

# INLAND REVENUE BOARD OF REVIEW DECISIONS

## Case No. D48/95

**Profits tax** – property trading – whether gain on sale of property subject to profits tax.

Panel: Ronny Wong Fook Hum QC (chairman), Chiu Chun Bong and Duncan A Graham.

Dates of hearing: 13 and 14 March 1995.

Date of decision: 18 August 1995.

The taxpayers were husband and wife who purchased a flat and sold it shortly thereafter. The resulting profit was assessed to property tax. The taxpayers appealed to the Board of Review and gave evidence.

Held:

The taxpayers had not discharged the onus of proof placed upon them.

**Appeal dismissed.**

Cases referred to:

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

Tse Yuk Yip for the Commissioner of Inland Revenue.  
Taxpayer in person.

**Decision:**

### **I. THE BACKGROUND**

1. The Taxpayers are husband and wife. They married in Macau on 23 February 1991.
2. Well prior to their marriage, they jointly purchased Flat A on 4 December 1982 for \$238,000. \$200,000 was raised by means of a mortgage over Flat A.
3. On 30 November 1988, the husband together with Mr W jointly purchased Flat B for \$1,160,000. On the same day, Flat B was mortgaged in favour of Bank X. On 6

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December 1988, the husband and Mr W let this flat to a Mr Z for 2 years at \$8,300 per month. This flat was eventually sold on 7 December 1990 to Mr Z for \$1,200,000.

4. On 7 May 1989, the wife entered into a tenancy in respect of Flat C. The tenancy was for 2 years from 1 June 1989 to 31 May 1991 at a rent of \$4,000 per month.

5. On 16 October 1989, the husband and the wife sold their interests in Flat A for \$430,000.

6. On 13 January 1990, the husband and the wife entered into a provisional agreement for the purchase of Flat D [‘the Subject Flat’] for \$930,800. On 24 January 1990, they raised \$837,720 through an equitable mortgage on the Subject Flat to pay for part of the purchase price in respect of the same.

7. On 1 May 1991, the couple entered into an agreement for the purchase of car park of Flat D [‘the Subject Car Park’] for \$200,000.

8. The couple was given notice on 12 June 1991 to complete the purchase of the Subject Flat and the Subject Car Park on or before 25 June 1991. Completion duly took place.

9. The couple produced before us 2 documents:

- (i) A bill dated 29 June 1991 issued by Company Y to the husband for \$4,800 of which \$3,800 was for polythene polishing for flooring and \$1,000 for final cleaning.
- (ii) A receipt dated 30 June 1991 issued by Company Z to the husband for \$600 for removal from Flat C to the Subject Flat.

It is the Taxpayers’ case that they moved into the Subject Flat on 30 June 1991.

10. On 2 July 1991, the couple entered into a provisional agreement selling the Subject Car Park for \$236,500.

11. By letter dated 8 July 1991, Firm M (solicitors for the purchaser) wrote to Firm N (solicitors for the couple) confirming the terms for sale and purchase of the Subject Flat as set out in a provisional agreement dated 6 July 1991. A draft agreement for sale and purchase was sent by Firm N to Firm M on 11 July 1991. Firm N called for a cheque for \$129,000 on return of the signed agreement for sale and purchase. The Subject Flat was assigned in favour of the purchaser on 10 August 1991 for \$1,780,000.

12. The Taxpayers alleged that they left the Subject Flat on 19 July 1991 and returned to Flat C. They were on friendly terms with the landlord of Flat C and were able to take a fresh tenancy on short notice.

13. On 10 September 1991, the Taxpayers entered into an agreement for the purchase of Flat E for \$2,722,890. On 24 December 1992, the couple mortgaged Flat E in

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favour of a finance company to secure general credit facilities. Flat E was sold by the couple on 12 January 1994 for \$4,480,000.

14. By letter dated 23 June 1993, the Revenue asked the Taxpayers to furnish information in relation to the Subject Flat, the Subject Car park and Flat A as well as 'all other properties sold by you (and/or your spouse if you are married) since 1 April 1987'. In their reply dated 12 July 1993, the Taxpayers furnished the following information:

<b>Premises</b>	<b>Date of sale</b>	<b>Usage</b>	<b>Reasons for sale</b>
Flat A	17-11-1989	Self-residence	To improve the living Environment
The Subject Flat	6-7-1991	Self-residence	Poor traffic, very inconvenient to get to office
The Subject Car Park	2-7-1991	Self-use	The apartment was already sold, the car parking space lost its function

The couple did not furnish any information in relation to Flat B.

15. By letter dated 24 November 1993, the Taxpayers gave the following additional explanations:

- (i) '... the several removals in the past were just for improving our living condition';
- (ii) '... we could hardly afford to purchase Flat A in an old building of area of 200 odd square feet (with limited money), which started the first step of our dream. We had lived there for eight years';
- (iii) '... we disposed the property at the old building and the sale proceeds were just enough to purchase Flat D. Concerning the parking space, we had got the lot for an allocation'.
- (iv) 'We were living far away from the urban district. After we moved into the property, we had travelled to and from for several times and experienced the actual traffic problem. ... After considering several suitable locations, we finally chose our present residence at Flat F'.
- (v) '... at each time of changing units, we did not make any profits at all.'

16. In their 'Objection to the Profits Tax' dated 10 October 1994 lodged after the Commissioner's determination of 12 December 1994, the Taxpayer asserted that:

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- (i) The Subject Flat was sold 'because we had a fierce neighbour who imposed a great mental pressure on us'.
- (ii) 'Apart from the inconvenience of the traffic, we were very satisfied with the living environment. If there were no fierce neighbour, I thought we would have been living there happily'.
- (iii) 'After purchasing the property before occupation, we had already scheduled for the driving examination... We got the lot of a car parking space on 21 May 1991... The timing was suitable if we could pass the driving examination by one time. Unfortunately, we failed in the first time and just passed in the second one (19 February 1992...)'

