

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D47/04

Profits tax – sections 2, 14(1) and 68(4) of the Inland Revenue Ordinance – whether a property is a capital asset or trading asset – intention of the taxpayer at the time of acquisition of the property must be genuinely held, realistic and realizable – burden of proof on the taxpayer.

Panel: Patrick Fung Pak Tung SC (chairman), Sandy Fok Yue San and Albert Yau Kai Cheong.

Date of hearing: 18 May 2004.

Date of decision: 23 September 2004.

In 1990, the taxpayer applied to redevelop the land as village houses. The land was owned by the taxpayer and two others as tenants-in-common. The Government permitted a three-storey development on the said land and the development of the said land was being carried out. On 12 August 1997, certificate of compliance has been issued for the completion of the development of the said land. The new buildings on the said land consisted of six units and they were all divided amongst the taxpayer and the two other co-owners.

The taxpayer became the registered owner of two of the six units. These two units were sold on 29 September 1997. The assessor assessed profits tax for the sale of these two units. The taxpayer argued that her intention was to make long term investment and not to trade in real property. The taxpayer decided to sell the properties because the financial condition of her family was deteriorating and the taxpayer also needed money to emigrate.

Held:

1. First, in deciding whether a property is a capital asset or trading asset, it is necessary to ascertain the intention of the taxpayer at the time of acquisition of the property. Secondly, a mere declaration of intention is of limited value. Subjective intention has to be tested against objective facts and circumstances. The intention must be genuinely held, realistic and realizable (Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196 and All Best Wishes Limited v CIR 3 HKTC 750 followed).
2. A quick sale of an asset at a substantial profit is per se more indicative of a trading activity than an acquisition as a long term investment. Having considered all the evidence, the Board is not convinced that the taxpayer acquired the property with

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the intention at the time that it should be a long term investment.

3. In order to succeed, the taxpayer bears the burden of satisfying the Board on the balance of probabilities that she did have the intention of acquiring the property in question for the purpose of a long term investment and not of a trade at the time of such acquisition. On the Board's view of the totality of the evidence, the Board has come to the conclusion that the taxpayer has not discharged his burden.

Appeal dismissed.

Cases referred to:

Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196
All Best Wishes Limited v CIR 3 HKTC 750

Chan Siu Ying for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against the determination of the Respondent ('the Commissioner') dated 29 January 2004 whereby the Commissioner acting by one of her deputies confirmed the assessment for profits tax for the year of assessment 1997/98 raised on the Taxpayer with assessable profits in the sum of \$3,407,336 and tax payable thereon in the sum of \$459,990.

The facts

2. The basic facts of the case are set out in the following paragraphs.
3. The Taxpayer is married to a Mr A with whom she has a daughter born in 1974 and a son born in 1976.
4. On 14 December 1989, the Taxpayer and a Mr B acquired land in Village C in District D and registered in the District Office as Lots Nos aaa, bbb and ccc in DD E ('the First Land') and all the buildings thereon ('the First Buildings'). The purchase price was \$990,000 and they held the interest as tenants-in-common in equal shares.

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5. On 16 August 1990, Mr B sold his interest in the First Land and the First Buildings to a Mr F and a Mr G for the price of \$495,000.
6. On 22 August 1990, the Taxpayer applied to the Lands Department in her capacity as a villager of Village C for permission to redevelop the First Land by erecting thereon two three-storey village houses.
7. On 20 October 1990, Mr A signed an agreement for the purchase of a property known as Address H ('Property 1').
8. On 17 December 1990, the Taxpayer and Mr A signed an agreement for the sale of a property co-owned by them known as Address I ('Property 2') at the price of \$1,685,000. They purchased that property on 17 November 1987 at the price of \$900,000.
9. On 28 December 1990, Property 1 was assigned to Mr A.
10. By a letter dated 8 March 1994, Government indicated that it was prepared to effect a modification by way of insitu exchange to permit a three-storey development of the First Land for a premium of \$3,010,000. This was accepted by the Taxpayer, Mr F and Mr G. The said premium was paid to Government on 14 July 1994.
11. On 31 March 1995, pursuant to the said insitu exchange, Government issued a New Grant No J in favour of the Taxpayer, Mr F and Mr G, and in respect of Lot No ddd in DD E ('the Second Land').
12. In September 1994, the Taxpayer applied to emigrate to Country K.
13. In May 1996, the Taxpayer was granted permission to emigrate to Country K. On 15 November of the same year, she landed as an immigrant in Country K.
14. In the meantime, the development on the Second Land was being carried out. On 12 August 1997, the District Officer, District D certified for the completion of the development by issuing a Certificate of Compliance.
15. The Taxpayer, Mr F and Mr G became registered as tenants-in-common as to one-third each in respect of the Second Land and the new buildings erected thereon.
16. The said new buildings consisting of six units were divided amongst the three co-owners.
17. The Taxpayer became the registered owner of two of the six units which were known as the First Floor of House No 1, No XX Village C, Lot No ddd in DD E, District D, New

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Territories ('the First Floor Flat') and the Second Floor and Roof just above the First Floor Flat ('the Second Floor Flat').

