</u>

8. The Taxpayers objected to the assessment on the following grounds:

- 8.1 '... we never intended to speculate but were forced into selling the property because of unexpected circumstances. We believe that the increase in property value at its sale should not be considered taxable profits because we lacked the intent to speculate.'
- 8.2 Even if the profit should be chargeable, it is excessive because the actual profit is \$1,314,611, which is computed as follows:

	\$	\$
Selling price		7,430,000
<u>Less : Purchase price</u>		<u>5,600,000</u>
		1,830,000
<u>Less :</u>		
Legal fees on purchase	16,790	

INLAND REVENUE BOARD OF REVIEW DECISIONS

Stamp duty	154,000	
Bank interest	223,552	
Decoration	18,800	
Legal fees on sale	11,150	
Commission on sale	74,300	
Appraisal fee	1,600	
Insurance fee	5,250	
Management fee	<u>9,947</u>	<u>515,389</u>
Profits		<u><u>1,314,611</u></u>

9. In reply to the assessor's enquiries, the Taxpayers put forth the following information:

9.1 During the period from 1 April 1994 to 31 December 1997, their daughter returned to Hong Kong twice. The first time was in the summer of 1995 when she worked with Company E as an intern. The second time was in the Christmas of 1996.

9.2 Since their daughter was over 21 and was no longer receiving formal education, she would not fit into the criteria of 'dependent children' to enjoy fringe benefits provided by the employer. Therefore, they considered that it was not appropriate for her to reside with them except for short vacation and a separate accommodation was required.

9.3 Their daughter had approached an investment company and more than ten other companies for job application but no interview was offered. As they had removed several times, the copies of the correspondence except the one from that investment company could not be traced.

9.4 Their daughter was first extended a job offer in the United States in February 1997.

Determination

10. By determination dated 30 September 1999, the Commissioner of Inland Revenue dismissed the Taxpayers' objection save that the profits tax assessment for year of assessment 1996/97 is reduced as per paragraph 8 above.

Grounds of appeal

11. The grounds on which the Taxpayers are appealing against the assessment in question may be summarised as follows:

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 11.1 At the time of purchase their intention was to purchase the property for their daughter's residence. They can prove that such intention had been very strong. As soon as they realised that their daughter was going to work in the States, they paid the downpayment and relevant fees for her house in the States. Their intention of purchasing a residence for their daughter had been very consistent.

They purchase the Hong Kong property in their names because it was impossible for their daughter to obtain mortgage. On the contrary, the house in the States was bought under their daughter's name because they had difficulty in obtaining mortgage there.

When their daughter expressed her interest in returning to Hong Kong, they already kept an eye on available flats. They understood that it was not easy to find a suitable property so once the landlord offered to sell them the flat, they showed no hesitation in accepting the offer.

- 11.2 It was not practical for them to reside in the property. They can prove that:
- (a) It is illegal for them to reside in their own property if they receive private tenancy allowance from their employer.
 - (b) They would be entitled to only \$16,010 per month for ten years if they opted for the home purchase allowance, whereas they were entitled to \$29,810 per month until the retirement age of 65 if they opted for the private tenancy allowance.
- 11.3 The Inland Revenue Department also has query on the time lapse between the date of sale of the property and the time their daughter determined to stay in the States. They actually could not recall exactly when their daughter set her mind to stay in the States. The date of sales contract could be traced but the date their daughter determined to stay was retrospective impression only. The two incidents most likely occurred concurrently. Besides, their daughter's decision was made after a period of consideration.

Hearing and witnesses

12. At the hearing of this appeal, the Taxpayers appeared in person, while Mr Fung Ka-leung, assessor, represented the Commissioner of Inland Revenue. The Taxpayers gave evidence for themselves. No other witness was called.

