

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D31/97

Profits tax – profit derived from sale of property – whether assessable to tax.

Panel: Robert Wei Wen Nam SC (chairman), Richard Neil Standing and Terence Tai Chun To.

Dates of hearing: 29 and 30 April 1997.

Date of decision: 26 June 1997.

In February 1991, the taxpayer acquired a flat at a consideration of \$1,219,680. It was still under construction. The purchase was financed by a down payment of 10% and a bank loan repayable by 240 monthly instalments of slightly over \$10,000 each. The taxpayer was 49 years old. From 1984 until August 1994, she was employed by a real estate agency first as a sales lady and later as a staff manager. Her income was unstable, consisting mainly of commission earned each time she closed a deal for a vendor and a purchaser. Her income for the year ended 31 March 1992 totalled \$234,441 which compares with an income of \$154,482 for the ensuing year. Immediately before the acquisition, she had no less than \$500,000 savings. She was paying \$3,000 a month rent for sharing a flat owned by her sisters. The taxpayer could not have afforded the subject flat by herself. She obtained a promise from her sister T that T would come and live with the taxpayer in the subject flat and pay her \$5,000 a month for as long as T lived there. There was no agreement as to the nature of the payment or how long the arrangement would continue. About six months after T had given her promise of assistance, and well before the subject flat was ready for occupation, T terminated her assistance in anticipation because she was planning to get married, and might no longer be able to share the instalments. At that stage the taxpayer was worried about her ability to pay instalments in the future so, in September 1991, she sold the subject flat for \$2,160,000. The taxpayer's evidence was that, at the time of the acquisition, her intention was to hold the subject flat as a long-term investment, that is, as her residence.

Held:

The taxpayer's stated intention was not backed by an ability to carry it out. She failed to show that she had a reasonable prospect of being able to clear the 240 mortgage instalments. The Board finds that she had a trading intention, that the subject flat was a trading asset, and that the profit derived from the resale is a trading profit and is subject to profits tax.

Appeal dismissed.

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Cases referred to:

Scottish Australian Mining Co Ltd v FC of T [1950] 9 ATC 135
Simmons v CIR 53 TC 461
All Best Wishes Ltd v CIR 3 HKTC 750
Cunliffe v Goodman [1950] 2 KB 237
D11/80, IRBRD, vol 1, 374

Wong Kuen Fai for the Commissioner of Inland Revenue.
John Tam of Messrs John Tam & Co for the taxpayer.

Decision:

Nature of appeal

1. This is an appeal by an individual (the Taxpayer) against the profits tax assessment raised on her for the year of assessment 1991/92 in respect of the profit derived by her from the sale of a flat (the subject flat). She claims that the profit is capital in nature and should not be assessable to tax.

Facts not in dispute

2. The Taxpayer resided at a flat in the same district as that of the subject flat (Flat A) from 1 January 1990 until 29 August 1991 when she moved to Flat B to be mentioned later.

3. Flat A had a total floor area of 545 square feet with two bedrooms. The Taxpayer shared one bedroom with her mother, while the Taxpayer's two sisters, T and W, shared the other.

4. Flat A was owned by T and W.

5. From 1984 until August 1994, the Taxpayer was employed by H Estate Agency firstly as a sales lady and later as a staff manager. As shown by the employer's returns for the years of assessment 1991/92 and 1992/93, she received the following income for those two years:

Particular	Amount received from	Amount received from
	1-4-1991 to 31-3-1992	1-4-1992 to 31-3-1993
	\$	\$
Salary/Wages	39,516	43,500

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Commission/Fees	174,845	86,982
Any other Rewards, Allowances or Perquisites	<u>20,080</u>	<u>24,000</u>
Total	<u>234,441</u>	<u>154,482</u>

6. By a sale and purchase agreement dated 12 February 1991 the Taxpayer agreed to purchase the subject flat at a consideration of \$1,219,680. The subject flat had a total floor area of 845 square feet and was still under construction at the time of purchase.

7. The purchase was financed by a down payment of 10% of the purchase price and a bank loan of \$1,097,712 repayable by 240 monthly instalments of \$10,593.20 each except the last instalment which was to be \$10,557.62, the first instalment to be payable on 23 March 1991.

8. On 2 May 1991, the Taxpayer and Y, another sister of hers, purchased as tenants in common in equal shares two shopping units (the shops) at a total consideration of \$602,000. The purchase was financed by a down payment of \$182,000 and a bank loan of \$420,000. The shops were used for the business of a restaurant operated by Y's husband. The business was unsuccessful, and the shops were disposed of at a loss of \$2,000 in November 1992.

