

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D45/01

Profits tax – whether the sale of a property was trading in nature – the time span between the purchase and sale – the history of dealings in real property – burden of proof on the taxpayer – sections 2(1), 14 and 68(4) of the Inland Revenue Ordinance (‘IRO’).

Panel: Patrick Fung Pak Tung SC (chairman), Samuel Chan Yin Sum and Roger Leung Wai Man.

Date of hearing: 8 March 2001.

Date of decision: 20 July 2001.

The taxpayers, who were husband and wife, appealed against a determination of a profits tax assessment for the year of assessment 1997/98 arising out of the purchase and sale of the Subject Property. The issue in the appeal was whether the taxpayers were liable to profits tax by having entered into an adventure in the nature of trade (sections 14 and 2(1) of the IRO).

Held:

1. Section 14(1) of the IRO provides for the charge of profits tax.
2. Section 2(1) of the IRO defines ‘trade’ as including every trade and manufacture, and every adventure and concern in the nature of trade.
3. The onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer (section 68(4) of the IRO).
4. In view of the extremely short period between the time when the taxpayers agreed to purchase the Subject Property and the time they agreed to sell it, the history of their dealings in real property and the fact that they chose not to give evidence on oath, the Board did not accept that the Subject Property was purchased by them for the purpose of or with the intention of their holding it as a long term investment.
5. The Board found that the taxpayers had failed to discharge their burden of proof in this appeal.

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Appeal dismissed and a cost of \$5,000 charged.

Lau Fu Wah for the Commissioner of Inland Revenue.

Taxpayers in person.

Decision:

1. This is an appeal by the Taxpayers against a profits tax assessment for the year of assessment 1997/98 raised on them. An objection was lodged by them against such assessment. By his letter dated 24 November 2000, the Commissioner made a determination and rejected the Taxpayers' objection. The Taxpayers have brought this appeal against such determination.

The facts

2. The Taxpayers are husband and wife. The second Taxpayer works at a university in Hong Kong.

3. The subject matter of this appeal is a property known as 'Address A' ('the Subject Property').

4. By a provisional agreement for sale and purchase dated 16 May 1997, the Taxpayers agreed to purchase the Subject Property at the price of \$12,200,000.

5. On 3 June 1997, the Taxpayers completed the purchase of the Subject Property.

6. The Taxpayers financed the purchase of the Subject Property partly by a mortgage loan of \$8,000,000 granted by Bank B which was to be repayable by 457 instalments in the amount of \$34,827 per fortnight. This loan was also supported by a personal unlimited guarantee by a Ms C, the employer of the first Taxpayer.

7. By a provisional agreement for sale and purchase dated 26 June 1997, the Taxpayers agreed to sell the Subject Property at a price of \$15,000,000. The sale was completed on 1 August 1997.

8. The Taxpayers' involvement in the sale and purchase of real property was not limited to the Subject Property. They, together with one Ms D ('the Sister'), the sister of the first Taxpayer, were involved in other property transactions. In the letter containing the Commissioner's determination, there appears a very helpful chart which summarises the details of the property transactions involving the three persons (with the first Taxpayer described as 'Mrs E' and the second Taxpayer as 'Mr E'). We produce the same below:

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Property	Location	Owners	Purchase	Sale
			(a) provisional agreement	(a) provisional agreement
			(b) formal agreement	(b) formal agreement
			(c) assignment	(c) assignment
			[Purchase cost]	[Sale proceeds]
1	Address F	Mr E		(a) 31-1-1997
				(b) 14-2-1997
			(c) 15-4-1996	(c) 15-5-1997
			[\$4,170,000]	[\$6,780,000]
2	Address G	Mrs E	(c) 13-11-1996	(c) 28-4-2000
			[\$6,400,008]	[\$5,080,000]
3	Address H	Mrs E and the Sister as tenants in common of equal shares	(a) 7-6-1997	
			(b) 21-6-1997	
			(c) 25-7-1997	
			[\$10,800,000]	
4	Address I	Mr E	(b) 17-10-1997	
			(c) 3-12-1997	
			[\$8,900,000]	

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9. Further, the first Taxpayer also had an interest in a company called Company J which owned a property known as 'Address K' ('Property 5'). The shareholders and directors of Company J were the first Taxpayer and Ms C. Property 5 was sold at a profit and Company J offered the same for assessment for profits tax and paid the same. The net proceeds or part thereof in the sum of \$608,237 were utilised by the Taxpayers in paying a part of the downpayment for the Subject Property.

