

Case No. D43/12

Profits tax – whether profit derived from the sale of property chargeable to profits tax – sections 2(1), 14, 59(3) and 68(4) of the Inland Revenue Ordinance.

Panel: Colin Cohen (chairman), Cheng Chung Hon Neville and Jose Antonio Maurellet.

Date of hearing: 6 November 2012

Date of decision: 14 December 2012.

The Taxpayer asserted that it was his intention to purchase the Property as a capital asset for a long term investment and self-use. The Inland Revenue representative contended that the Taxpayer's behaviour when compared to his asserted intention was unconvincing.

Held:

The Board held that the Taxpayer had failed to show that the assessment was excessive or incorrect and that it was clear that the Taxpayer had acquired the Property for trading and as such, the profits as derived therefrom were chargeable.

Appeal dismissed.

Cases referred to:

Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196

All Best Wishes Ltd v CIR (1992) 3 HKTC 750

Marson (Inspector of Taxes) v Morton and related appeals [1986] STC 463

Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6

Henry L W Fung Counsel instructed by Messrs Michael Pang & Co Solicitors for the Taxpayer.

Wong Pui Ki, Leung Kin Wa and Yu Wai Lim for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal by Mr A ('the Taxpayer') against the Determination dated 27 January 2012 by the Deputy Commissioner of Inland Revenue in respect of a profits tax

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assessment for the year of assessment 2007/08 showing an assessment profit of \$1,431,403 with tax payable thereon of \$204,024.

The issue

2. The only one issue for the Board to consider in respect of this appeal is whether the profit derived by the Taxpayer from the sale of a property at Address B ('the Property') was chargeable to profits tax.

Agreed facts

3. The parties very helpfully agreed the following facts and we find them as facts:

- ' (1) Mr A ('the Taxpayer') has objected to the profits tax assessment for the year of assessment 2007/08 raised on him. The Taxpayer claims that the gain derived from the sale of a property should not be chargeable to profits tax.
- (2) The Taxpayer was employed by Hotel C, a branch of Company D, as Front Office Manager during the period from 1 April 2005 to 25 June 2006. During the employment period with Company D, the Taxpayer resided at Flat E.
- (3) (a) By a preliminary agreement for sale and purchase dated 23 July 2006 ('the Purchase Agreement'), the Taxpayer purchased Address B ('the Property') at a price of \$4,226,240.
- (b) At the time of purchase, the Property was still under construction. The purchase was completed by an assignment dated 10 December 2007.
- (c) To finance the purchase, the Taxpayer, with the Property as security, obtained a loan of \$3,380,992 ('the Loan') from Bank F. The loan was repayable by 240 monthly instalments at \$23,085.63 each subject to adjustments of interest rate.
- (4) By a provisional agreement for sale and purchase dated 30 December 2007 ('the Sale Agreement'), the Taxpayer sold the Property at a price of \$6,200,000. The sale was completed by an assignment dated 28 March 2008.
- (5) The Assessor issued to the Taxpayer a 2007/08 Tax Return – Individuals and a questionnaire in respect of the purchase and sale of the Property for his completion. However, no response was received from the Taxpayer.

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- (6) The Assessor was of the view that the purchase and sale of the Property by the Taxpayer amounted to an adventure in the nature of trade. As the Taxpayer failed to file his 2007/08 Tax Return – Individuals within the stipulated time, the Assessor raised on the Taxpayer the following 2007/08 Profits Tax assessment pursuant to section 59(3) of the Inland Revenue Ordinance ('the Ordinance'):

	\$
Assessable profits	<u>1,530,000</u>
Tax payable thereon (after deducting tax reduction)	<u>219,800</u>

- (7) The Taxpayer objected against the above assessment. To validate the objection, the Taxpayer filed his Tax Return – Individuals for the year of assessment 2007/08. In the return, the Taxpayer did not report the gain derived from the sale of the Property.
- (8) In reply to the Assessor's questionnaire concerning the purchase and sale of the Property, the Taxpayer asserted, among other things, the following:

Location of property	: The Property
Intended or actual usage of the property	: Occupation as self residence
Reason(s) for selling the property	: Change of residence
Reason for changing to new residence	: New job in City G, Region G
Location of new residence	: Hotel in City G, Region G
Date of occupation of new residence	: 1 September 2006
Net profits	\$1,381,403 ¹