13. The Taxpayer's daughter and son were in the States and had each sworn an affidavit for use at the hearing of this appeal. The Taxpayers offered their children for cross-examination by

INLAND REVENUE BOARD OF REVIEW DECISIONS

telephone. The Board declined the offer on the ground that there was no opportunity to watch the demeanour, but the affidavits were admitted in evidence subject to the reservation that they had not been tested by cross-examination.

14. Ms B opened with a few general remarks. It was mainly Mr A who opened for the Taxpayers, assisted from time to time by Ms B's remarks. It was agreed by all parties that statements of fact made in the course of the opening should be treated as evidence-in-chief and should be subject to cross-examination.

The Taxpayers' testimony

15. Mr A's testimony may be summarised as follows:

Evidence-in-chief

15.1 Since they lived in Building C their daughter has returned during the summer break and winter break almost once a year.

15.2 Right after they attended their daughter's graduation ceremony, they flew to America with her, and within six days they decided to buy her a house. They paid the down payment but of course she would take care of the monthly instalments. She was already working. The monthly instalments should be about US\$700. The down payment was about US\$12,000 to US\$13,000, with other related expenses. Also, they bought her a new car as a gift for her graduation as she got two degrees, an MBA and juris doctor. She is now earning a yearly salary of about US\$80,000 to US\$85,000, with some fringe benefits. This is before tax. The down payment is about 10% of the house which will amount to \$120,000 something, much lower than the prices in Hong Kong. Also it has a front yard, back yard, etc and about 6,000 square feet lawn.

15.3 [Citing a paragraph of a handbook for academic and equivalent administrative staff of Mr A's employer university (the handbook)] "Dependent children" means your unmarried children who are wholly dependent financially on you and under the age of 19 years or, if receiving full-time education or full-time vocational training or suffering from any physical or mental infirmity, under the age of 21 years.' Their daughter will not be eligible for any benefits since she is over that age. To his knowledge, she is not supposed to reside in any accommodation provided by the university to him under any of its schemes.

INLAND REVENUE BOARD OF REVIEW DECISIONS

15.4 [Mr A referred to the following documents:

- (1) a copy letter dated 28 December 1999 from Mr Fung, assessor, to a property agency, Company F (Doc 1) which reads as follows:

‘ Re: [The subject property]

I understand that your company was the estate agent in a property transaction between Mr A with Ms B (the Vendors) and Mr G with Ms H (the Purchasers) concerning the sale of the captioned property on 20 November 1996. A copy of the provisional sale and purchase agreement dated 20 November 1996 is attached herewith for your easy reference.

For the purpose of exercising my functions under the Inland Revenue Ordinance (Chapter 112) and, in particular, to obtain full information as authorised under section 51(4)(a) of that Ordinance, your company is required to furnish me within the next 14 days, the following information:

- (a) The earliest date on which the Vendors offered the captioned property for sale through your company.
 - (b) The asking price(s) of the captioned property sought by the Vendors.’
- (2) a copy letter dated 26 January 2000 from Company F to Mr Fung (Doc 2) which reads as follows:

‘ Re: [The Subject Property]

As per your request, we are pleased to provide you the following information regarding the transaction of the captioned premises for your reference.

Date	Details of transaction
4 July 1996	New stock with leasing price of Hong Kong Dollars Thirty-two Thousand and Five Hundred was asked.
12 July 1996	Asking price of Hong Kong Dollars Seven Million and Fifty Thousand for sale.
16 July 1996	Leasing price of Hong Kong Dollars Thirty-two

INLAND REVENUE BOARD OF REVIEW DECISIONS

Thousand was asked.

- 4 October 1996 Asking price was Hong Kong Dollars Seven Million and Forty Thousand.
- 18 November 1996 Asking price was Hong Kong Dollars Seven Million and Fifty Thousand.
- 20 November 1996 Sold at Hong Kong Dollars Seven Million and Forty-three Thousand.'

