

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D36/02

Profits tax – sale of property – intention at the time of purchase – whether the property was capital asset or trading asset – section 68(4) of the Inland Revenue Ordinance (‘ IRO ’) – onus of proof on the appellants.

Panel: Ronny Wong Fook Hum SC (chairman), David Lee Tai Wai and Wong Kwai Huen.

Date of hearing: 16 May 2002.

Date of decision: 22 July 2002.

Company A was engaged in the trading of building materials. In December 1993, Mr B acquired all the shareholdings in Company A through Company C. Company A rented Office 1 for a period of two years from 13 April 1993 to 12 April 1995.

By a provisional agreement dated 5 January 1994, Mr B agreed to purchase Office 2. By a joint investment agreement entered into between Mr B and Company A, Mr B purchased Office 2 on behalf of himself and Company A on an equal basis. It was provided in the joint investment agreement that Office 2 would be used as office for Company A.

By a provisional agreement dated 31 March 1994, Mr B sold Office 2. The issue is whether Mr B and Company A are liable for profits tax in respect of the gains they made through their dealings with Office 2.

Held:

1. The intention of Mr B and Company A at the time of acquisition of Office 2 is crucial in determining whether that unit was capital asset or trading asset. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively (Simmons v IRC (1980) 53 TC 461 and All Best Wishes Ltd v CIR (1992) 3 HKTC 750 followed).
2. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the appellant. In order to discharge this onus, it is incumbent on the appellants to place before the Board supporting materials in support of their assertions. Although the standard of proof is one of balance of

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probabilities, the appellants must ensure that the balance be tilted in their favour by furnishing the Board with primary evidence that is within their easy access.

3. The appellants' case has to be assessed on the basis that binding contracts to purchase and sell were made within a period of less than three months. Having considered the evidence of the case, the Board was of the view that the appellants failed to discharge the onus of proof resting upon them.

Appeal dismissed.

Cases referred to:

Simmons v IRC (1980) 53 TC 461
All Best Wishes Ltd v CIR (1992) 3 HKTC 750

Tse Yee Keung for the Commissioner of Inland Revenue.
Taxpayers represented by their financial consultant and financial manager.

Decision:

1. Company A is a company incorporated in Hong Kong on 23 February 1993. At the material times, Company A was engaged in the trading of building materials.
2. Company A had six shareholders on incorporation. Mr B was one of the six holding 25% of Company A's issued share capital. On 30 December 1993, Mr B acquired the rest of the shareholdings in Company A through Company C.
3. By a tenancy agreement dated 16 April 1993, Company A rented a unit ('Office 1') for a period of two years from 13 April 1993 to 12 April 1995. Office 1 was about 2,400 square feet in area.
4. By a provisional agreement dated 5 January 1994, Mr B agreed to purchase another unit ('Office 2') for \$5,671,500. Office 2 was about 950 square feet in area. The purchase was scheduled to be completed within 13 days of issuance of the occupation permit in respect of that office. According to a joint investment agreement entered into between Mr B and Company A, Mr B purchased Office 2 on behalf of himself and Company A on an equal basis. It was provided in the joint investment agreement that Office 2 'will be used as office for [Company A]'.

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5. The occupation permit in respect of Office 2 was issued on 3 February 1994. By a provisional agreement dated 31 March 1994, Mr B sold Office 2 for \$8,075,000.

6. On 9 February 1995, Company A renewed its tenancy in Office 1 for two years from 13 April 1995 to 12 April 1997. This renewed tenancy was terminated prematurely on 15 December 1995. Company A moved from Office 1 to Address D ('Office 3'). Office 3 was about 2,200 square feet in area.

7. The issue before us is whether Mr B and Company A are liable for profits tax in respect of the gains they made through their dealings with Office 2.

Case of the Appellants

8. After Mr B's purchase of the entire issued capital of Company A, he decided to wind down its business. Company A's market was in China and the Chinese Government was seeking to cool down the overheated property market.

