

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D42/02

Profits tax – whether the sale of a property was trading in nature – it was crucial to ascertain the intention of the taxpayer at the time of acquisition of the property – the stated intention of the taxpayer was not decisive – actual intention had to be determined objectively – burden of proof on the appellant – incumbent on the appellants to substantiate their contention – section 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Simon Ho Shun Man and Adrian Wong Koon Man.

Date of hearing: 6 May 2002.

Date of decision: 26 July 2002.

The appellants, a married couple ('Mr A and Mrs A'), appealed against a profits tax assessment in respect of the gains they made from their dealings with one of the properties ('Property 3') among four properties related to them between 1984 and 1997. The Revenue did not accept that Property 3 was purchased as the family home.

The facts appear sufficiently in the following judgment.

Held:

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

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of proof was one of balance of probabilities, they must ensure that the balance be tilted in their favour by furnishing the Board with primary evidence that was within their easy reach.

5. The Board was of the view that the following points were in favour of the appellants:
 - (a) At all material times, they held only one piece of landed property.
 - (b) Mr A sold Property 1 prior to his purchase of Property 3. They purchased Property 2 after their sale of Property 3 and they have been residing in Property 2 ever since.
6. The credibility of Mr A was however tarnished by the following factors:
 - (a) There was no break in his tenancy over Property 2. His wholly unjustifiable reliance on the alleged break suggested a contrived attempt to belittle the weakness of his case arising from his continued occupation of Property 2.
 - (b) In correspondence with the Revenue, he asserted that his whole family moved into Property 3. His testimony before the Board indicated that the alleged occupation of Property 3 was merely casual and the whole family did not move into that house. The Board was of the view that Mr A was forced to adjust his evidence in the light of the letter from CLP Power Hong Kong Limited.
 - (c) Mr A did not produce any evidence to support his contention that he incurred over \$300,000 in redecorating Property 3.
 - (d) Mr A's return for the year of assessment 1995/96 was grossly inaccurate. He blamed his secretary for the errors in that return. Such cavalier attitude did not engender confidence in his testimony.
7. The Board took into consideration the following factors in assessing the balance of probabilities:
 - (a) At the material times, the center of gravity of the whole family was in District D. The inconvenience of moving into the New Territories was self-evident. Strong evidence was required in order to support an intention to uproot the whole family.
 - (b) On Mr A's evidence, the purchase of Property 3 was a haphazard process. There was no clear evidence that Mrs A inspected the unit prior to her purchase.

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8. Bearing these factors in mind, the Board was not persuaded that Mr A and Mrs A had discharged their burden on a balance of probabilities.

Appeal dismissed.

Cases referred to:

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

Chow Chi Leung for the Commissioner of Inland Revenue.
Taxpayers in person.

Decision:

Background

1. The Appellants ('Mr and Mrs A' respectively) are husband and wife. They have two children, a son ('the Son') born on 9 January 1984 and a daughter ('the Daughter') born on 9 January 1986. Madam B is the mother of Mr A.
2. By an agreement for sale and purchase dated 16 November 1984, Mr A purchased a flat at Address C1 in District D on Hong Kong Island ('Property 1') for \$380,000.
3. By a tenancy agreement dated 16 September 1993, Mr A rented a flat at Address C2 in District D ('Property 2') for a term of three years commencing from 10 October 1993 at a rental of \$23,000 per month.
4. By an agreement dated 7 February 1996, Mr A sold Property 1 for \$2,750,000.
5. By a memorandum for sale dated 27 April 1996 ('the Memorandum for Sale'), Mrs A purchased a house in Housing Estate E in the New Territories ('Property 3') for a consideration of \$4,581,700. According to the terms of the Memorandum for Sale, a deposit of \$100,000 was payable upon signing of the Memorandum for Sale, \$816,340 was payable on or before 3 May 1996 and the balance of \$3,665,360 was payable on or before 3 June 1996. The Memorandum for Sale was amended on 1 May 1996 by insertion of Mr A as an additional purchaser. The saleable area of Property 3 was 1,463 square feet. It had a roof or flat roof of 550 square feet and a garden of 743 square feet.

