

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D38/98

Profits tax – whether sale of the property a trading activity – whether the property was purchased for the purpose as a residence – Inland Revenue Ordinance sections 2 & 68(2B)

Panel: Christopher Chan Cheuk (chairman), James Kwan Yuk Choi & Emily Lam Yuet Ming.

Date of hearing: 28 April 1998.

Date of decision: 10 June 1998.

Mr A and his wife are the taxpayers. Mr A appeared before the Board. He claimed that he represented his wife but could not produce any written authorization as required under section 2 of the Inland Revenue Ordinance (IRO). The Board exercised their discretion under section 68(2B) of the IRO to hear the case in the absence of his wife.

At the time of purchase of the Subject Property, the taxpayers' family were living at Property C which they had acquired only a few months ago.

The taxpayers purchased the Subject Property because they wanted to move to a place which was much nearer to their daughter's school, Primary School E, a leading education institute in Hong Kong. There was no other new site with units available in that place which had larger flat area. They also thought that the property market was rising very quickly and it was the right time for them to purchase a new property to hedge against inflation.

On the other hand, the taxpayers sold the Subject Property because in March 1993, the assistant headmaster of an international school, a friend of the taxpayers, indicated to them that the school was soon open for application and there was a chance that their daughter could secure a place there. It was their earnest desire that they wanted their daughter to get into an international school. They found the Subject Property was not so convenient and close to the international school as Property C. Furthermore, they had some difficulty in obtaining mortgage. Then they feared that the real estate market would collapse at any time and they decided to sell the Subject Property.

Held:

1. The main issue is whether the sale of the Subject Property is a trading activity and whether it was purchased as a residence for the taxpayers' family as claimed. The circumstances of the whole case would have to be looked at. (All Best Wishes Limited v CIR [1992] 3 HKTC 750 applied)

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2. The Subject Property was only half of that size of Property C. The Board found that the taxpayers could not explain why the family decided to choose a much smaller flat.
3. The Board did not believe that the taxpayers bought Property C for good reasons but changed their mind and decided to buy the Subject Property within a few months. Then they were afraid of keeping it for too long three months later.
4. Though the Subject Property was nearer to Primary School E, it was still not within walking distance for their daughter. The Board did not think that the location between Property C and the Subject Property made the taxpayer's family decide to move.
5. The Board did not believe that the taxpayers made the decision to sell Property C without commitment from their friend in March 1994 that their daughter could get a place in the next term.
6. Taking all the evidence into consideration, the Board found that the taxpayers and their family did not have any intention of using the Subject Property as residence nor it was purchased for long term investment.

Appeal dismissed.

Cases referred to:

All Best Wishes Limited v CIR [1992] 3 HKTC 750

Wong Ki Fong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Appeal

1. This is an appeal by Mr A and his wife ('the Taxpayers') against the determination by the Commissioner in respect of profits tax assessment for the year of assessment 1993/94 relating to sale of the property known as the Subject Property.

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2. The Taxpayers act in person. Mr A of the Taxpayer appeared before us but not his wife Madam B. He claimed that he represented her but producing no written authorisation. According to section 2 of the Inland Revenue Ordinance ‘*Authorised Representative*’ is defined as a person duly authorised by the taxpayer in writing. It is not right for us to take that Mr A has been duly authorised by Madam B just because of their close relationship of being husband and wife.

3. As a tribunal we have to ascertain the truth and maintain a fair hearing. Under section 68(2B) we have the discretion to decide whether we should hear the case in the absence of Madam B. We understand from Mr A that the case was handled by both of them and he had full knowledge of what had happened. The law does not and cannot compel any party to appear and to give evidence. Having heard what Mr A has said we have come to the conclusion that the case can safely proceed in the absence of Madam B without causing any prejudice to Madam B. Mr A gave evidence on oath.

Issue

4. The main issue is whether the sale of the Subject Property is a trading activity and whether the Subject Property was purchased for the purpose as a residence for the Taxpayers’ family as claimed.

5. Mr Justice MORTIMER in All Best Wishes Limited v Commissioner of Inland Revenue [1992] 3 HKTC 750 at 771 rightly pointed out:

‘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 common place 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.’

We have decided to look at the circumstances of the whole case which we now undertake to do.

Reasons for purchase

6. At the time of purchase of the Subject Property Mr A and his family were living at Property C which he acquired only a few months ago. The reasons for the purchase of the Subject Property are as follows:

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- (a) He wanted to move to a place in District D which was much nearer to his daughter's school, Primary School E, a leading education institute in Hong Kong. There was no other new site with units available for sale in District D at that time which had larger flat area.
- (b) They wanted to buy a new flat; Property C was built some thirty years ago. The purchase of a new flat could maintain the value of their investment.
- (c) They found that the property market was rising very quickly and it was the right time for them to purchase a new property to hedge against inflation; otherwise they could hardly get into the market again.
- (d) The Subject Property was still in the course of construction; as they were living at Property C they could wait.

Reasons for purchasing Property C

7. He purchased Property C because it was a quiet place and was in District F. It was near to the place where his daughter learnt piano and swimming.

Reasons for sale of the Subject Property

8. Mr A gave a number of reasons. It was not a single particular reason that caused them to sell the Subject Property but a mixture of the different reasons that prompted them to sell.