¹ Computation of the net profits:

	\$	\$
Sale proceeds		6,200,000
<u>Less: Purchase cost</u>		<u>4,226,240</u>
Gross profits		1,973,760
<u>Less: Expenses -</u>		
Legal fees on purchase	6,785	
Stamp duty	112,624	
Commission to agent on purchase	42,262	

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	\$	\$
Bank interest	300,000	
Decoration	50,000	
Legal fees on sale	8,950	
Commission to agent on sale	62,000	
Management fees	<u>9,736</u>	<u>592,357</u>
Net profits		<u>1,381,403</u>

(9) In response to the Assessor's enquiries, the Taxpayer replied as follows:

(a) 'I have been living in City H, Country J since 1985 ... I have never lived in Hong Kong prior to March 2005.'

(b) 'I have relocated to City G, Region G for a Hotel Management job at Hotel K ... started September 1, 2006.'

(c) 'Since I have relocated and was not living in Hong Kong, I have disposed [the Property] due to lack of usage as I did not have family or relatives in Hong Kong and I was not able to sell [the Property] until close to two years as there is a penalty from [Bank F] for early withdrawal of the mortgage.'

(d) 'I had appointed a Real Estate Agent in Area L, Hong Kong to sell [the Property] and confirmed date of appointment was in December 2007 and HKD62,000 commission was paid however I do not have records of the documentary evidence as I cannot find the copies.'

(e) Sources of finance

'I have worked in [City H] for over eight years and has savings of US\$40,000 from my hotel management job at [Hotel M] in [City H] ... which assisted me in downpayment. Also with the one-year income I have earned at [Company D] in Hong Kong, I was able to make annual savings of HKD240,000 for the downpayment. I have been able to make monthly repayment of mortgage my salary income at my hotel management job at [Hotel K] in [City G, Region G] started September 1 [2006].'

(f) Decoration expenses

'Did not have any furnishing as [the Property] has already been furnished and completed in livable conditions as it was designed as a serviced apartment.'

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- (10) The Taxpayer provided copies of the following documents:
- (a) His Country J Individual Income Tax Return for the calendar years 2004 and 2005 with reported income of USD36,233 and USD62,017 respectively.
 - (b) A letter dated 24 April 2006 issued by Company D certifying that the Taxpayer was employed by the company since 1 April 2005 and his total income for the period from 1 April 2005 to 31 March 2006 was \$556,414.
 - (c) A letter dated 10 August 2006 issued by Hotel K to the Taxpayer ('the Hotel K Offer Letter') offering him the position of Rooms Division Director effective from 1 September 2006.
- (11) The Assessor maintained the view that the profit derived by the Taxpayer from the disposal of the Property was a trading profit and therefore should be subject to tax. Also, as the Taxpayer confirmed that there was no decoration work on the Property [Fact (9)(f)], no decoration expenses should be allowed for deduction. Accordingly, the Assessor wrote to the Taxpayer explaining her views and proposed to revise the 2007/08 Profits Tax assessment as follows:

	\$
Net profits per the Taxpayer's computation [Fact (8)]	1,381,403
<u>Add: Decoration [Fact (8)]</u>	<u>50,000</u>
Assessable Profits	<u>1,431,403</u>
Tax payable thereon (after deducting tax reduction)	<u>204,024</u>

The Taxpayer's evidence

4. The Taxpayer gave evidence before us. He is a Country J citizen and graduated in Hotel Administration and Management in 1998. His career has been in the hotel industry. He told us that between January 2000 and January 2005, he worked at Hotel M in City H as a Front Office Manager. Between 1 April 2005 and 30 June 2006, he worked at Hotel C again as a Front Office Manager. He gave evidence as to the reason for him wishing to come to Hong Kong. In short, he wished to advance his career and gain international experience. He was single and when he came to Hong Kong, he had no family or relatives living here.

5. He resided in Hong Kong at Flat E and paid a monthly rent in the sum of HK\$15,000 excluding utility charges. However, the lease of the flat was in the name of Hotel C. He obtained a housing allowance.