- (3) a copy letter in Mr A' s handwriting dated 28 January 2000 and sent by fax from Mr A to Company F (Doc 3) which reads as follows:

' Re: [The Subject Property]

I am a former customer of your company concerning the transaction of the above property on 20 November 1996. The deal was introduced by an agent of your branch in Location I which was no longer operated. I would appreciate very much if you would answer the following questions:

1. Was your company a sole agent in the process of the lease/sale of the above property?
2. What is the standard rate being a property agent for a successful lease and sale?
3. Was the above property put into market for letting only at first?
4. Was the commission for the sale of the above property much higher than the lease?

Please also provide me with a full set of your company' s computer record for the above property from July 1996 to December 1996'

- (4) a copy letter dated 28 January 2000 from Company F to Mr A (Doc 4) which reads as follows:

' Re: [The Subject Property]

Thanks for your fax dated 28 January 2000. Upon your request, we are pleased to provide the following information for your reference.

INLAND REVENUE BOARD OF REVIEW DECISIONS

1. We are **NOT** the sole agent of the transaction of the captioned premises.
2. The commission rate for sale and purchase is 1% of the transaction price. The commission for lease is 50% of the monthly rental.
3. The captioned premises were for lease at first.
4. The commission for sale would be higher than the commission for lease of the captioned premises.

For your reference, please find the copy of letter which we sent to Inland Revenue Department. Should you have any query, please feel free to contact our Senior Customer Services Officer, Miss X at telephone number Y.'

- 15.5 On 27 January 2000, he received from Mr Fung Doc 1 and Doc 2. As a result, he sent to Company F Doc 3 by fax on 28 January 2000 and, on the same day, received from Company F Doc 4 with enclosure which was another copy of Doc 2.
- 15.6 If he lives in his own apartment he only gets about half the allowance and it is limited to ten years only under the home purchase scheme.
- 15.7 [Referring to Doc 2, the first item dated 4 July 1996] The term for the lease was either one year only or two years with a fixed first year and an optional second year.
- [Referring to item dated 12 July 1996] They put the property in the classified advertisements and were approached by many agents. They just said for letting only. But the agents kept telephoning urging them not only to lease but to sell as well. So they just gave the agents an unrealistic, high price and sent them off. They were not interested in selling. [Ms B interposing] As to why not tell the agents that they were not going to sell, they told them so, but they still kept calling.
- 15.8 They were the sitting tenants but they moved out in mid-June. From June 1996 until January 1997, six months, it was vacant.
- 15.9 [Referring to item dated 16 July 1996] The agents approached them and they were willing to cut a little the price for leasing. They wanted to lease it.

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 15.10 [Referring to item 4 October 1996] It was not the case that they were putting the property on the market for sale. During the summer they were away from Hong Kong. In October they were in Hong Kong and were extremely busy at the beginning of the term. The agents kept calling again talking about the price and they just said 'All right, okay' to send the agents away. They did not mean to give the agents instruction. They just wanted to send the agents away by saying that. [Ms B interposing] The price of Hong Kong dollars seven million and forty thousand was the agents' suggestion.
- 15.11 [Referring to item dated 18 November 1996] At that time, they were willing to sell, unlike the previous time. He cannot remember whether the instructions came from them or whether the agents asked and then they gave them instructions.
- 15.12 [Referring to last item dated 20 November 1996] They sold the property at \$7,430,000. The price stated in the item, 7 million and 43 thousand seems a mistake made by the Company F people.
- 15.13 In 1996 he and his wife were earning about \$120,000 a month, plus their housing allowance. Their net would be around \$110,000 per month, quite roughly. The two children's education in the States would cost \$40,000 per month. Mortgage for the flat cost \$44,000 per month. That would cost about \$90,000.
- 15.14 He paid a down payment of \$2,100,000. The superannuation from his previous employer, another tertiary institution, was quite a lot. They do not spend much on other items. What they cherish most is their children's future.
- 15.15 His daughter probably earned \$10,000 when she worked with Company E during the summer. They never discussed how much she expected to get if she really came back to work in Hong Kong in detail, so he did not have a concrete idea about that.
- 15.16 When they were offered by the landlord the priority to purchase that property, what came to their mind was that during the last year their daughter had come back to work for Company E and showed a strong interest in seeking employment in Hong Kong and that would be a great place for her to live in, on the basis of her living in the apartment on her own.
- 15.17 As to why they sold the apartment later, their daughter was very disappointed from the job searching process in Hong Kong whereas she got a very favourable response in the United States and she told them she had changed

