INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D39/95**

**Profits tax** – purchase and sale of two properties – whether profit assessable to profits tax.

Panel: Kenneth Kwok Hing Wai QC (chairman), Andrew Chan Weng Yew and Yeung Kwok Chor.

Dates of hearing: 22 and 23 June 1995.
Date of decision: 21 July 1995.

The taxpayer purchased and sold a number of properties. The Commissioner assessed the profit on two such properties to profits tax. The taxpayer appealed and gave evidence. The taxpayer contended that the profits were capital gains.

Held:

The taxpayer was not telling the truth. The taxpayer had not discharged the onus of proof.

**Appeal dismissed.**

[**Editor's note:** The taxpayer has filed an appeal against this decision but withdrawn later.]

Cases referred to:

Marson v Morton [1986] STC 463
Simmons v IRC [1980] 1 WLR 1196
Simmons v IRC [1980] 53 TC 461
All Best Wishes Limited v CIR [1992] 3 HKTC 750

Tam Tai Pang for the Commissioner of Inland Revenue.
Taxpayer in person.

**Decision:**

1. This is an appeal against the determination dated 22 November 1994 by the Commissioner of Inland Revenue, rejecting the Taxpayer's objection against the estimated profits tax assessment for the year of assessment 1992/93 dated 8 March 1994 showing

estimated assessable profits of $1,485,000 with tax payable thereon of $222,750. The profits arose from the sale of 2 properties at Place W ('the 2 subject properties').

**The Facts:**

2. The facts as we find them for the purpose of this appeal are as follows.

2.1 The residential address of the Taxpayer as stated by him in his profits tax return for the year of assessment 1992/93 dated 1 June 1994 was Property B.

2.2 The Taxpayer was still residing at Property B at the hearing of this appeal.

2.3 On the 10 March 1987, Property A was assigned to the Taxpayer. The Taxpayer executed an equitable mortgage/legal charge dated 10 March 1987 in favour of Bank H, and further executed a second mortgage to secure general banking facilities dated 9 February 1988 in favour of Bank H.

2.4 In his salaries tax return for the years of assessment 1986/87 to 1988/89, the Taxpayer gave Property A as his residential address.

2.5 Property B was assigned to the Taxpayer and Ms L on 30 September 1989. The Taxpayer and Ms L executed an equitable mortgage dated 13 February 1988 in favour of Credit Company Y and further executed a mortgage to secure general credit facilities dated 30 September 1989 in favour of Credit Company Y.

2.6 In his salaries tax returns for the years of assessment 1989/90 to 1992/93, the Taxpayer gave Property B as his residential address.

2.7 The Taxpayer sold and disposed of Property A on 20 April 1990.

2.8 On 28 April 1990, the Taxpayer and Ms L changed the mortgagee bank for Property B from Credit Company Y to Bank H which provided about $600,000 to $800,000 more by way of general banking facilities to them.

2.9 On 13 June 1991, Property C at Place W ('the first subject property') was assigned to the Taxpayer at the price of $1,338,000. The Taxpayer mortgaged the first subject property to Bank I by a mortgage dated 13 June 1991.

2.10 On 9 January 1992, Property D at Place W ('the second subject property') was assigned to the Taxpayer at the price of $2,175,000. The Taxpayer charged the second subject property to Bank J by a legal charge dated 9 January 1992.

2.11 By a formal agreement for sale and purchase dated 30 January 1992, the Taxpayer agreed with Mr X to purchase from him Property E at the price of $800,000.

2.12 The Taxpayer and Ms L executed a second mortgage dated 30 March 1992 in favour of Bank H in respect of Property B to secure an additional overdraft facility of about $1,000,000. The Taxpayer claimed on oath that this line was utilised by what he called his employer company.

2.13 By an assignment dated 1 May 1992, Property E was assigned to the Taxpayer at the price of $800,000. A mortgage to secure general banking facilities dated 1 May 1992 was executed by the Taxpayer in favour of Bank K.

2.14 By a formal agreement for sale and purchase dated 14 May 1992, the Taxpayer agreed to sell the first subject property to Miss M and Miss N at the price of $2,450,000. The completion date as stated in this agreement was 13 October 1992.

2.15 By an assignment dated 30 May 1992, the Taxpayer assigned the second subject property to Mr O at the price of $2,908,000.

