

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D41/02

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

Panel: Ronny Wong Fook Hum SC (chairman), Emily Lam Yuet Ming and David Wu Chung Shing.

Date of hearing: 2 April 2002.

Date of decision: 25 July 2002.

Commencing from 1 January 1998, the appellant rented Property 1 from a very close friend. The appellant purchased Property 2 on 19 July 1998. On 2 November 1999, the appellant put up Property 2 for sale through an estate agent. By a provisional agreement dated 13 November 1999, the appellant acquired Property 3. On 27 November 1999, the appellant appointed Company F to sell Property 3. Property 2 was sold on 12 January 2000.

The appellant is still residing in Property 1. The appellant contended that he bought Property 2 for family residence. The appellant sold it so as to finance purchase of Property 3 in order to improve the expected living condition. The appellant sold Property 3 because of the failure in business and the lack of income from a job. The appellant claimed further that he was not a trader of apartment. The issue before the Board is whether the appellant is liable for profits tax in respect of his gains arising from his dealings with Property 2 and Property 3.

Held:

1. The intention of the appellant at the time of the purchase of Property 2 and Property 3 is crucial in determining whether those units were capital assets or trading assets. 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 appellant to place before the Board supporting materials in

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support of his assertions. Although the standard of proof is one of balance of probabilities, the appellant must ensure that the balance be tilted in his favour by furnishing the Board with primary evidence that is within his easy access.

3. The Board was not satisfied that the appellant purchased Property 2 as his family residence and the appellant's position vis-à-vis Property 3 was wholly untenable. The appellant was merely seeking to reap a quick profit from his trading activities. The Board was of the view that the appellant failed to discharge the onus of proof resting upon him.

Appeal dismissed.

Cases referred to:

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

Fung Chi Keung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. Commencing from 1 January 1998, the Appellant was residing at Address A ('Property 1'). The Appellant rented Property 1 from a very close friend.
2. By a provisional contract dated 19 July 1998, the Appellant purchased a flat at Housing Estate B ('Property 2') for \$2,564,000. According to the terms of this provisional contract, the Appellant had to pay a preliminary deposit of \$256,400 on signing of the contract; \$256,400 on or before 5 August 1998 and the balance of \$2,051,200 on or before 21 August 1998.
3. At all material times until 25 September 1999, the Appellant was a manager of Bank C. The Appellant acquired Property 2 with the aid of a term loan of \$1,794,800 extended by Bank C on 24 July 1998. This term loan was repayable by 240 monthly instalments of \$17,918.92 each. The Appellant repaid this term loan on 27 September 1999 shortly after cessation of his employment with Bank C.

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4. On 2 November 1999, the Appellant put up Property 2 for sale through the estate agent, Company D. The asking price was \$3,100,000.
5. By a provisional agreement dated 13 November 1999, the Appellant acquired a flat at Housing Estate E (' Property 3 ') for \$3,171,000. According to the terms of this provisional agreement, the Appellant had to pay an initial deposit of \$150,000 upon signing of this provisional agreement; \$167,100 upon signing of the formal agreement and the balance of \$2,853,900 on or before 16 December 1999.
6. On 27 November 1999, the Appellant appointed Company F to sell Property 3 at an initial asking price of \$3,580,000. By a provisional agreement dated 9 December 1999, the Appellant sold Property 3 for \$3,580,000.
7. The occupation permit in respect of Property 2 was granted on 2 December 1999. By a provisional agreement dated 12 January 2000, the Appellant sold Property 2 for \$3,033,000.
8. Company G is a company incorporated by the Appellant pursuant to the Companies Ordinance (Chapter 32) on 22 December 1999. According to the Appellant, Company G was de-registered on 13 July 2001.
9. The Appellant is still residing in Property 1. The area of that flat is about 500 square feet. It does not have any bedroom. The gross floor area of Property 2 is about 670 square feet. It has two bedrooms. The gross floor area of Property 3 is about 750 square feet. It also has two bedrooms. At \$2,564,000, the unit rate paid by the Appellant for the purchase of Property 2 was \$3,827 per square foot. At \$3,171,000, the unit rate paid by the Appellant for the purchase of Property 3 was \$4,228 per square foot.
10. The issue before us is whether the Appellant is liable for profits tax in respect of his gains arising from his dealings with Property 2 and Property 3.

