

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D41/95

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

Panel: Ronny Wong Fook Hum QC (chairman), Karl Kwok Chi Leung and Herbert Tsoi Hak Kong.

Date of hearing: 3 May 1995.

Date of decision: 28 July 1995.

The taxpayers were husband and wife who purchased and sold a property. The profit was assessed to profits tax. The taxpayers appealed to the Board of Review on the ground that it was a capital gain. The taxpayers gave evidence.

Held:

Looking at the evidence as a whole the Board was not satisfied that the taxpayers had discharged the onus of proof.

**Appeal dismissed.**

Cases referred to:

Lionel Simmons Properties Ltd v CIR 53 TC 461  
All Best Wishes Limited v CIR 3 HKTC 750

Ng Yuk Chun for the Commissioner of Inland Revenue.  
Taxpayer in person.

**Decision:**

### **I. BACKGROUND OF THIS CASE**

1. The Taxpayers are husband and wife. They married in November 1984. The husband is a civil servant. As from 20 January 1987, the husband was provided with quarters by the Government. Between 29 September 1989 and 11 September 1994, a quarter of about 285 square feet was provided in District A. As from 12 September 1994, a larger quarter of 460 square feet was provided in District B.

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2. According to the salary statement of the husband dated 29 November 1990, his total salary for November 1990 was \$13,847. He paid \$333.5 by way of rent for his quarter.
3. By a sale and purchase agreement dated 4 December 1990, the Taxpayers purchased the First Flat in District C for \$1,123,000. The First Flat is of an area of 760 square feet. In support of the purchase, the Taxpayers obtained a loan of \$1,123,000 from Bank S through an equitable mortgage dated 12 December 1990. Commencing from 10 January 1991, the Taxpayers had to make monthly repayment of \$13,747.1 under this equitable mortgage.
4. The father of the wife contracted cancer and he passed away on 28 July 1991.
5. On 8 November 1991, the wife entered into a tenancy agreement [‘the Stall Agreement’] for rental of a stall in a public market for three years from 1 July 1990. Flat K in District B was given as the address of the wife in the Stall Agreement.
6. The Taxpayers had their first child, a son, on 27 December 1991. Flat K was also given as their address on the birth certificate of the son.
7. On 10 January 1992, the vendor of the First Flat served notice on the Taxpayers calling on them to take possession of the flat the occupation permit in respect of which was issued on 22 November 1991. The First Flat was duly assigned in favour of the Taxpayers on 10 February 1992.
8. On 17 March 1992, the Taxpayers entered into a sale and purchase agreement selling the First Flat for \$2,450,000. The Commissioner takes the view that this transaction produced an assessable profit of \$1,004,000 with tax thereon at \$150,600. The Taxpayers dispute liability for the same.
9. By letter dated July 1993, the Taxpayers furnished explanations to the Commissioner as to why they disposed of the First Flat. The following reasons were given:
  - (a) The wife was with child and this increased the outlay of the family;
  - (b) The wife would like to reside with her mother because:
    - (i) Her father passed away;
    - (ii) A physically handicapped brother was residing with the mother and she had to help out; and
    - (iii) The mother was suffering from ill health.
  - (c) Attempts to let the First Flat were unsuccessful.

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10. On 4 August 1993, the Taxpayers entered into an agreement for the purchase of the Second Flat in District C for \$2,196,000. They gave Flat K as their address in the relevant agreement. This Second Flat was duly assigned in favour of the Taxpayers on 25 May 1994. The Taxpayers effected this purchase without resort to any banking facility. They did not move into this flat which is of an area of 755 square feet. By a sale and purchase agreement dated 2 September 1994, the Taxpayers sold the same for \$3,500,000.

11. By letter dated 30 March 1994, the Taxpayers made the following additional submissions to the Commissioner:

- (a) At the material time, the wife was a housewife. The husband's salary of \$9,750 was the sole source of income.
- (b) The First Flat was purchased 'for long-term rental purpose or for self-residence in the future'.
- (c) The mother-in-law provided irregular monthly amounts of between \$3,000 - \$5,000 to meet the mortgage instalments. This stopped when it was discovered in early 1991 that the father-in-law was suffering from cancer. Thereafter the Taxpayers had to borrow from relatives in order to meet such mortgage instalments.
- (d) Attempts were made to let out the premises. When those attempts proved unsuccessful, a friend versed in fung shui was asked to view the premises. Adverse comments were made by this friend.
- (e) In these circumstances, the First Flat was sold in order to ease their financial burden.

12. By a determination dated 24 October 1994, the Commissioner confirmed the assessment on the Taxpayers. The Commissioner placed reliance on the following factors:

- (a) The Taxpayers held the First Flat for less than four months after the issue of the occupation permit;
- (b) The Taxpayers did not let out the First Flat and had not produced any evidence to show that attempts were made to let out the same;
- (c) The Taxpayers did not ever reside in the First Flat;
- (d) The Taxpayers managed to sell the flat at a handsome profit despite the alleged bad fung shui and
- (e) The Taxpayers had not demonstrated their ability to finance the First Flat on a long term basis.