2.16 By an assignment dated 13 October 1992, the Taxpayer assigned the first subject property to Miss M and Miss N at the price of $2,450,000.

2.17 By a formal agreement for sale and purchase dated 5 August 1993, the Taxpayer agreed to sell Property E to Mr P at the price of $829,000. The transaction was completed by an assignment dated 31 August 1993.

2.18 Thus, from 10 March 1987 to the hearing of this appeal, the Taxpayer (and Ms L in respect of Property B) owned the following properties:

| | **Period** | **Property/Properties** |
|---|---|---|
| (a) | 10-3-87 to 30-9-89 | Property A |
| (b) | 30-9-89 to 20-4-90 | Properties A and B |
| (c) | 20-4-90 to 13-6-91 | Property B |
| (d) | 13-6-91 to 9-1-92 | Property B and the first subject property |
| (e) | 9-1-92 to 1-5-92 | Property B and the first subject property and the second subject property |
| (f) | 1-5-92 to 30-5-92 | Property B, and the first subject property and the second subject property and Property E |
| (g) | 30-5-90 to 13-10-92 | Property B and the first subject property and Property E |
| (h | 13-10-92 to 31-8-93 | Property B and Property E |

)
(i) 31-8-93 to 22-6-95 Property B

2.19 The Taxpayer sold and disposed of the first subject property within 16 months of its being assigned to him.

2.20 The Taxpayer sold and disposed of the second subject property within 5 months of its being assigned to him.

2.21 On 14 September 1993, the assessor issued a profits tax return for the year of assessment 1992/93 to the Taxpayer for completion.

2.22 The Taxpayer failed to submit the return within the stipulated time and by an assessment dated 8 March 1994, the assessor raised an estimated profits tax assessment with estimated assessable profits of $1,485,000, with tax payable thereon of $222,750.

2.23 $1,485,000 is the difference between the total of the sale prices of the 2 subject properties ($2,450,000 and $2,908,000) and the total of the purchase prices of the 2 subject properties ($1,338,000 and $2,175,000), with $360,000 being allowed as estimated expenses.

2.24 By a letter in Chinese dated 7 April 1994, the Taxpayer objected to the assessment, stating in effect:

> that when he bought the first subject property, he intended to use it as his residence and had carried out some interior decoration work; that later on he considered it to be relatively small and therefore sold it; that he then bought the second subject property which was relatively bigger; that due to fung shui problem he did not live in it; that he changed his plan and intended to put up the property for rental; that it could not be let out since the rental market was not satisfactory; that eventually the second subject property was sold; that the whole process of buying and selling was entirely based on investment on the basis of having one property replacing another; and that there was no speculative activity as he did not sell a number of properties at the same time or within a short period of time.

2.25 The Taxpayer eventually submitted the profits tax return for the year of assessment 1992/93 and dated his return 1 June 1994. He declared that ‘no business [was] carried on’ and that the assessable profits were ‘NIL’.

2.26 By his determination dated 22 November 1994, the Commissioner rejected the Taxpayer’s objection and confirmed the estimated profits tax assessment.

2.27 The Taxpayer appealed from the determination.

**Relevant provisions**

3.1 Section 68(4) of the Inland Revenue Ordinance (the IRO), chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Taxpayer.

3.2 Section 2 defines 'trade' as including 'every trade and manufacture, and every adventure and concern in the nature of trade'. Section 14(1) excludes profits arising from the sale of capital assets.

**The Issues**

4. The issues are whether the Taxpayer has discharged his onus of proving that the estimated assessment on the gain arising from the sale of the 2 subject properties (a) is incorrect in that it is not assessable to profits tax in accordance with section 14(1) on the ground that the 2 subject properties were acquired as capital assets, and (b) is excessive.

**Authorities**

5. We do not find it necessary to refer to all the relevant authorities on whether there was an adventure in the nature of trade. Each case depends on its own facts.

6. We remind ourselves of what Sir Nicholas Browne-Wilkinson VC said in Marson v Morton [1986] STC 463 at pages 470-471; what Lord Wilberforce authoritatively stated in Simmons v IRC [1980] 1 WLR 1196 at page 1199 and [1980] 53 TC 461 at pages 491-492; and the statement of the law by Orr L J at pages 488 and 489 of the report in Tax cases, which was approved by Lord Wilberforce as a generally correct statement (WLR at page 1202 and Tax Cases at page 495).