INLAND REVENUE BOARD OF REVIEW DECISIONS

her mind, and she did not want to return to Hong Kong. That would certainly frustrate the original intention. The purpose was not served so they sold it.

- 15.18 [Referring to the following statement he had made to the Inland Revenue Department in a questionnaire (see paragraph 4 above):

‘ My daughter had several job offers in the United States and she decided to stay rather than returning to Hong Kong. We could not afford to leave the flat vacant so we sold the flat instead.’]

That is what they said.

- 15.19 As to proof of her efforts to seek jobs in Hong Kong, apart from the summer job with Company E in Hong Kong in 1995, there is the rejection letter from the investment company.
- 15.20 He does not think that it is extravagant for a single girl to live in a three-bedroom flat. At present she is also living in a three-bedroom [apartment]; one is her master bedroom, one is her working place, and one is a storeroom and occasionally to entertain visitors.
- 15.21 As to the estate agents’ unsolicited sale calls, there is nothing in any of the articles he seeks to rely on which says the owner was forced by the tactics of the agent into agreeing to sell.
- 15.22 At the time of purchase they did not intend that their daughter would sponsor anything but when she returned to Hong Kong, they expected that she would contribute – whatever she could afford after she was offered a job in Hong Kong. They did not think on the lines of what if she did not get a job.

Cross-examination

- 15.23 [Mr Fung having demonstrated by calculations that the total after tax income of the Taxpayers for the year ended 31 March 1997 was \$1,176,000, or about \$100,000 a month] He believes Mr Fung and his colleague are tax experts and they should calculate it right.
- 15.24 His daughter could not reside with him because she was over 21, except for vacation visits. There is no regulation to forbid the staff to do so or to allow them to do so. To his understanding of what is called dependent or independent children, after all that education, two graduate degrees and earning good money, he thinks it would be very inappropriate for her. At the

INLAND REVENUE BOARD OF REVIEW DECISIONS

time of purchasing the flat in 1996, she was 24.

15.25 [When asked whether she could stay with him if she came back to Hong Kong after graduation but had not been able to get a job] If she stayed a long time, it would be inappropriate.

15.26 [Mr Fung citing : (1) the following from a letter dated 3 February 2000 from Mr Fung to the human resources office of his employer university (Doc 5):

‘ ... I should be grateful if you would provide the following information :

Whether in the years of assessment 1995/96 and 1996/97 there is any regulation to forbid Mr A, a married male staff member who was receiving private tenancy allowance to lease a property, to reside with his unmarried daughter who was over 21.’]

And (2) the following from a letter dated 8 February 2000 (in reply to Doc 5) from the human resources office of the university to Mr Fung (Doc 6):

‘ According to our ‘Housing Regulations’, there is no regulation/rule to forbid Mr A who was eligible for receiving private tenancy allowance to reside with his unmarried daughter who was over 21.’]

They cannot find any exact wording from the book of housing regulations.

15.27 All the factors added together – the property becoming available at that period of time, his daughter showing the intention to return almost at that period, and also they being financially sound to purchase the property – as caring parents, they had to make a decision by that time that they thought was in the best interests of her.

15.28 [When asked whether their daughter mentioned to them that she enjoyed working in the States in the summer of 1996] [Ms B, interposing] 1996, Company J, yes. [Mr A] As a summer intern. Although she enjoyed her experience with Company J, she still had some intention to come back to Hong Kong around that time. He had bought that flat before he went to the States to see his daughter. The formal sale and purchase agreement was in April and the assignment was executed in June 1996.