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13. The Taxpayers appealed against the Commissioner's determination. In their notice of appeal dated 22 November 1994, the Taxpayers:

- (a) sought to meet the Commissioner's criticism of their financial position by pointing out that:
  - (i) the wife was helping her mother 'to manage the rental collection in respect of several properties at Street F and the property at Street G'. A bundle of demands for rates in respect of those premises were produced.
  - (ii) the wife was helping her father to manage a laundry at Street H.
  - (iii) the wife helped in the management of the stall in the public market which was transferred to her name by the Stall Agreement after her father's death.
  - (iv) the husband and wife both obtained financial support from their respective families.
- (b) pointed out that when they purchased the First Flat, their intention was 'to move in for self-residence if our financial situation was good. Otherwise, the property would be let out for rental income as a long-term investment'.
- (c) drew attention to the fact that they incurred stamp duty in obtaining an assignment of the First Flat in their favour.

## II. EVIDENCE OF THE TAXPAYERS

1. Only the husband gave evidence. He told us the following:
- (a) Flat K is of 915 square feet with three rooms. In 1991 his father and mother-in-laws stayed there with their two sons.
  - (b) He paid a total of 14 mortgage instalments before disposing the First Flat.
  - (c) The stall in the public market belonged to her mother-in-law. His wife received no income from that stall.
  - (d) He has no evidence to demonstrate the financial support from the in-laws.
  - (e) There was no decoration of the First or the Second Flats at all.

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- (f) He tried to let out the First Flat with three estate agents. It was offered at \$8,000 and then reduced to \$7,000 but with no taker. He made attempts to obtain evidence from those agents in respect of such offers but without success.
- (g) Advice on fung shui of the First Flat was sought as his son cried when he first entered that flat. The advice was given by Mr X who had since emigrated to Canada. This took place a month or so after the attempts to let out the premises.
- (h) The Second Flat was purchased with the aid of a \$1,400,000 loan from an aunt. He sold the Second Flat as the bus depot was in its vicinity.
- (i) He had bought a Third Flat in District C on 25 March 1995 for \$2,692,700. This is of 654 square feet. All his acquisitions were in District C as his wife would like to be near her mother.

2. Apart from the agreement for the purchase of the Third Flat, the Taxpayers had not produced further documentary evidence before us.

### III. THE STATUTORY PROVISIONS

1. Section 14 of the Inland Revenue Ordinance (the IRO) provides that:

*'Subject to the provisions of this ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) ...'*

2. Section 2(1) of the IRO defines 'trade' to mean 'every trade and manufacture, and every adventure and concern in the nature of trade'.

3. Section 68(4) of that IRO further provides that:

*'The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'.*

### IV. THE RELEVANT LEGAL PRINCIPLES

1. In Lionel Simmons Properties Ltd v CIR 53 TC 461, Lord Wilberforce pointed out that:

*'Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of acquisition of the asset. Was it*

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*acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’*

2. The self-serving statement by a Taxpayer has to be tested against the objective facts of the case. As pointed out by Mortimer J in All Best Wishes Limited v CIR 3 HKTC 750

*‘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 action speaks louder than words’.*

### V. OUR DECISION

1. The Taxpayers bought the First Flat on 4 December 1990. It was sold on 7 March 1992. The Taxpayers had in the meantime paid 14 instalments. It would not be right in ascertaining the intention of the Taxpayers to home in on the four months after the issuance of the occupation permit. We would not attach weight to the first factor relied upon by the Commissioner.

2. The very short period between 10 January 1992 notification from the vendor and the re-sale of the First Flat on 17 March 1992 is however relevant in casting doubt on the attempts made to let the premises in question. The evidence on the Taxpayers’ alleged instructions to the estate agents is sketchy. Whilst we appreciate that there might be difficulty in retrieving documentary proof, we see no reason why none of the three estate agents was called.

3. The fung shui issue is related to the lack of use of the First Flat as the Taxpayers’ residence. After seeing the husband, we have doubts as to the genuineness of this issue as a reason. It was not put forward as a reason in the Taxpayers’ first letter to the Revenue of July 1993. In the letter of 30 March 1994, the Taxpayers indicated that fung shui advice was sought because there was no success in their attempts to let out the flat. This is contrary to the evidence of the husband that reaction of the son on entry of the flat rendered such consultation necessary. There is no evidence to indicate any fung shui advice being taken on the purchase of Second and Third Flats.

4. We also attach little weight to the fourth factor relied upon by the Commissioner. The issue is the Taxpayers’ intention as at 4 December 1990. Bad fung shui for some might be good fung shui for others.

5. The ability of the Taxpayers to finance the acquisition on a long term basis is a factor that weights heavily in our deliberation. The husband was earning less than the monthly instalment due. Even accepting the alleged financial support from the in-laws at \$3,000 to \$5,000 per month, it is difficult to see how the couple envisaged their living expenses would be met. The Taxpayers chose not to call the mother of the wife to substantiate her pledge. It is not clear what financial benefit the wife obtained in managing

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various assets of her father and mother after her father's death. Any benefit is difficult to reconcile with the Taxpayers' assertion in their letter of 30 March 1994 that they had to borrow from other relatives since mid 1991. Their payment of 14 instalments is equally consistent with a determination to wait for an upturn of the market so as to reap a substantial profit.

6. At all material times, the Taxpayers had the benefit of Government quarters. In all the documents placed before us, the Taxpayers referred to Flat K as their address. Successive Flats in District C were purchased but the Taxpayers did not move into any of them. These pointers do not support a genuine desire to acquire the First Flat as the Taxpayers' home.

7. Looking at the evidence as a whole, we are not satisfied that the Taxpayers had discharged the onus that rests on them. We would dismiss the appeal and confirm the assessment.