7. In All Best Wishes Limited v CIR [1992] 3 HKTC 750 at page 770 and page 771, Mortimer J, as he then was, was reported to have said:

> *'Reference to cases where analogous facts are decided, is of limited value unless the principle behind those analogous facts can be clearly identified.'*
>
> (at page 770).
>
> *'The Taxpayer submits that this intention, once established, is determinative of the issue. That there has been no finding of a change of intention, so a finding that the intention at the time of the acquisition of the land that it was for development is conclusive.*
>
> *I am unable to accept that submission quite in its entirely. I am, of course, bound by the Decision in the Simmons case, but it does not go quite as far as is submitted. This is a decision of fact and the fact to be decided is defined by the Statute – was this an adventure and concern in the nature of trade? 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. Having said that, I do not intend in any way to minimize the difficulties which sometimes arise in drawing the line in cases such as this, between trading and investment.'* (at page 771).

**Evidence**

8.1 The Taxpayer produced 5 exhibits. Exhibit T-1 consists of copies of 2 provisional agreements for sale and purchase, the birth certificate of his daughter, extracts from the notes to the accounts of Company Z, and his salaries tax assessments for the years ended 31 March 1989, 31 March 1991 and 31 March 1992. Exhibit T-2A consists of copies of documents in relation to the Taxpayer's account with Company U, and exhibit T-2B consists of copies of documents in relation to Ms L's account with Company V. Exhibit T-3 is a copy of the loans account history listing of the Taxpayer's loan account with Bank I and exhibit T-4 is a copy of the account history record of the Taxpayer's loan account with Bank J. The Taxpayer gave oral evidence himself but called no other witness.

8.2 The Commissioner produced 17 documents as exhibits. They consist of copies of land search cards in respect of Properties A and B, the 2 subject properties, and Property E; the Taxpayer's salaries tax returns for the years of assessment 1986/87 to 1992/93; Ms L's salaries tax return for the year of assessment 1990/91 and the employer's returns in respect of Ms L for the years ended 31 March 1992 and 31 March 1993; the agreement referred to in paragraph 2.11 above; and the agreement referred to in paragraph 2.14 above. The Commissioner did not adduce any oral evidence.

9. Before us, the Taxpayer testified on oath that he resided at Property B and that his occupation was the manager of Company Z. He said that sometime at the end of 1990 he paid a visit to a friend of his at Place W and formed the intention and wish to occupy and live in a house at Place W. Sometime in the middle of March 1991, his friend telephoned him and told him that there was an available unit which was 'very beautiful' and suitable for him and requested him to go over there and have an inspection. That unit was the first subject property. Without going there to inspect physically, the Taxpayer instructed his friend to enter into a provisional agreement for and on his behalf. The first page of T-1 is the provisional agreement which his friend entered into on his behalf. The Taxpayer had already made arrangements with his 'employer company' to loan him a sum of money. After completion of the purchase of the first subject property and after Ms L had given birth

to the Taxpayer's daughter on 1 June 1991, in July or August, the Taxpayer went to inspect the first subject property with a fung shui master as the Taxpayer absolutely believed in fung shui. The fung shui master told the Taxpayer that he had acquired an incorrect house as there was some evil influence existing in the house, and advised the Taxpayer to dispose of the house as soon as he could. The Taxpayer was not prepared to sell at a loss and so he instructed estate agents to try to rent out the first subject property. Since his house was without any decorations', there was no willing tenant. Sometime at the beginning of November 1991, the same friend telephoned the Taxpayer saying that a better house had been found. This time the Taxpayer went with a fung shui master. After inspecting the second subject property and having received positive advice from the fung shui master, the Taxpayer entered into the provisional sale and purchase agreement on the third page of T-1. The Taxpayer did not have cash in hand for the purchase of the second subject property and instructed estate agents to try to sell the first subject property.

> 'Unfortunately when it was 10 December, the day of completion of my second item, my first item of property had not been successfully sold, that is why in order to complete the purchase of the second item [the Taxpayer] was obliged to once again borrow a sum of money from [his] employer company and for reason unknown to [him] the first item of property just could not be sold for a long, long time. So it was at the beginning of 1992, that is just after the Chinese New Year festival [the Taxpayer's] employer company was of the view that [the Taxpayer] was juggling and that it was impossible that [the Taxpayer] had been unable to sell [his] property. So [his] employer company impose a time limit that at the end of May [he] must take repayment of a certain sum of money to [his] company'.