15.29 [Ms B] Her daughter worked for an academy and was assigned to Company

INLAND REVENUE BOARD OF REVIEW DECISIONS

J. The academy was one of the top ten internships in America. It is rated number one. It would be foolish to resist the offer. That explains why she did not come back to Hong Kong to work in the summer. [When asked whether she applied to Hong Kong firms for summer jobs in 1996] She thinks she applied for jobs very early. When she was given the job, there was no way she would apply to Hong Kong. She had applied for a summer job in the academy in late March. They do not have information as to when she got the offer from the academy.

- 15.30 [Referring again to Doc (2)] Yes, On 12 July 1996 he mentioned to Company F the price of \$7,500,000. One may say the price was determined by him, but it was an unrealistic price to scare them off. [Mr A agreed that all the selling prices in Doc (2) were wrong by misstating \$7,500,000 as \$7,050,000, \$7,430,000 as \$7,043,000 and so on.]
- 15.31 [Ms B] They told the agents that they did not want to sell it. As to why they did not protest to Company F about the way they wrote Doc (2), they did not know what the agents had put into their computer.
- 15.32 \$7,500,000 was a very high price on 12 July; the market price should be around \$6,200,000. As for 4 October it should read \$7,400,000. They did not ask. Just in response to them. The market price at that time should be \$6,400,000 or \$6,500,000. \$7,400,000 is the price they gave the Company F agents in response to their telephone call; the real market price would be \$1,000,000 less.
- 15.33 [Referring to transacted price analysis by Economic Property Research Centre for the period from 1 July 1996 to 31 December 1996 relating to Building C 01 [(doc 7)] Doc 7 concerns sales of flats in Building C (including the subject property). He refers to sale of Flat C on the 22nd floor (C22). As compared with the subject property (B 17), C22 is 961 square feet, that is, 7 square feet less, but very similar. On 23 October 1996 C22 was sold at \$6,410,000.
- 15.34 [Mr Fung pointed out that for the subject property, B17, the sale and purchase agreement is dated 4 December 1996, while the date of the sale and purchase agreement of C22 is 26 September 1996. The provisional agreement should be about two weeks earlier. That is, the provisional agreement for C22 would have been entered into on 12 September 1996, and the price of \$6,400,000 would be the price on that day, and not on 23 October 1996.]

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 15.35 [Ms B refers to sale of C8 at \$6,150,000 on 14 October 1996. Chairman pointed out that after deducting 14 days, it is really the market value as of 1 October.]
- 15.36 They came back to Hong Kong late August 1996. In September they were in Hong Kong. He lowered the asking price to \$7,400,000 on 4 October, because of persuasion from the property agent. They tried to keep the agents off, and the agents suggested a price and then they just told them, all right, okay, and then the agents stopped calling for a while. The agents kept calling, ‘Why don’t you lower a little bit?’, so they just said, okay, \$7,400,000’, something like that.
- 15.37 \$7,500,000 or \$7,400,000, it is still an unrealistic market price at that period. As the agents kept on calling, well, they just casually answered, reducing a little bit to make them happy.
- 15.38 On 18 November 1996, the asking price was \$7,500,000. That price was suggested by him, because at that point of time after their daughter showed them that she did not want to return of Hong Kong, then they really wanted to sell it, in mid-November. At that point of time their daughter had not yet got an offer in the States. [Ms B] She got invitations for interviews. This was roundabout November 1996.

The law

16. In considering whether an asset is a trading asset or a long-term investment, one has to consider the intention which existed at the time of acquisition of the asset. ‘... Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? ... What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset. It must be one or other ... (per Lord Wilberforce in Simmons v IRC [1980] 1 WLR 1196 at page 1199).’

17. A self-serving statement of intention is of little value until it has been tested against the objective facts. The intention must be on the evidence ‘genuinely held, realistic and realisable ... 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 (per Mortimer J in All Best Wishes Limited v CIR 3 HKTC 750 at page 771).’