18. By an Agreement for Sale and Purchase dated 15 September 1997, the Taxpayer agreed to sell the Second Floor Flat for \$3,150,000. The Assignment to the purchaser was dated 29 September 1997.

19. By an Agreement for Sale and Purchase dated 29 September 1997, the Taxpayer agreed to sell the First Floor Flat for \$2,550,000. The Assignment to the purchaser was dated the same date.

20. On the basis of the sale of the two units, the assessor assessed that for the year of assessment 1997/98 the assessable profits of the Taxpayer was \$3,407,336 on which she should pay profits tax in the sum of \$459,990.

The issue

21. There is only one issue in this appeal. It arises out of section 14 of the Inland Revenue Ordinance Chapter 112 ('IRO').

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

'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.'

23. Section 2 of the IRO defines 'trade' to include:

'every trade and manufacture, and every adventure and concern in the nature of trade.'

The law

24. The law on the interpretation and application of sections 14(1) and 2 of the IRO regarding 'trade' and 'trading asset' is well settled in both England and Hong Kong.

25. First, in deciding whether a property is a capital asset or trading asset, it is necessary to ascertain the intention of the taxpayer at the time of acquisition of the property. In Lionel Simmons Properties Ltd v CIR [1980] 1 WLR 1196, Lord Wilberforce at page 1199 said:

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‘One must ask, first, what the Commissioners were required or entitled to find. 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 acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment?’

26. Secondly, a mere declaration of intention is of limited value. Subjective intention has to be tested against objective facts and circumstances. The intention must be genuinely held, realistic and realizable. In All Best Wishes Limited v CIR 3 HKTC 750, Mortimer, J said at page 771:

‘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 realizable, 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.’

The case of the Taxpayer

27. The main points in the case of the Taxpayer can be summarized as follows:

- (i) The reason why she chose to buy a property in District D was that the air was cleaner and that the living accommodation would be more spacious. Her intention was to make a long term investment and not to trade in real property.
- (ii) She and Mr F and Mr G decided to redevelop the First Land and build new houses for occupation by themselves. Their intention was to make a long term investment.
- (iii) The Taxpayer and her family decided to emigrate to Country K because of the uncertain political situation in Hong Kong.

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- (iv) The Taxpayer decided to sell her interest in the development because the financial condition of her family was deteriorating and also they needed money to emigrate to Country K.
- (v) Mr F and Mr G also decided to sell their interest in the development because they subsequently discovered that there was to be a plot for the placing of urns for ashes of the dead nearby.

Our conclusion

28. To begin with, a quick sale of an asset at a substantial profit is per se more indicative of a trading activity than an acquisition as a long term investment. Here, the Taxpayer sold her two units in the development very soon after it was completed.

29. Having considered all the evidence, we are not convinced that the Taxpayer acquired the property with the intention at the time that it should be a long term investment. We set out our main reasons below.

30. The Taxpayer gave evidence to the effect that in 1990 she and her family moved to the First Land and the First Buildings from her Property 2. She kept both residences but left the Property 2 virtually unoccupied for one year. She admitted however that at that time one of her children was studying in District D and the other in District L in the Hong Kong Island. She also said that one or two months after she had applied for permission to redevelop the First Land, she and her family left District D and moved to Property 1 in District M in Kowloon.

31. We find it difficult to accept the evidence set out in paragraph 30 above bearing in mind especially the places to which the children went to school. Such evidence also does not support the allegation that the reason for the purchase of an interest in the First Land and First Buildings was the attraction offered by District D. Why, we ask, did the Taxpayer and her family move away from District D to District M so quickly.

32. Furthermore, the Taxpayer was unable to adduce any evidence to prove that she and her family actually moved to District D at any stage other than her own bald allegation.

33. The Taxpayer was questioned about her allegation that she had to borrow money from relatives in the region of \$500,000 to \$600,000 to enable her to take part in the development. She was, however, unable to give any details of the loan or the relatives who allegedly made the loans or the manner of repayment.

34. The Taxpayer was further unable to explain why the redevelopment was designed into separate units as opposed to something which was suitable for her and her family to live in as one single household.

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35. 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.'

36. In order to succeed, the Taxpayer (and not the Commissioner) bears the burden of satisfying us on the balance of probabilities that she did have the intention of acquiring the property in question for the purpose of a long term investment and not of a trade at the time of such acquisition.

37. On our view of the totality of the evidence, we have come to the conclusion that the Taxpayer has not discharged this burden.

38. Accordingly, we dismiss the appeal of the Taxpayer and confirm the determination by the Commissioner that the assessable profits in respect of the Taxpayer for the year of assessment 1997/98 are \$3,407,336 with tax payable in the sum of \$459,990.