The Taxpayer put both subject properties on the market for sale to find out which one could be sold in order to save the other. The second subject property was sold on 31 May 1992 but the actual proceeds available to the Taxpayer was not so much because he had spent money on renovation and decoration of the second subject property. Eventually, the first subject property was sold on 30 October 1992 and the proceeds of sale were used to repay the Taxpayer's friends and partly used to repay his company. The Taxpayer referred to the last 3 pages of T-1 and said that at that time his monthly income was approximately $20,000 odd, and that, financially speaking, without the support of his company to lend him the money to acquire the property, it was beyond his financial capabilities to purchase properties. The Taxpayer was pretty certain that at the time when he acquired the 2 subject properties, they were only intended for his own use and there had never been any desire to speculate on those properties. The Taxpayer had suffered losses in speculation on foreign currencies and relied on T-2A and T-2B to say that the total loss amounted to about $2,000,000. After having lost so much money by 1990, the Taxpayer:

> 'reminded [himself] that [he] was just unfit to speculate or to engage in any kind of gambling activities like that. Well so [the Taxpayer] had negotiated with [his] employer company to work out a plan of making repayments to [his] company and [he] had already prepared for the worst, that [he] had just to sell Property B. Well however [his] company was so much understanding of [him]

> and extended opportunities for [him] to make repayments to it. Therefore the state of [his] mind was that it was just impossible that [he] would have such guts to embark upon any other speculating activities. So because between 1989 to 1990 my annual total emolument would not be exceeding $250,000 however [he] lost about $2,000,000 in speculations so this was to [him] a very very bitter lesson … So that state of [his] mind remained the same until the time [his] friend introduced [him] to purchase the property there and [he] was thinking of acquiring it for own occupations, at the same time also planning for rescheduling of [his] debts'.

He entered into the agreement IRD-16 because the vendor Mr X, then a colleague of his, owed him in excess of $400,000. He spent about $200,000 odd on decoration of the second subject property. Up to the date when the first subject property was assigned to him in June of 1991, his intention was to hold on to Property B for 2 years.

**Our Decision**

10. We find that the Taxpayer is a thoroughly dishonest witness, telling us a pack of lies. We categorically reject his evidence that he purchased the 2 subject properties for the purpose of self-occupation and that he had spent about $200,000 odd on decorating the second subject property which he disposed of within 5 months of acquisition (see paragraph 2.20 above). We further find that he was not purchased any of the 2 subject properties as an investment. We are not satisfied on the balance of probabilities that the Taxpayer has spent any sum decorating any of the 2 subject properties.

11.1 The Taxpayer stated on oath that he had read the objection letter dated 7 April 1994 (see paragraph 2.24 above) before he signed it and that at the time when he signed it, the contents of the letter were to his knowledge true.

11.2 The house said to have fung shui problem in his objection was the second subject property. Before us, he claimed that it was the first subject property which had fung shui problem or had evil spirits. Since he claimed to be an absolute believer in fung shui, he would have required no document to remind him which house in fact allegedly had any fung shui problem.

11.3 The house said to have been redecorated in his objection was the first subject property. Before us, the claimed that it was the second subject property, to the tune of $200,000 odd.

11.4 The relative smallness of the size of the first subject property was the reason given in the objection for changing his alleged intention to reside therein. Before us, he admitted that both houses were of the 1,300 square feet type, although he claimed that there were differences in the sizes of the gardens and the master bedrooms.

11.5 The house which was said to be put on the rental market in the objection was the second subject property. Before us, he claimed that it was the first subject property, a

house which his friend allegedly told him was 'very beautiful' whereas the Taxpayer also asserted that the house was 'without any decorations'.

12. This is most certainly not a case of a one-off transaction. Even a one-off transaction is in law capable of being an adventure in the nature of trade. Paragraph 2.18(d)-(g) above shows that the Taxpayer owned 2 to 4 properties during his short period of ownership of the 2 subject properties.

13.1 The fact that the source of finance for the purchases of the 2 subject properties was substantially borrowed is a factor against the Taxpayer. Indeed, not only were both subject properties purchased on bank loans secured on legal charges or mortgages, the Taxpayer was indebted to Bank H under 2 mortgages in respect of Property B (see paragraphs 2.8 and 2.12 above).