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6. He told us that when he came to Hong Kong, he hoped to remain in Hong Kong for a period of at least five years because he wished to develop his hotel management career in Hong Kong.

7. He told us that his contract with Hotel C came to an end since Hotel C indicated to him that they were looking to localise his position. The normal practice in his industry was for him to tender his resignation in order to obtain a reference letter from Hotel C. Hence, he did so. However, during the course of his notice period, he tried to look for opportunities to work in Hong Kong. He sent emails to Hotel N and to Hotel P enquiring as to whether they had any posts vacant. However, he was not successful in obtaining employment in Hong Kong. Through a contact through a friend, he was able to obtain a position in City G, Region G. In early August 2002, he travelled to City G for an interview and shortly after his interview, Hotel K offered him a position. He then left Hong Kong to take up residence in City G, Region G. He commenced work with Hotel K in early September. He also told us that since that date, he continued to work in the hotel industry in City N and City P.

8. He also gave evidence to us as to the circumstances that led to him to purchase the Property here in Hong Kong. He made it clear that he wanted to develop his career in Hong Kong and he thought it would be wise to own a property instead of paying rent each month in respect of Flat E.

9. He therefore decided to purchase his residence and at the same time, this would also be an investment in a personal asset.

10. As can be seen from the Agreed Facts on 26 July 2006, he entered into a preliminary agreement for the sale and purchase of the Property at a price of HK\$4,226,240. He also gave evidence to us that he was able to finance this out of some of his savings. These were US\$40,000 from his hotel management job at Hotel M in City H. He also managed to save whilst working for Hotel C in the sum of HK\$240,000.

11. However, on cross-examination when it was shown to him that his savings were not sufficient for him to pay the deposit and finance the Property, he indicated that he was involved in an accident when he was young in Country J and as a result of this accident, he received damages arising out of a civil claim. We note that this was the first time he mentioned this. This was not included in his witness statement. He did not produce any documents in support. He also drew to our attention that he obtained a loan from Bank F for the balance of the purchase price of the Property. This loan was to be repayable by 240 monthly instalments at a monthly sum of HK\$23,085.63.

12. He told us that at the time of purchase, the Property was under construction. Having regard to its location and its unique nature, that is being a serviced apartment, he felt this would suit his requirement due to the type of work he carried out. He also told us that he was assisted by his girlfriend who lived in Hong Kong. She was able to advise him as to the type of property that would be suitable for him to purchase. Again, he emphasized to us that

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it was his intention to purchase the Property as a capital asset for a long term investment and self-use. He was hopeful that his career in Hong Kong would flourish.

13. However, as can be seen, the Property was only to be completed in early December 2007. The assignment of the Property was on 10 December 2007 and shortly thereafter, he entered into a provisional sale and purchase agreement for its disposal.

14. On 30 December 2007, the Taxpayer entered into a provisional sale and purchase agreement and subsequently, the Property was assigned on 28 March 2008. As can be seen from the Agreed Facts, he sold the Property at the price of HK\$6,200,000 and hence, after various deductions, etc, he obtained a profit of HK\$1,431,403.

15. During the course of his evidence and on cross-examination by Ms Wong on behalf of the Inland Revenue Department ('IRD'), he confirmed that he had obtained a work visa and was only permitted to remain in Hong Kong to work with Hotel C.

16. However, Hotel C informed the Immigration Department that the termination of his employment agreement would be effective as of 26 June 2006. There was no subsequent approval for change of employment by the Taxpayer.

17. As we have mentioned above, he was cross-examined as to his financial capability. The purchase price of the Property was HK\$4,200,000. It was clear that in order to finance the purchase of the Property, he obtained a mortgage in the sum of HK\$3,400,000. Therefore, there was a balance of approximately HK\$800,000 and the associated expenses, that is legal fees, stamp duty, etc. Therefore, it was put to him by Ms Wong that his own resources were only HK\$550,000. When asked to explain the shortfall of HK\$400,000, he was asked as to why there was no further documentation produced to the IRD showing that he has the financial means of financing the Property. It was at that time he mentioned at the very first time that he was suffered an injury in Country J and obtained damages. Again, his evidence to us was somewhat vague as to the amount and he really could not give an explanation as to why he never mentioned this beforehand.