10. At the hearing, the Commissioner's representatives drew the Board's attention to yet another property known as 'Address L' ('Property 6') which was bought and sold by the first Taxpayer between May and December 1996 out of which the first Taxpayer made a gross profit of \$480,000. This was not disputed by the Taxpayers.

11. The Commissioner's representatives also produced a chronology of events relating to dealings with regard to the Subject Property, Property 6 and Properties 1 to 5 which we find very helpful and which we reproduce as Appendix I hereto.

12. At the commencement of the hearing of the appeal, the Taxpayers were asked whether they wished to give evidence on oath and it was explained to them that, if they did so, they would be subject to cross-examination, but that if they did not, their evidence might not be attached with much weight by the Board. At first, they said that they would give evidence on oath. Later, after some discussion between them, they changed their minds and said that they would prefer to give evidence not on oath. They therefore gave unsworn evidence and called no witness.

13. The Taxpayers put forward reasons to support their contention that they should not be charged with profits tax in relation to the Subject Property because they had intended to purchase the same for long term investment. Such reasons are basically those set out in their grounds of appeal contained in their letter to the Clerk to the Board of Review dated 20 December 2000. We do not find it necessary to repeat the same here.

Conclusion

14. Section 14 (1) of the IRO provides as follows:

'14. Charge of profits tax

(1) 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.'

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Section 2 (1) defines ‘ trade’ as including every trade and manufacture, and every adventure and concern in the nature of trade.

Section 68 (4) provides that the onus of proving that the assessment appealed against is excessive or incorrect shall be on an appellant.

15. In view of the extremely short period between the time when the Taxpayers agreed to purchase the Subject Property and the time they agreed to sell it, the history of their dealings in real property and the fact that they chose not to give evidence on oath, we do not accept that the Subject Property was purchased by them for the purpose of or with the intention of their holding it as a long term investment. We find that they have failed to discharge their burden of proof in this appeal.

16. Accordingly, we dismiss the appeal of the Taxpayers.

17. We order that the Taxpayers do pay the costs of the appeal in the sum of \$5,000.

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Appendix I

Chronology of relevant events

Date	Event
6-11-1994	Mr E entered into tenancy agreement to rent Quarters 1 (15-12-1994 to 14-12-1996).
15-4-1996	Purchase of Property 1 by Mr E at \$4,170,000 was completed.
15-5-1996	Mrs E entered into agreement to purchase Property 6 at \$3,800,000.
15-6-1996	Mr E let out Property 1 for two years (15-6-1996 to 14-6-1998).
12-7-1996	Property 6 was assigned to Mrs E.
17-10-1996	Mrs E entered into agreement (' the First Agreement ') to sell Property 6 for \$4,050,000.
5-11-1996	Cancellation of the First Agreement.
10-11-1996	Mr E entered into second tenancy agreement to rent Quarters 1 (15-12-1996 to 14-12-1998).
13-11-1996	Mrs E entered into agreement to purchase Property 2 at \$6,400,008.
25-11-1996	Mrs E entered into agreement to sell Property 6 for \$4,280,000.
12-12-1996	Sale of Property 6 was completed.
15-12-1996	Mrs E let out Property 2 for two years (15-12-1996 to 14-12-1998).
30-12-1996	Incorporation of Company J.
19-1-1997	Company J entered into provisional agreement to purchase Property 5 at \$11,999,980.
31-1-1997	Mr E entered into provisional agreement to sell Property 1 for \$6,780,000.
14-2-1997	Formal agreement to sell Property 1.
17-2-1997	Formal agreement to purchase Property 5.
2-4-1997	Company J entered into provisional agreement to sell Property 5 for \$13,380,000.
16-4-1997	Formal agreement to sell Property 5.