18. ‘Intention’ connotes an ability to carry it into effect. It is idle to speak of ‘intention’ if the person so intending did not have the means to bring it about or had made no arrangements or taken any steps to enable such intention to be implemented (D11/80, IRBRD, vol 1, 374 at page

INLAND REVENUE BOARD OF REVIEW DECISIONS

379).

19. The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant (see section 68(4) of the Inland Revenue Ordinance).

Findings and reasons

20. The question is, did the Taxpayers acquire the subject property as a trading asset or as a long-term investment? The Taxpayers say that it is the latter, because they acquired it as a long-term investment for use by their daughter as her residence. If they prove that they are right in saying so, the profit they have made by subsequently selling it will be capital gain which is not taxable. On the other hand, if they fail to prove that the subject property was acquired as a long-term investment for use as their daughter's residence, it will fall to be treated as a trading asset and the profit is assessable to profits tax. To succeed in this appeal, the Taxpayers must discharge the burden of proving that the subject property was acquired as a long-term investment.

21. The purchase of the subject property was financed by a bank loan of \$3,500,000 repayable by 120 equal monthly instalments of \$44,336 each (see paragraph 3(c) above). The two children's education in the United States cost about \$40,000 per month (see paragraph 15.13 above). The Taxpayers' net after tax income in the year ended 31 March 1997 was \$1,176,000, or about \$100,000 per month (see paragraph 15.23 above). That would leave only a balance of less than \$20,000 per month for the Taxpayers to live on – an amount hardly sufficient for the purpose, we should think. Of course, if the daughter, for whose use the subject property is supposed to have been purchased, should return and work in Hong Kong and make a meaningful contribution, they might have been able to keep the subject property as a long-term investment, but, what if their daughter did not come back and get a job in Hong Kong? They say they did not think of that (see paragraph 15.22 above). When it turned out that she had decided to stay on in the United States after all, they sold the subject property because they say they could not afford to leave the flat vacant (see paragraph 4 above). We take that to mean that they could not afford to pay the monthly instalments all the way without the daughter's assistance. Did they not realise at the time of purchase that their daughter just might not come back to Hong Kong and that her contributions just might not be forthcoming? We cannot imagine that they did not, intelligent and educated as they are. If they did, can we believe that at the time of purchase, they nevertheless had a 'genuinely held, realistic and realisable' intention to hold the subject property as a long-term investment for use as their daughter's residence? We cannot.

22. Further, the Taxpayers' course of dealings with their estate agent leading to the sale of the subject property is inconsistent with a long-term-investment intention. The dealings are tabulated in Doc 2 at paragraph 15.4(2) above. The Taxpayers' explanations are summarised as follows, accompanied by our comments:

22.1 4 July 1996

INLAND REVENUE BOARD OF REVIEW DECISIONS

Explanation :

This was a true asking price for leasing for one or two years (see paragraph 15.7 above).

Comment :

Looking at their dealings as a whole, this was the first step in nurturing the subject property until a good opportunity for sale presented itself.

22.2 12 July 1996

Explanation :

They were not interested in selling and they told the agents so, but the agents kept calling. So they just gave the agents an unrealistic, high price and sent them off.

Comment :

The reason for naming an unrealistic price is unconvincing. Anyway it was an indication that they were willing to sell at the price of \$7,500,000 (the price of \$7,050,000 mentioned in Doc 2 was a mistake, as agreed between the parties (see paragraph 15.30 above)).

22.3 16 July 1996

Explanation :

They wanted to lease and they were willing to cut the leasing price a little.

Comment:

The nurturing process continued.

22.4 4 October 1996

Explanation :

The agents kept calling, talking about the price and they just said, ' All right, okey' to send the agents away. They did not mean to give the agents instruction. The price of \$7,040,000 was the agents' suggestion (the price of \$7,040,000

INLAND REVENUE BOARD OF REVIEW DECISIONS

was a mistake for \$7,400,000 (see paragraph 15.30 above)).