9. On about 29 August 1991, the Taxpayer purchased Flat B at a consideration of \$790,000. The purchase was financed by a down payment of \$290,000 and a bank loan of \$500,000 repayable by 180 monthly instalments of \$5,449 each, the first instalment to be payable on 30 September 1991. The total floor area was 432 square feet. The Taxpayer occupied this flat as her residence during the period from 29 August 1991 to about 25 June 1996, when it was sold for \$1,600,000.

10. On 15 September 1991, the Taxpayer entered into an agreement to sell the subject flat for \$2,160,000. On 23 January 1992, the sale was completed with the Taxpayer acting as confirmor.

The assessment

11. The assessor was of the view that the purchase and sale of the subject flat by the Taxpayer amounted to an adventure in the nature of trade, while the Taxpayer maintained that there was no profit assessable to tax. In a letter submitted together with a nil profits tax return, the Taxpayer's representative, Messrs John Tam & Co (the representatives) stated that the net profit arising from the sale of the subject flat amounted to \$847,073 but claimed that the subject flat was intended to be the sole residence of the Taxpayer and that the profit on sale was a capital profit not assessable to profits tax.

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12. The assessor did not accept the Taxpayer's contention that the subject flat was purchased for use as a residence. On 29 November 1995 the assessor raised on the Taxpayer the following profits tax assessment for the year of assessment 1991/92:

Estimated Assessable Profits under Section 59(2)(b) of the Inland Revenue Ordinance	\$847,073
Tax payable thereon	\$127,060

13. On behalf of the Taxpayer, the representatives objected against the assessment on the ground that the profit on sale should not be assessable to profits tax. The Commissioner of Inland Revenue did not accept the Taxpayer's contention that the subject flat was purchased for self-residence purposes. On 14 May 1996, the Commissioner determined against the objection and confirmed the assessment.

Grounds of appeal

14. The Taxpayer appeals against the Commissioner's determination. The grounds of appeal are to the following effect.

14.1 Before she acquired the subject flat in February 1991, the Taxpayer was living with her mother and two sisters in Flat A which had a floor area of only 545 square feet. The Taxpayer had never owned any property and was therefore desirous of acquiring her own residence to improve her living standard.

14.2 In February 1991, the Taxpayer decided to acquire the subject flat with intention to use it as her sole residence when construction of the property was completed. The Taxpayer had a verbal agreement with her sister T that T should share the subject flat with her. The subject flat was chosen as it was close to Flat A so that it would cause minimal disturbance to the life pattern of T and the Taxpayer. The proximity of the subject flat to Flat A supports the Taxpayer's case of self-residential use: had she had any intention to acquire a property for trading purposes, the property acquired need not have been so close to their residence at Flat A.

14.3 Subsequently, due to personal reasons, T revoked the verbal agreement to share the subject flat with the Taxpayer and acquired another property for her own use. With the revocation of T's decision and the decrease in come of the Taxpayer as evidenced by the employer's returns for the years of assessment 1991/92 and 1992/93, the subject flat became too big for the Taxpayer and she also had difficulties in maintaining the monthly repayment of \$10,593.20 for the mortgage loan. Under such circumstances, the Taxpayer was forced to dispose of the subject flat and Flat B, which was a smaller flat with a floor area of 432 square feet, was acquired under a mortgage loan of \$500,000. The Taxpayer then moved out of Flat A and resided in Flat B for 5 years as her sole residence. This further supports the capital claim.

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14.4 Further, the Taxpayer did not have any previous property trading record. The subject flat was the first property acquired and also the first property disposed of by the Taxpayer.

14.5 The shops were acquired by the Taxpayer and her sister Y in May 1991 for the operation of the business of a restaurant by Y's husband. The purchase was financed by a bank loan of \$420,000. The restaurant business failed after two months. This also increased the financial strain on the Taxpayer and contributed to the decision to sell the subject flat in September 1991. The shops were disposed of in November 1992 at a loss of \$2,000 (loss on legal fees, stamp duty and interest etc not included) and the Taxpayer has never claimed that the loss was trading in nature.

14.6 Although the subject flat was held by the Taxpayer for less than 8 months, her intention was to hold it on a long-term basis. The sale of the subject flat was merely a realisation of a capital asset and it was involuntary in the sense that her financial circumstances changed after acquisition of the subject flat and the series of events which occurred was just a coincidence out of her control. The Scottish Australian Mining Co Ltd v FC of T [1950] 9 ATC 135 was referred to.