Case of the Appellant

11. In relation to Property 2, the Appellant asserted that:

‘ I bought [Property 2] on July 19, 1998 in order to live in my own flat instead of renting one when the flat was ready for occupancy. Since my employer at that time [Bank C] did not accept uncompleted flat under their staff housing loan scheme, I took up a commercial loan with the bank in July 1998 in order to change the commercial loan to a staff housing loan once the apartment was ready for occupancy. However, I decided to start my own Internet business and resigned from the bank in September 1999. In November, my partners and I had already built the site for demonstration to investors ... On Sept 27, 1999, I fully repaid the mortgage. I sold

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the flat on Jan 26, 2000. The initial motive was to sell the apartment and to buy a bigger one to improve the expected living conditions. Subsequently, the reasons behind were the failure in my Internet business and the lack of income from a job ... I am not a trader of apartment ...’

12. In relation to Property 3, the Appellant said this:

‘ I bought [Property 3] on Nov 17, 1999 in view of further improving my living environment. I planned to sell [Property 2] to finance the purchase. However, in early December, I felt that I might not be able to get financing for my Internet business. As a result, I decided to sell this flat. At the same time, I started to look for a job and I finally started working for [University H] in July 2000. I had also deregistered [*sic*] my company [Company G] on July 13, 2001’ .

Evidence of the Appellant

13. Property 1 is located in a 40-year-old building. He first rented that flat at a rental of \$8,000 per month. The current rental is \$7,000 per month.

14. His prime motivation leading to the purchase of Property 2 was the possibility of obtaining a staff housing loan from Bank C. He explained that the staff loan would carry interest at the rate of 4% per annum. The monthly repayment for a 20-year loan would be \$10,876 as opposed to \$17,919 on the basis of a commercial loan. He did consider units in other sites but he cannot recall the whereabouts of those units. He was told by the developer that the unit would be completed within a year. He did not expect a delay of 19 months before getting Property 2.

15. He left Bank C in September 1999 in order to expand his Internet business. He succeeded in developing a prototype by November 1999. He was then looking for an investor into his project.

16. He came across the development in Housing Estate E. He thought the market price for Property 3 was about the same as Property 2. He therefore decided to sell Property 2 in order to purchase Property 3.

17. He failed to secure any investor into his Internet business in November 1999. He took the view that it would be better to have cash in hand as opposed to having any property. Company F was therefore appointed on 27 November 1999.

The law

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18. The intention of the Appellant at the time of the purchase of Property 2 and Property 3 is crucial in determining whether those units were capital assets or trading assets. 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 asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’

19. 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:

‘ 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’.

20. 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 Appellant to place before this Board supporting materials in support of his assertions. Although the standard of proof is one of balance of probabilities, the Appellant must ensure that the balance be tilted in his favour by furnishing the Board with primary evidence that is within his easy access.

Our decision

21. We are not satisfied that the Appellant purchased Property 2 as his family residence. He was then residing in Property 1 on Hong Kong Island. He was employed with Bank C. He gave no evidence as to his place of work. Property 2 is in the New Territories. Had the same been genuinely selected as the Appellant’s future residence, we would have expected some evidence to justify his move to such a radically different location. When viewed in the light of the Appellant’s failure to describe any alternative site that he considered, we find it hard to accept that Property 2 was purchased as the Appellant’s residence. Given the importance which the Appellant attached to the availability of a housing loan, his selection of a unit still in the process of construction is

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perplexing. The reason which he gave for sale of Property 2 is also unconvincing. The unit rate for Property 3 is much higher than the unit rate for Property 2. The Appellant is an accountant with Master of Business Administration degree. Such marked difference could not have gone unnoticed by the Appellant.

21. The Appellant's position vis-à-vis Property 3 is wholly untenable. Property 3 was purchased on 13 November 1999. Company F was instructed to sell this flat on 27 November 1999. The flat was sold on 9 December 1999. There was no genuine intention to purchase Property 3 as the Appellant's family home. He resigned his position with Bank C on 25 September 1999 in order to expand his Internet business. Given his level of education, he must have known the risks inherent in venture of this nature when he decided to embark upon the purchase. There was no material change between 13 November 1999 and 9 December 1999. The Appellant was merely seeking to reap a quick profit from his trading activities.

22. For these reasons, we are of the view that the Appellant failed to discharge the onus of proof resting upon him. We dismiss his appeal.