Comment :

The story of the Taxpayers being coerced into naming the selling price suggested by the agents is difficult to accept. We fail to understand why the agents should suggest a price which was \$1,000,000 higher than the market price (see paragraph 15.32 above). We are inclined to believe, and we find, that the price of \$7,400,000 was given by the Taxpayers to their agents in the normal course of dealings.

22.5 18 and 20 November 1996

Explanation :

On the 18th, the asking price was \$7,500,000 (the price of \$7,050,000 stated in Doc 2 was agreed to be a mistake (see paragraph 15.30 above)). That price was suggested by Mr A. At that time, in mid-November, they really wanted to sell because their daughter had indicated to them that she did not want to return to Hong Kong. At that point of time, she had not yet got an offer in the States. She got invitations for interviews (see paragraph 15.38). On the 20th, they sold the subject property for \$7,430,000 (see paragraph 15.12 above) (the \$7,043,000 stated in Doc 2 was a mistake – see paragraph 15.30 above).

Comments

The explanation for the sale is that in mid-November they learned from their daughter that she was not coming back to Hong Kong after all. So this time they really decided to sell and the asking price of \$7,500,000 was a true price named by Mr A. But at that point in time, their daughter had not yet got a job offer in the United States, although she had received invitations for interviews. She only got her first job offer in February 1997 (see paragraph 9.4 above). In November 1996 it could not be said with certainty that she would find employment in the United States. Yet the Taxpayers sold the subject property on 20 November 1996. This shows that the question of their daughter's finding employment in the United States had little to do with the sale of the subject property in Hong Kong.

23. Having considered the evidence, we find that from the outset the Taxpayers' intention was to hold and nurture the subject property for resale at a profit. Doc 2 is in our view a true record of the Taxpayers' dealings with their agent. The asking prices for sale, ranging between \$7,400,000 and \$7,500,000, were all named by the Taxpayers and were true indications of the

INLAND REVENUE BOARD OF REVIEW DECISIONS

prices at which they were willing to sell at different stages during the five-month period. Doc 7 (Transacted price analysis by Economic Property Research Centre, see paragraph 15.33 above) shows, and we accept, that the asking prices were higher than the relevant market prices by about \$1,000,000 until November 1996 when the market price, for the first time in that five-month period, reached the desired level of the asking price.

24. The Taxpayers purchased the subject property in April 1996 (see paragraph 3(b) above). In July they embarked upon a course of trading activities by naming asking prices for leasing and for sale. We find that the two offers for leasing as well as the offers for sale were part and parcel of the nurturing process whereby the Taxpayers waited for an opportune moment to sell the subject property. In November 1996 when the market price had caught up with the desired named price, the subject property was sold.

25. We find that the Taxpayers, while waiting to sell the subject property, entertained the idea of letting their daughter use the subject property as her residence if she chose to come back to Hong Kong, found herself a good job and made contributions towards the payment of the mortgage instalments. But we find that idea was a mere hope which never developed into an intention to displace the intention of trading. Had the hope been realised, the subject property would have changed in status from trading asset to capital asset. But that never happened.

26. The Taxpayers pleaded frustration. We disagree. No frustration can arise because in our view there was no long-term-investment intention to start with.

27. The Taxpayers cited D70/94, D8/95 and D61/97. We could derive no assistance from these cases. By and large they are the result of applying the same principles to very different facts and findings.

28. The two children's affidavits are of little assistance. The son's does not deal very much with the relevant facts of the case, while the daughter's seeks to corroborate some of her mother Ms B's evidence but can raise no compelling inferences to override the restrictions imposed on her credibility by the lack of cross-examination.

Conclusion

29. It follows that this appeal is dismissed and that the profits tax assessment for year of assessment 1996/97 as revised is hereby confirmed.