Hearing and parties

15. At the hearing of this appeal, Mr Tam, proprietor of the representatives, appeared for the Taxpayer, while Mr Wong, senior assessor, appeared for the Commissioner. The Taxpayer and her sisters T and Y were called as witnesses for the Taxpayer. No other witness was called.

Evidence of the Taxpayer

16. The evidence of the Taxpayer is to the following effect.

In chief

16.1 She purchased the subject flat in February 1991. Her intention was to use it for residential purposes. She intended to live with her younger sister T. She could not have afforded it by herself, but T promised to share it with her.

16.2 She had the money for the down payment of 10%. After acquisition, she could maintain the payment of instalments.

16.3 Asked why she sold it, she stated that T only promised to share it with her for a short term, and then because of T's indication she thought about selling it because she worried about the longer term.

16.4 T agreed to live with her because Flat A was crowded. T promised to share the money with her. They had talked before the purchase. The subject flat was opposite Flat A. The new building was due for sale. She suggested to T that they go and live separately. She

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asked T if she was willing to share the financial burden of the new flat. T agreed to be a tenant. Upon hearing the suggestion, T indicated to her that she was interested in the idea. The Taxpayer suggested to T that they share the monthly instalments on a fifty and fifty basis. She could not recall how T put it, but she had the impression that T agreed. T would know the rough figure. T would pay rent and the Taxpayer would use the rent to finance repayment to the bank.

16.5 Before the purchase and sale of the subject flat, she had not purchased or sold any other property.

16.6 She purchased Flat B because later on T indicated that she would not share the subject flat with her. The Taxpayer would like to buy a smaller flat, so she bought Flat B.

16.7 She lived in Flat B for some 4 years. She has moved back to Flat A, because now she had financial problems. She sold Flat B in June 1996. She has been unemployed since August 1994. That is why she has not bought another property.

16.8 She is 49 years old. T and Y are her younger sisters. She commenced employment with H Estate Agency in 1984 and ceased employment in August 1994. She was first employed as a sales lady and later as staff manager. She would bring an intending vendor and purchaser together for a deal and earn a commission should a deal result. Commission was most important.

16.9 As to T's agreement to share the financial cost of the subject flat, basically it was for a short term, but she would pay rent as long as she stayed in the place. A short term was not for a few months. T never indicated how long she would stay with the Taxpayer. She did not think thoroughly about what would happen once T had finished her short term period with her. After T, she did not advertise for a tenant, but tried to make it known to close friends.

16.10 She sold Flat B for \$1,600,000. She had purchased it for \$790,000.

In cross-examination

16.11 Of the 240 instalments for the subject flat, the Taxpayer paid 7, with her own money. The flat was not due for occupation, so she paid the instalments by herself. Besides, she had to pay \$3000 rent for Flat A. She paid the 10% down payment with her savings. Some balance left, could not tell how much. She still needed T's promise before she would commit herself to purchasing the subject flat.

16.12 The instalments for the shops amounted to about \$6,000 per month. Her share was \$3,000.

16.13 Her payments in respect of the subject flat, the shops and Flat A totalled about \$16,000 per month. As for personal expenses, it was around \$2,000 per month. She lived a simple life and did not spend much.

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16.14 She had no interest in the restaurant business carried on in the shops. She paid the \$290,000 down payment for Flat B with her savings. Asked why she did not use the \$290,000 to pay part of the purchase price or reduce the instalment loan for the subject flat, she stated that, because the subject flat was a bigger property, she was afraid that in the longer term she might not be able to pay off the instalments.

In re-examination

16.15 T promised to share the flat with her, so she bought it. She did not think about whether she would still have bought it if T had made no such promise.

16.16 As to what she understood by a 'short term', since they were sisters, there was no formal agreement as to how long.

16.17 After the Taxpayer had paid several instalments, T said no. The Taxpayer panicked, worried that she might not have sufficient money to pay future instalments. She tried to find a tenant for a room in the subject flat but without success. She was still paying the instalments. The subject flat was not ready for occupation. She was trying to secure a tenant beforehand.

16.18 At that time she was worried about her ability to pay instalments in the future, so she thought why not buy a smaller place to reduce the financial burden. She only wanted to find a place to live in. She liked to play safe. At that stage, she still had money to pay the instalments. But she was afraid about the future.

Evidence of T

17. The evidence of T is to the following effect.

In chief

17.1 She intended to go and live with the Taxpayer. She planned to move over. At that time she had no plans for marriage. She was 38 then and only had a friend. Later he became her boyfriend.

17.2 She planned to get married, so she told the Taxpayer that she might not be able to share the instalments; that would be about 6 months after she had promised to help her. She had no plans for marriage at the time of purchase.