17. At the material time the wife was working with a company. The employer's returns for the years ending 31 March 1990 and 31 March 1991 in respect of her remuneration were produced before us. Flat A was given as the wife's quarter with the employer refunding various amounts of rental in her favour. We requested the wife to consider producing before us the return for the year ending 31 March 1992. That request was declined on the basis that her prospect of employment with that company might be affected as a result. Her salaries tax assessment for the year of assessment 1989/90 dated 6 December 1990 and for the year of assessment 1990/91 dated 4 October 1991 were also placed before us. Those were addressed to the wife at Flat C. The determination of the Revenue dated 12 September 1994 was also sent to the Taxpayers at Flat C.

18. The issue before us is whether the gains derived by the Taxpayers from the purchase and sale of the Subject Flat and the Subject Car Park are assessable to profits tax or not.

### **II. THE ORAL TESTIMONY**

- 1. The husband and wife gave evidence before us.
- 2. The husband told us that:
  - (i) The reasons why they moved out of Flat A were '... to change for better environment, to occupy a greater area flat, to live together with my father-in-law. Furthermore if the illegal structure had to be dismantled the whole of the kitchen was built on illegal structure then the usable area would become less and less.'
  - (ii) They moved into the Subject Flat in the morning of 30 June 1991. They moved in with 'only a few items such as table, household miscellaneous items, a bed that was made up of angle bars... and some small items.' They did not purchase any new furniture because 'our old items of furniture were sufficient for our use.'
  - (iii) When they moved in on 30 June 1991, there were some 'banging and bumping... The neighbour opened the door and came out to see what had

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happened. And then on the following days they also pursued on this matter. I was of the opinion that my neighbours appeared to be somewhat biased and prejudicial on this matter.’ Subsequent quarrels started 2 or 3 days after they moved in.

- (iv) Their reasons for moving out of the Subject Flat were ‘Bad relationship with the neighbourhood. Secondly to convenience my father-in-law and also for our convenience to go to work.’
- (v) They are currently residing at Flat F. This was rented for a period of 2 years. They moved out of Flat E because ‘The fishing boats sail in and out of the typhoon shelter throughout the night and this produces a very loud noise incessantly and in addition after living there for a short period of time my father-in-law then passed away so after that only the two of us living in a flat of 900 odd square feet for us it appeared that we just did not need the area’.
- (vi) In May 1994, the couple purchased Flat G for over \$3,000,000.

3. The wife told us that:

- (i) The Subject Flat was first offered for sale around Christmas 1989. It was during the period of holiday that they inspected the site. ‘That is why we did not actually detect that the traffic and transport situation was not so desirable.’
- (ii) In relation to the Subject Car Park, ‘we did not actually acquire valid driving licence so it was already decided that the car park should be sold in the first place’. They still do not own a car now.
- (iii) After they sold the Subject Flat, they entered into a new tenancy agreement in August 1991 for Flat C for a term of 2 years at \$4,900 per month.
- (iv) She maintained that she informed her employer of her tenancy at Flat C. However, as pointed out above, she declined to produce the employer’s return for the relevant year.

### 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 same IRO defines ‘trade’ to mean ‘every trade and manufacture, and every adventure and concern in the nature of trade’.

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

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

### **IV. THE RELEVANT LEGAL PRINCIPALS**

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 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. What was the intention of this couple on 13 January 1990 when they purchased the Subject Flat and on 1 May 1991 when they purchased the Subject Car Park?

2. We have no difficulty in relation to the Subject Car Park. At the date of purchase they did not have any driving licence. They still do not own a car now despite passing the tests. The opportunity to purchase the car park arose fortuitously through allotment. The car park was sold 2 days after their alleged occupation of the Subject Flat. The wife's evidence confirmed that it was never their intention to treat the Subject Car Park as capital asset.

3. We have great difficulty in relation to the Subject Flat. This is a young couple with humble background striving hard to tackle their accommodation problem. Whilst it would be easy to criticise the total lack of preparatory steps for decorating the Subject Flat that is going to be their permanent home, we are of the view that any such emphasis would be misplaced in the circumstances of this case.

4. The Revenue laid stress on the inconsistencies of the Taxpayers' case. Their letter of 12 July 1993 only relied on the traffic problem as a reason for their departure from the Subject Flat. Relationship with their neighbours was given as an additional reason in their letter of 10 October 1994 after the Commissioner's determination of 12 September 1994. The convenience of the father-in-law was put forward in the course of their oral evidence. There is some force in the Revenue's contention. Furthermore we find it difficult

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to attach weight to each of these reasons furnished by the Taxpayers when viewed in the light of the fact that the provisional agreement for sale of the Subject Flat was dated 6 July 1991, less than a week after they allegedly moved into the Subject Flat. Their letter of 12 July 1993 pointed out that the Subject Car Park was sold on 2 July 1991 because 'The apartment was already sold, the car park space lost its function'. If there is any truth in this statement, the Taxpayers would have sold the Subject Flat just 1 or 2 days after they moved in.

5. We are also puzzled by the precise status of Flat C. The alleged new written tenancy of August 1991 was not produced. The return of the wife's employer would throw light on whether there was a break of their tenancy in Flat C. The invitation to produce this document was refused.

6. In these circumstances, we are of the view that the Taxpayers have not discharged their onus. We confirm the assessment of the Revenue in relation to the Taxpayer's gains from the Subject Flat and the Subject Car park.