18. It is also quite clear that as at the time of purchase of the Property, that is on 23 July 2006, the Taxpayer had already ceased employment with Hotel C and it is also quite clear that he had not received at that time any offer of employment from Hotel K. His interview only took place in August and he subsequently took up the job shortly thereafter.

19. It was also clear that the Property was still under construction. We have to say having considered his financial situation, it was quite clear that he really failed to show to us that he had the financial ability to hold the Property in the long run having regard to the position he found himself in at the time of purchase of the Property.

20. He was also cross-examined in respect of various papers he put forward to the IRD and to the Board with regard to decoration expenses. It is quite clear from those

documents that the decoration expenses had scant regard to the size of the premises nor did they have any relevance to the type of premises in which he was going to live in.

21. Hence, we have to say questions can be raised as to why he would have submitted these documents to the IRD and to the Board regarding these decoration expenses when he knew full well that they really were not relevant and indeed, the costs of the decoration seemed to somewhat disproportionate to decorating a property that was a serviced apartment. Indeed, the layout of the flat was totally different from the proposals which he received. It is also interesting to note that the decoration company was in City G and there was no evidence put before the Board that the decoration company could carry out such decoration work in Hong Kong.

22. Having listened very careful to the Taxpayer's evidence, we have to come to the conclusion that his actions and behaviour contradict his declaration of intention and in our view, having regard to his evidence, it is clear that he would have had difficulties in financing the Property.

23. Serious questions can be raised as to the quotation he put to the Board in respect of renovation of the Property and having regard to the fact that once he left his employment with Hotel C and subsequently moved to City G, it would be highly unlikely that he would have been able to acquire the Property for his self-residence.

The relevant statutory provisions

24. Section 14 of the Inland Revenue Ordinance ('the IRO') is the charging provision on profits tax. Sub-section (1) 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) as ascertained in accordance with this Part.'

25. Section 2(1) of the IRO defines 'business' and 'trade' as follows:

'business (業務) includes agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person of any premises or portion of any premises held by him under a lease or tenancy other than from the Government'

'trade (行業、生意) includes every trade and manufacture, and every adventure and concern in the nature of trade'

26. Section 68(4) of the IRO provides that:

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

The relevant legal principles

27. One should look at the taxpayer’s intention towards the Property at the time of acquisition. In Simmons v Inland Revenue Commissioners [1980] 1 WLR 1196, Lord Wilberforce set out the principle at page 1199 as follows:

‘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? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa.’

28. The Taxpayer’s own declaration of intention is inconclusive and has to be tested against all objective facts and circumstances. In All Best Wishes Ltd v CIR (1992) 3 HKTC 750, Mortimer J (as he then was) stated the approach on how to test the taxpayer’s intention at page 771 as follows:

‘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 entirety. 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.'

29. The badges of trade are of assistance in considering in determining whether the taxpayer's transaction amounted to an adventure in the nature of trade. In Marson (Inspector of Taxes) v Morton and related appeals [1986] STC 463, Sir Nicholas Browne-Wilkinson V-C usefully set out the approach at pages 470e to 471g. We would summarize these as follows:

- (a) Only one point is as a matter of law clear, namely that a single, one-off transaction can be an adventure in the nature of trade.
- (b) The question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case.
- (c) There are certain features or badges which may point to one conclusion rather than another and that the factors are in no sense a comprehensive list of all relevant matters, nor is any one of them decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate. The matters which are apparently treated as a badge of trading are as follows:
 - (i) Whether the transaction in question was a one-off transaction?
 - (ii) Whether the transaction related to the trade which the taxpayer otherwise carried on?
 - (iii) Whether the transaction concerned a commodity which was normally the subject of trade?
 - (iv) Whether the transaction carried through was typical of the trade in that commodity?
 - (v) Whether the source of finance for the transaction was borrowed money?
 - (vi) Whether the item purchased was resold as it stood or whether work was done on it for the purposes of resale?
 - (vii) Whether the item purchased was broken down into saleable lots?

(viii) Whether the purchaser intended to resell at the time of purchase?

(ix) Whether the item was purchased to provide enjoyment to produce income pending resale?

(d) In order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?