17.3 She was going to help to the extent of paying \$5,000 per month. There was no agreement as to the nature of the payment, no fixed idea as to what the money was for, nor any agreement as to how long. She told the Taxpayer that if she had no other plans, she would continue to pay her that away. She would not pay if she did not move in. The flat was bought in the name of the Taxpayer; she did not think she was a co-owner. She was thinking of a home after marriage; that would not be the subject flat.

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In cross-examination

17.4 Flat A was owned by her sister W and herself. In February 1991, they were close to paying off the mortgage of Flat A. The Taxpayer was paying a package fee not exceeding \$3,000 per month, including household expenses and the cost of living there.

17.5 She promised the Taxpayer to help to the extent of about 50% of the instalments.

17.6 She was a teacher. Her salary at that time was about \$15,000.

17.7 When the Taxpayer moved out of Flat A, she would cease to pay the \$3,000 monthly payment. But sister W would pay more to make up the deficit. She was willing. They were sisters.

17.8 The Taxpayer could pay the instalments on her own, but barely. With T's help, it would be better.

17.9 She never made any payment to the Taxpayer in respect of the subject flat. She broke her promise because she was considering getting married. The intention to get married lasted about 6 months. Then they had differences. She is not married.

17.10 She thought that, if she helped her out, the Taxpayer could continue to own the subject flat, but if she failed to help her, the Taxpayer could still sell it and get a smaller flat. She knew prices would rise, so the Taxpayer would not suffer. She read the newspapers and knew that would be the trend of the prices. She said that she had a feeling that prices were rising.

17.11 In February 1991, T and W had not yet paid off the mortgage of Flat A. The monthly instalment of \$3,300 was shared between the two of them.

Evidence of Y

18. The evidence of Y is to the following effect.

In chief

18.1 The shops were not purchased for the purpose of resale at a profit.

In cross-examination

18.2 In 1991, F, her husband, was in the restaurant business.

18.3 The shops were purchased for the total price of \$602,000. The purchase was financed by a down payment of \$182,000 shared between the Taxpayer and Y equally and a

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mortgage loan of \$420,000 repayable by monthly instalments of about \$6,000 shared equally between the two of them.

18.4 The restaurant business carried on at the shops was a failure. The Taxpayer did not have to bear any of the loss.

In re-examination

18.5 There was no discussion with the Taxpayer as to what would be her return if the business made a profit. Whether the business made a profit or loss, that had nothing to do with the Taxpayer.

The law

19. The following propositions will be applied in this case.

19.1 Trading requires an intention to trade. Was the asset acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? It is not possible 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 (per Lord Wilberforce in Simmons v CIR 53 TC 461 at 491).

19.2 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 (per Mortimer J in All Best Wishes Ltd v CIR 3 HKTC 750 at 771).

19.3 An intention connotes a state of affairs which X decides, so far as in him lies, to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. X cannot be said to 'intend' a result which is wholly beyond the control of his will. He cannot 'intend' that it shall be a fine day to-morrow. At most he can hope or desire or pray that it will. Nor can X be said to 'intend' a particular result ... if X's volition is no more than a minor agency collaborating with, or not thwarted by, the factors which predominantly determine its occurrence (per Asquith, LJ in Cunliffe v Goodman [1950] 2 KB 237 at 253).

19.4 '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

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arrangements or taken any steps to enable such intention to be implemented (see D11/80, IRBRD, vol 1, 374).

19.5 A permanent or long-term investment is a capital asset. Profit arising from the sale of a capital asset is not taxable, while profit arising from the sale of a trading asset is. In this case, the onus is on the Taxpayer to prove that the assessment under appeal is incorrect (see section 68(4) of the Inland Revenue Ordinance) and, for that purpose, to prove that the subject flat was acquired as a long-term investment.

Findings and reasons

20. The subject flat could only acquire the status of a long-term investment if, at the time of acquisition, the Taxpayer's intention was to hold it as a long-term investment. In practical terms, the question is whether at that time she was so placed that she could reasonably expect that she would be able to pay off all the 240 monthly instalments of the mortgage loan used to finance the purchase. Has she satisfied us that she had a reasonable prospect of being able to do so? We think not.