9. Some time in March 1993 his friend Mr G, the assistant headmaster of an international school, indicated to him that the school was soon open for application and there was a chance that his daughter could secure a place there. It was their earnest desire that they wanted their daughter to get into an international school. They found that the Subject Property was not so convenient and not so close to the international school as Property C. As Mr A put it, this was not the only reason for sale but our assessment is that it was one of the main reasons.

10. Another reason is that they had some difficulty in obtaining mortgage. Banks were very cautious in financing property purchase. The purchase price of the new premises was paid in accordance with the building stages and they needed to pay a sum of nearly \$5,000,000 equivalent to 75% of the purchase price. Mr A's submission did not go as far as to say that because of the financial constraint they were unable to complete the purchase and he claimed that when it was necessary he could borrow money from his parents and relatives. There is no reason for us to doubt this claim.

11. They realised that the real estate market was at its top and they feared that it would collapse at any time. They decided to off load one of the properties. At that time they were residing at Property C and there was no reason for them to sell it. As they felt the

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imminent danger of real property would collapse it was logical for him to sell the unit still under construction. After discussion with his wife it was their joint decision to scrap their original plan to live at the Subject Property and let out Property C to service the mortgage loan which in any event was difficult to arrange.

Evidence evaluation

12. Mr A is a well educated person; he received education in England. After his return to Hong Kong he started his own business and opened a gift shop which was not very successful. He closed it down in 1991 and before that he ventured into shoe business. This time he succeeded and was able to secure the sole agency of certain product for the whole region of Southeast Asia, of which he spoke with pride. Mr A is a young entrepreneur with a lot of common sense. He is very eloquent and has presented his case in an orderly manner. He is very thoughtful. He has all the qualities of a successful entrepreneur. However, as Mr Justice MORTIMER puts it, *'actions speak louder than words'*. There are a number of aspects of this case which we find unconvincing.

13. Mr A was not able to explain to us why their family decided to choose a much smaller flat. They used to live in a flat with an area well over 2,000 square feet in Building H in 1991 to 1992, then in another flat of 1970 square feet in Building I and in Property C also around that figure while the Subject Property was only half of that size. His explanation was that at that time it was the only new site with flats available for sale near Primary School E. We find ourselves unable to accept such argument if the property was meant for self-use. A few months ago he purchased Property C which they thought was the right size. Why couldn't they wait a little longer? Was there any urgency?

14. Mr A explained the urgency: he thought that the market was rising rapidly. They feared that they would miss the boat and could hardly get back to the market if they did not buy to hedge against the rapid rise in property price. Would one do that if he had already purchased a property a few months ago and lived there? It is not a case that one has nothing in hand. For a person who gave good justifiable reasons for buying Property C, which we accept, it is difficult for us to believe that one would change his mind within a few months and decide to buy a much smaller flat for their own use. Then, three months later they were afraid of keeping the flat for too long. The claim for self-use looks very artificial.

15. Mr A urged us not to consider any factor in isolation; this we accept. Another reason he gave was that the Subject Property was near to Primary School E. We accept that it was nearer but not within walking distance for a young child from a family of Mr A's living style. We do not think that the location between Property C and the Subject Property made such a lot of difference for the Taxpayer's family to decide to move. Neither do we think that the possible realisation of their dream for their daughter to enter an international school cause them to sell. What is the significant difference in term of distance between Road J to District K and Road L to District K where the international school is located if the child travels by private car or school bus? The answer is obvious.

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16. The school receipts have badly betrayed Mr A. The earliest payment we could find for school entry fee was 24 July 1995. When Mr A was cross examined on this, his explanation was that Mr G indicated to him in March 1994, but with no commitment whatsoever, that his daughter could get a place in the next term. We do not believe that a successful businessman like Mr A would make such an important decision to sell a place where he intended to live permanently without a firm commitment from Mr G, particularly, such a caring parent as Mr A described himself to be who placed so much importance in the child's education. We doubt very much his earnest and firm desire to send the child to an international school. The evidence is that his daughter studied in the international school for only 10 days from the end of August 1995 when she had the chance but returned to Primary School E to study for one further year before she changed to another international school at District M.

17. Miss WONG for the Revenue pointed out the inconsistency between the two statements and his testimony before the Board: the first statement is found in page 12 of the Appeal Bundle which states that *'we worried the market might collapse so we wanted to sell it and wait for another opportunity to get a cheaper property for our own residence'* and the second statement on page 35 of Exhibit 'R1' which states *'there were signs that property market was turning down and we decided that it was not worth keeping the flat for long term investment since we are not going to live there'*. In his testimony Mr A said that the market was very strong and commanded a very high price. He did not mention signs of weakness. Another inconsistent point is that in one of the statement they claimed that the Subject Property was for residence and in another for long term investment only.

18. We do not believe, and neither do we find any evidence, that within three months of acquisition there was a sudden change of circumstances that caused them to sell the Subject Property. Having taken into consideration all the evidence before us and having considered all the explanations given by both parties we are not convinced that the Taxpayers and their family ever had any intention of using the Subject Property as residence. Nor do we think that the Subject Property was purchased for long term investment.

Decision

19. For reasons given above we dismiss the appeal and confirm the profits tax assessment for the year of assessment 1993/94 as revised and shown in paragraph 10 of the Commissioner's determination dated 7 November 1997.