13.2 In addition to his indebtedness to a number of banks, the Taxpayer was also indebted to what he said in chief was his 'employer company' when the truth of the matter is that he has at all material times been a shareholder and director of Company Z. According to the 4th page of T-1, his indebtedness to Company Z as at 1 January 1990 was $1,980,000, as at 31 December 1990 $2,000,000, with the maximum amount outstanding during the year being $2,000,000. According to the 5th page of T-1, his indebtedness to Company Z as at 1 January 1991 was $2,000,000, as at 31 March 1992 $2,200,000, with the maximum amount outstanding during the period being $2,200,000. According to the 6th page of T-1, his indebtedness to Company Z as at 1 April 1992 was $2,200,000, as at 31 March 1993 $1,897,131, with the maximum amount outstanding during the year being $2,200,000. On such evidence, we find that the Taxpayer simply did not have the financial ability to acquire any of the 2 subject properties as an investment asset, bearing in mind that the Taxpayer's evidence that at the time when the first subject property was assigned to him he intended to hold on to Property B for another 2 years. To acquire an investment asset by borrowed funds in order to 'reschedule' his indebtedness is so absurd a proposition that we have no hesitation in rejecting.

14. The Taxpayer was unable to say whether the name of the vendor on page 1 of T-1 is 'Mr X T' or 'Mr Y T'. Mr T does not appear in the land registration records (IRD-1) to have ever had any interest in the first subject property. The Taxpayer was unable to tell us the name of the person from whom he acquired the first subject property. This is odd if the Taxpayer were purchasing his dream house. The name of the vendor on page 3 of T-1 is simply 'Mr S'. Mr S does not appear in the land registration records (IRD-2) to have ever had any interest in the second subject property. Again, the Taxpayer was unable to tell us the name of the person from whom he acquired the second subject property and did not know if it was Mr S. This is again odd if he were purchasing a house for his own residence after having purchased an 'incorrect' one and having taken a fung shui master with him to inspect the second one.

15.1 Since we have rejected the Taxpayer's claim that he acquired any of the 2 subject properties as a capital asset, the question why he subsequently changed his mind and

decided to sell what had been acquired as a capital asset does not arise. Be that as it may, we find the reasons given by him on appeal wholly unconvincing and reject them.

15.2 We reject his claim that he was pressed by Company Z to make repayments. It is clear from pages 4 to 6 of T-1 that his indebtedness to Company Z has remained within the region of $1,890,000 to $2,200,000 between 1 January 1990 and 31 March 1993. If, as the Taxpayer claimed, the additional $1,000,000 overdraft facility made available by Bank H under the second mortgage dated 30 March 1992 (see paragraph 2.12 above) had been utilised by Company Z, that would have been a good, if not perfect, answer to any suspicion which Company Z might allegedly have after the Chinese New Year in 1992 that the Taxpayer was 'juggling'. Company Z would be in no position to impose May 1992 as a deadline for the Taxpayer to make 'repayment of a certain sum of money' when Company Z had allegedly been using overdraft facilities secured by the second mortgage of the Taxpayer's and Ms L's Property B. The Taxpayer claimed that he had been pressed by Company Z to make repayment, but he could not offer any explanation why he agreed to allow the purchases of the second subject property 5 months to complete the transaction (see paragraph 2.14 above), particularly after he had just borrowed to complete the purchase of Property E (see paragraph 2.13 above).

16. We do not consider that any loss which the Taxpayer (and Ms L) might have suffered in speculating on foreign currencies assisted the Taxpayer in any way. We assume, without finding, that he (and Ms L) had suffered losses to the tune of some $2,000,000. That might deter him from speculating on foreign currencies. That did not in any way deter him from speculating on land.

**Assessment confirmed subject to reduction**

17. By IRD-18, the Commissioner conceded that the gain on the disposal of the 2 subject properties was $1,356,932.

18. We have carefully considered the grounds of appeal, the evidence adduced on appeal, and all the pointers towards investment. Taking all the relevant factors into consideration, we have no doubt that, subject to the concession by the Commissioner, the Taxpayer has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. Subject to reducing the amount of the assessable profits in the assessment appealed from $1,485,000 to $1,356,932 which we hereby do, we dismiss the appeal.