21. The Taxpayer is 49 years old. From 1984 until August 1994, she was employed by a real estate agency first as a sales lady and later as a staff manager. Her income was unstable, consisting mainly of commission earned each time she successfully brought an intending vendor and purchaser together for a deal. Her income for the year ended 31 March 1992 totalled \$234,441 including \$174,845 commission, which compares with an income of \$154,482 including \$86,982 commission for the ensuing year (see paragraph 5 above). There is no evidence of her income for the year ended 31 March 1994, but she has been unemployed since August 1994. There is no direct evidence as to how much savings she had before she purchased the subject flat, but it would have been sufficient to cover the down payment of \$121,968 for the subject flat and probably also the subsequent half share of a down payment of \$182,000 for the shops as well as the down payment of \$290,000 for Flat B (see paragraphs 6, 7, 8, 18.3 and 9 above). We therefore find as a matter of inference that she had no less than \$500,000 savings. She was paying \$3,000 a month rent for sharing Flat A. That sums up her financial position immediately before the acquisition of the subject flat.

22. The Taxpayer stated in evidence that she could not have afforded the subject flat by herself. We consider that the Taxpayer was right in taking a cautious view of her financial position, bearing in mind the instability of her income, particularly her commission income (see paragraph 21 above) and the long-term mortgage loan which would take 20 years to pay off, and we accept her evidence that she could not have afforded the flat by herself.

23. So it was that the Taxpayer obtained a promise from T which was to this effect. T would share the financial cost of the subject flat for a short term. The arrangement was that T would come and live with the Taxpayer in the subject flat and pay her \$5,000 a month (which was nearly half the mortgage instalment) for as long as T lived there. There was no agreement as to the nature of the payment or how long the arrangement would continue.

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But, if she had no other plans, T would continue to pay the Taxpayer \$5,000 a month, which the Taxpayer would use to finance the monthly instalments. This agreement to share the financial cost of the subject flat was basically for a short term, but would continue as long as T stayed in the flat. A short term was not for a few months, but T never indicated how long she would stay. (See paragraphs 16.1, 16.3, 16.4, 16.9 and 17.3.)

24. On those terms, clearly T gave no commitment to any long-term financial assistance or indeed any financial assistance which the Taxpayer could rely on to support any plan for holding the subject flat as a long-term investment. The monthly payment of \$5,000 would have commenced to flow if and when T had moved in. But that was not to be. About six months after T had given her promise of assistance, and well before the flat was ready for occupation, T terminated her assistance in anticipation because she was planning to get married, and might no longer be able to share the instalments (see paragraph 17.2 above). As it turned out, T did not get married after all, but the point is that she was free to, and did, terminate the assistance.

25. At that stage, the Taxpayer was still paying the instalments, but she was worried about her ability to pay instalments in the future. On the other hand, the property market was rising (see paragraph 17.10 above). In those circumstances, she sold the subject flat and bought a smaller flat (Flat B) (see paragraphs 16.17 and 16.18 above).

26. The question for the Board is whether the Taxpayer has proved on a balance of probabilities that, at the time of acquiring the subject flat, her intention was to hold it as a long-term investment, that is, as her residence. That is her stated intention (see paragraph 16.1 above). But a stated intention is not decisive (see paragraph 19.2 above). We must look at the surrounding circumstances to see whether the declared intention was backed by an ability to carry it out (see paragraph 19.4 above). The practical question is whether she had a reasonable prospect of being able to pay off all the 240 monthly instalments of the mortgage loan as they fell due (see paragraphs 19.3 and 20 above).

27. As mentioned above, the Taxpayer could not afford the subject flat without assistance. Nor, in our view, did T's promise of \$5,000 a month demonstrably improve the Taxpayer's position to any meaningful degree. There was no commitment on which the Taxpayer could reasonably rely, and it was imponderable how long the assistance would last. The Taxpayer has admitted in evidence that T's promise of assistance was for the short term only (see paragraph 16.3 above). The Taxpayer has therefore failed to show that she had a reasonable prospect of being able to clear all the 240 mortgage instalments. Without a reasonably expected ability to do so, she cannot be said to have 'intended' to hold the subject flat as a long-term investment.

28. As pointed out by the Commissioner, the subject flat was held by the Taxpayer for a period of less than eight months and was sold before it could be put to the purported use. A sale under those circumstances is inconsistent with a long-term-investment intention towards the subject flat. It is for the Taxpayer to explain away the inconsistency, but she has failed to do so.

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29. On the evidence, we find as follows:
- 29.1 That the Taxpayer acquired the subject flat for resale at a profit;
- 29.2 That she obtained from T a promise of assistance so vague that she could not reasonably rely on it;
- 29.3 That the subject flat was a trading asset; and
- 29.4 That the profit derived from the resale is a trading profit and is subject to profits tax.
30. It follows that this appeal is dismissed and that the assessment under appeal is hereby confirmed.