30. In Lee Yee Shing v Commissioner of Inland Revenue (2008) 11 HKCFAR 6, Bokhary PJ and Chan PJ emphasized at paragraph 38 that the question whether something amounts to the carrying on of a trade or business is a question of fact and degree to be answered by the fact-finding body upon a consideration of all the circumstances. It is also important to note that the Taxpayer has not discharged the burden of proof in showing to us that the intention he held was indeed a realistic intention.

Discussion

31. Very helpfully, we received written submissions on behalf of the Taxpayer and the IRD. Having considered these written submissions, it is quite clear that the parties did not dispute the relevant legal principles which the Board will need to apply.

32. Indeed, Mr Fung on behalf of the Taxpayer did not take issue with the principles set out in the written submissions put forward by Ms Wong on behalf of the IRD.

33. Mr Fung in his helpful written submissions asked us to conclude that as a result of the Taxpayer's relocation, he did not need to retain the Property in Hong Kong and as he said 'to have the trouble to maintain the same in the future'.

34. Hence, he concluded that it was reasonable and realistic for him to dispose of the Property by appointing real estate agents. He also asserted that the Taxpayer was genuinely confident and optimistic in obtaining a luxury hotel management job in Hong Kong. He submitted that the Taxpayer did not expect that he would have to relocate to City G. He asserted that the disposition of the Property was simply due to the unexpected change of employment by relocation to another country and as such, he concluded that it was impractical to retain the Property and therefore, it was realistic for him to sell the Property in such circumstances.

35. Having considered the facts and the evidence of the Taxpayer, this clearly was not the case. We have no hesitation in accepting the submission of Ms Wong that the Taxpayer's behaviour when compared to his asserted intention was unconvincing.

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36. In our view, it is quite clear that he lacked of financial ability and that the various matters he drew to our attention made it clear that the acquisition of the Property could never have been for his self-residence.

37. Such an intention which he held was not realistic. In short, it is clear that he purchased the Property when he knew full well that he was having great difficulties in obtaining a position in Hong Kong. He signed the relevant documentation towards the end of July. At that time, it was quite clear that he was no longer employed with Hotel C and at that time, there was uncertainty as to his future earning capacity. It was only in mid-August after he had travelled to City G that he obtained an indication that he was likely to obtain employment outside of Hong Kong.

38. Hence, we have come to the conclusion that it was clear that the Taxpayer's intention of acquiring the Property for himself as self-residence was not genuinely held nor could be said to be realistic.

39. As we have said above, there were serious issues as to whether or not the Taxpayer did have the ability to hold the Property in the long run. We also have serious concerns over the evidence that he put to us with regard to the decoration of the Property. In our view, this was somewhat unrealistic.

40. We also have had the opportunity to consider the badges of trade. It was clear in our view that this was a one-off transaction. The Property was only held for 20 days. Hence, the period was very short. The Taxpayer had attributed the sale of the Property to his relocation to Region G due to his new position. However, if the Taxpayer had really intended to develop a career in Hong Kong, it was quite clear that he should made further attempts to look for a position in Hong Kong other than dispatching two emails.

41. He applied to Hotel K only one week after he purchased the Property. We also note that the Property was a new property which had been furnished and was a serviced apartment and as such, would be in a livable condition. In short, no further decoration was needed.

42. It is also clear that in December 2007 as soon as it became known that the Property was about to be completed, the Taxpayer took steps to appoint an real estate agent to effect the sale. It is also clear that the Taxpayer although asserted the Property was his self-residence, had not moved into it and in turn, disposed of it within 20 days after the assignment.

43. Finally, the Taxpayer asserted that the purchase of the Property could be financed by his own savings and a mortgage loan. Indeed, as we have previously stated, there was no evidence to show that the Taxpayer had the financial ability to hold the Property in the long run.

Conclusions

44. Hence, having regard to all the above circumstances and having considered the evidence very carefully and having reviewed the submissions of both the Taxpayer and the IRD, it is clear that the Taxpayer has failed to show that the assessment is excessive or incorrect and that it is clear in our view that the Taxpayer had acquired the Property for trading and as such, the profits as derived therefrom were chargeable. Hence, the appeal is dismissed.

45. Finally, we thank the parties for their assistance in respect of this matter.