9. '[Mr B] acquired [Office 2] which was about 950 sq. feet and were planned to use as office. However, there was no sufficient space for this location to maintain 20 staff and to keep display space for the building materials. Since some contracts at that time were still under negotiation and need to follow up, so [Company A] would not suddenly terminated the contract with its staff and they were only progressively decreased. Besides, the wind down plan had not been changed but was carried out progressively. As a result, the company maintained its [Office 1] and [Office 2] had not actually been used as office. [Mr B] considered that it was no reason to tie up the working capital of the company which lead to disposal the property on May, 1994'.

Case of the Respondent

10. The objective evidence does not support the Appellants' case of an intended winding down of Company A's business.

(a) For the period between 23 February 1993 and 31 March 1994, the turnover of Company A was \$17,462,963. It paid \$1,849,501 by way of wages and \$732,841 by way of rental. For the period between 1 April 1994 and 31 March 1995, the turnover of Company A increased to \$20,535,458 with corresponding increase of wages to \$3,016,221 and rent to \$975,414.

(b) There was no decrease in the number of staff engaged by Company A.

Period	Number of staff
23-2-1993 – 20-1-1994	21
21-1-1994 – 2-5-1994	19

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3-5-1994 – 19-12-1995

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11. The Appellants' case is inconsistent with the assertions they made in their notice of appeal dated 27 February 2002. The Appellants stated in that notice that:

‘ We further emphasize that our company engages in business of trading building material but not trading property. Our initiative intention to acquire the property in early Jan., 94 was **to increase our office space as to meet the expanding China market**, but subsequently, we found the change of PRC government policy ... this would definitely affect our coming business volume, then finally decided the sales of the property ...’ (emphasis supplied).

The hearing before us

12. Mr E and Mr F, financial consultant and financial manager of Company A, appeared before us. They elected not to give sworn testimony on behalf of Mr B and Company A. They made the following submissions on behalf of Mr B and Company A:

- (a) Company A did not trade in any other property. Office 2 was its only purchase and sale.
- (b) It is inappropriate to compare the turnover between the years of assessment 1994/95 and 1995/96. Turnover for the ten months in the year of assessment 1994/95 was on the low side.
- (c) Company A did not want to dismiss any staff. Company A preferred to rely on voluntary resignations of their staff in its process of winding down.

The law

13. The intention of Mr B and Company A at the time of acquisition of Office 2 is crucial in determining whether that unit was capital asset or trading asset. As stated by Lord Wilberforce in Simmons v IRC (1980) 53 TC 461

‘ *Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the 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?*’.

14. An intention to hold property as a capital investment must be definite. The stated intention of the taxpayer is not decisive. Actual intention can only be determined objectively. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750 Mortimer J gave the following guidance:

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‘ 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 ... 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’ .

15. Under section 68(4) of the IRO, the onus of proving the assessment appealed against is excessive or incorrect is on the appellant. In order to discharge this onus, it is incumbent on the Appellants to place before this Board supporting materials in support of their assertions. Although the standard of proof is one of balance of probabilities, the Appellants must ensure that the balance be tilted in their favour by furnishing the Board with primary evidence that is within their easy access.

Our decision

16. Office 2 was first acquired on 5 January 1994. It was sold on 31 March 1994. The Appellants sought to rely on 31 October 1994 which was the date of completion of the sale. That is not a pertinent date in the context of this case. Their case has to be assessed on the basis that binding contracts to purchase and sell were made within a period of less than three months.

17. Given the size of Office 2, it was obviously inadequate for Company A's then operations. Two inconsistent assertions were made in order to explain the difference in size between Office 1 and Office 2. It was said in the notice of appeal that the acquisition was for the purpose of expansion. This is in complete variance with the case that the purchase of Office 2 was to cater for the winding down of Company A. No explanation has been given for this inconsistency.

18. We accept the submissions of the Revenue that the objective facts lend no weight to the Appellants' contention of an intended winding down of Company A. There was no significant decrease in Company A's turnover. It renewed the tenancy in respect of its Office 1. It moved to Office 3 with no reduction in area. The suggestion that Company A relied on voluntary resignations of its staff in its process of winding down is not credible bearing in mind that Company A increased its staff to 24 members after a reduction to 19 members.

19. For these reasons, we are of the view that the Appellants failed to discharge the onus of proof resting upon them. We dismiss their appeal.