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6. Mr A submitted his return for the year of assessment 1995/96 on 10 May 1996. According to this return, his then residential address was Address F in Kowloon ('Property 4'). He earned a total of \$336,000 as a director of Company G. He claimed dependent parent allowance in respect of Madam B. Madam B was allegedly residing with him in Property 4 continuously throughout the year.

7. Mr and Mrs A duly completed the purchase of Property 3 under the Memorandum for Sale. Their purchase was financed in part by an instalment loan of \$3,200,000 extended in their favour by Bank H on 29 May 1996. This loan was repayable by 120 instalments of \$40,970.47 each.

8. On or about 12 June 1996, Mr and Mrs A and the Son became members of Club I formed for use by residents in Housing Estate E. Mr and Mrs A obtained possession of Property 3 on 14 September 1996. By an agreement of the same day, Mr A engaged Company J to undertake garden design work for Property 3 for \$14,860. Mr and Mrs A allege that they spent a total of \$314,860 in decorating Property 3.

9. On or about 10 October 1996, Mr A renewed his tenancy in respect of Property 2. The renewal was for a term of two years commencing from 10 October 1996. The rent for this renewed term was increased from \$23,000 to \$28,500.

10. By an agreement dated 27 November 1996, Mr and Mrs A sold Property 3 for \$7,770,000.

11. By an agreement dated 26 February 1997, Mr A purchased Property 2 from his previous landlord for \$7,800,000. He financed this purchase by a loan of \$5,460,000 extended by Finance Company K which loan was repayable by 120 monthly instalments of \$68,428.5 each.

12. At the material times, Mrs A operated the following photo service shops in District D:

Name of the shop	Address	Date of commencement	Date of cessation
Shop 1	Address L	1989	1991
Shop 2	Address M	20-12-1993	15-12-1995
Shop 3	Address M	28-1-1996	28-11-1997
Shop 4	Address N	Still in operation	

13. The issue before us is whether Mr and Mrs A are liable for profits tax in respect of the gains they made from their dealings with Property 3. Mr and Mrs A abandoned their appeal in relation to the deductibility of the sum they allegedly incurred in decorating Property 3.

Case of Mr and Mrs A

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14. According to Mr and Mrs A's letters to the Revenue dated 3 February 1999 and 6 March 1999:

- (a) Mr A rented Property 2 on 16 September 1993 by virtue of the disputes between Madam B and Mrs A. Madam B continued to reside in Property 1.
- (b) At a December 1995 family meeting, it was resolved that Property 1 be sold and the proceeds be used to acquire larger premises. It was further resolved that Madam B should move into Property 2 in order to facilitate the sale of Property 1.
- (c) Property 1 was sold in February 1996 and Property 3 was purchased in April 1996. The family planned to move into Property 3 in July 1996.
- (d) There was delay in the construction of Property 3. In August 1996 Mr A obtained a one-month extension of his tenancy in Property 2. Mr and Mrs A asserted that the first tenancy for Property 2 was for the period between 16 September 1993 and 15 September 1996 and the second tenancy was for the period 10 October 1996 and 9 October 1998. They laid considerable emphasis on the alleged break between 15 September 1996 and 10 October 1996. They asserted that this break supports their contention that they resided in Property 3.
- (e) The couple first moved into Property 3 in September 1996 in order to supervise renovation works. Madam B, the Son, the Daughter and their maid joined them at the end of September 1996.
- (f) They decided to sell Property 3 for three reasons:
 - (i) Madam B did not have any friend in the vicinity;
 - (ii) The Son and the Daughter attended schools in District D and District O on Hong Kong Island. They had to spend too much time on the road travelling to schools from Property 3.
 - (iii) Mrs A started Shop 3 in March 1996. It was time consuming for her to travel to her work. The new shop was trading at a loss and she had to devote considerable time in its supervision. Mr and Mrs A asserted that this was the most important reason leading to the sale of Property 3.

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- (g) There was no time for them to locate alternative premises. They decided to accept a new tenancy in respect of Property 2 despite the increase of rental.

Challenge by the Revenue

15. The Revenue does not accept that Property 3 was purchased as the family home. The Revenue conducted investigation into two assertions of Mr and Mrs A.

- (a) In relation to the assertion that the family moved into Property 3, the Revenue obtained from CLP Power Hong Kong Limited their record as to the amount of electricity consumed at Property 3:

Account holder	Period	Unit consumed
Company P	23-4-1996 to 21-5-1996	9
	To 19-6-1996	2
	To 20-7-1996	24
	To 21-8-1996	60
	To 20-9-1996 [Account closed]	20
Mrs A	20-9-1996 to 19-10-1996	3
	To 21-11-1996	0
	To 19-12-1996	1
	To 20-1-1997	0

- (b) In relation to the assertion that there was a break in the tenancy over Property 2, the Revenue approached the then owner ('Mr Q') of that flat. Mr Q confirmed that there was no break in his letting. He provided the Revenue with two tenancy agreements which he signed with Mr A. As outlined in paragraphs 3 and 9 above, the initial tenancy was for a term between 10 October 1993 and 9 October 1996. The renewed tenancy was for a term between 10 October 1996 and 9 October 1998.

Sworn testimony of Mr A before us

16. Mr A strongly argued that at all material times, he and his wife held only one piece of property. They purchased Property 2 after their sale of Property 3 and his family has been living in Property 2 ever since.

17. He said he paid at least two visits to Housing Estate E prior to his acquisition of Property 3. He inspected old units in that complex. Mrs A and Madam B did not accompany him during those visits.

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18. Mrs A could well have visited Housing Estate E with her friends. Housing Estate E was then a popular development and units in that complex were in hot demand.

19. He took a decorator to visit Property 3 prior to his obtaining possession of that premises from the developer. The decorator took two to three weeks to decorate that flat. The decoration fees included provision of furniture. The furniture was on-sold to his purchaser of Property 3.

20. He said he stayed in Property 3 when he returned from work in China. His wife also stayed in that house overnight but her stays were mostly during Saturdays.

The law

21. The intention of Mr and Mrs A at the time of acquisition of Property 3 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?’.

22. 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 or after. Often it is rightly said that actions speak louder than words’.

23. 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 Mr and Mrs A to place before this Board supporting materials in support of their assertions. Although

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the standard of proof is one of balance of probabilities, they must ensure that the balance be tilted in their favour by furnishing the Board with primary evidence that is within their easy reach.

Our decision

24. The following points are in favour of Mr and Mrs A.
- (a) At all material times, they held only one piece of landed property.
 - (b) Mr A sold Property 1 prior to his purchase of Property 3. They purchased Property 2 after their sale of Property 3 and they have been residing in Property 2 ever since.
25. The credibility of Mr A is however tarnished by the following factors:
- (a) There was no break in his tenancy over Property 2. His wholly unjustifiable reliance on the alleged break suggests a contrived attempt to belittle the weakness of his case arising from his continued occupation of Property 2.
 - (b) In correspondence with the Revenue, he asserted that his whole family moved into Property 3. His testimony before us indicates that the alleged occupation of Property 3 was merely casual and the whole family did not move into that house. We are of the view that Mr A was forced to adjust his evidence in the light of the letter from CLP Power Hong Kong Limited.
 - (c) Mr A did not produce any evidence to support his contention that he incurred over \$300,000 in redecorating Property 3.
 - (d) Mr A's return for the year of assessment 1995/96 is grossly inaccurate. He blamed his secretary for the errors in that return. Such cavalier attitude does not engender confidence in his testimony.
26. We take into consideration the following factors in assessing the balance of probabilities:
- (a) At the material times, the centre of gravity of the whole family was in District D. The inconvenience of moving into the New Territories was self-evident. Strong evidence is required in order to support an intention to uproot the whole family.
 - (b) On Mr A's evidence, the purchase of Property 3 was a haphazard process. There is no clear evidence that Mrs A inspected the unit prior to her purchase.

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27. Bearing these factors in mind, we are not persuaded that Mr A and Mrs A have discharged their burden on a balance of probabilities. We dismiss their appeal.